M&G Investments

M&G Namibian Enhanced Income Fund

Multi-asset

Q1 2023

Market overview

So far in 2023, global financial markets have experienced wild swings – particularly in the normally less volatile fixed income markets – dictated by the guessing game over the path of US interest rates, inflation and growth. January's sentiment was relatively bullish, dominated by expectations of a weaker US economy going into 2023, which would have increased the likelihood of softer inflation, lower-than-expected interest rates and a relatively imminent pause to the US Federal Reserve's rate hiking cycle. This was all up-ended in February by surprisingly strong economic data, including more widely embedded inflation than previously thought. With the Fed signalling its intention to continue hiking, this sent market uncertainty higher and global asset prices lower, an environment that continued well into March.

Then the emergence of banking sector turmoil sparked by the sudden failure of specialist Silicon Valley Bank and the engineered buyout of Swiss banking giant Credit Suisse by UBS shocked markets even further, with swift central bank and government interventions preventing contagion to other sectors. Gold benefited and risk-off sentiment prevailed as global financial stocks sold off. Central banks suddenly had an even tougher policy balancing act, having to choose between their duties of fighting inflation, safeguarding national banking systems and supporting growth and employment. Ironically, this led back to more positive expectations of lower interest rates and sooner-than-expected rate pauses.

In fact, the US Fed hiked by a measured 25bps in March, as expected, as did the Bank of England (BOE), while the European Central Bank (ECB) and SA Reserve Bank (SARB) announced relatively robust 50bp increases given their higher inflation threats. Looking back, investment managers have rarely seen such sharp changes in market views in such a short period of time. US Treasury bonds, for example, experienced high volatility of around 10%, with the 10-year UST yield falling by 50bps from around 4.0% to 3.5% between February and March – an exceptionally big move in that market.

In the US, the US Fed hiked the Fed Funds rate by 25bps at both its February at March meetings, moves that were expected by the market. However, uncertainty was created by surprisingly robust economic data, including strong retail sales data, a higher-than-expected January CPI at 6.4% y/y, and a still-strong jobs market. February's core CPI, at 5.5% y/y, showed inflation was more deeply entrenched than thought. This data, combined with hawkish language from the US Fed, led investors to expect higher interest rates for longer and sparked global equity and bond sell-offs.

This bearish sentiment was later reversed by the global banking turmoil, which led investors to expect central banks to move less aggressively in their rate increases in order to support the banking sector. While banking stocks did sell off, March's confirmed "small" 25bp increase by the Fed appeared to reinforce the idea that US rate hikes might be close to an end, and that therefore uncertainty had eased to an extent. Upward revisions to US growth forecasts, and for other key economies, also reinforced the broadly more positive outlook by the end of the quarter.

The oil price fell during the quarter on the back of expected lower demand as global growth slowed, and improved supply. Brent crude oil lost approximately 7% in US$ terms, ending the quarter at roughly US$80 per barrel after having fallen as low as US$72 per barrel in mid-March. Other commodity prices were mixed in Q1 amid the uncertain sentiment, with gold the largest beneficiary. Nickel was the largest loser, down 24.2%, while zinc lost 3.9% and aluminium fell 1.0%, while copper gained 6.5%. Among precious metals, gold rose 8.0%, but platinum lost 7.6% and palladium was down 18.5%.

South Africa and Namibia

In South Africa, the SARB surprised with a larger-than-expected 50bp interest rate hike on 30 March, citing strong inflationary pressures from food, administered prices and a depreciating rand. February CPI came in at 7.0% % y/y, aided by substantial increases in food, transport and medical services prices. Many had thought the Bank would follow the US and UK with a 25bp rise, especially given very weak local economic growth: Stats SA reported that Q4 2022 GDP contracted by 1.3%, more than expected, due to intensifying load-shedding. At the same time, National Treasury revised downward its projection for annual real GDP growth, now expected to average 1.4% from 2023 to 2025, versus 1.6% previously.

The 50bp rate increase did help to reinforce the SARB's inflation fighting credibility, while the rand reacted by strengthening below the key R18/1USD level. As at 31 March, the SA forward rate market was pricing in a further 30bps in interest rate hikes from the SARB this year before the central bank pauses and then starts cutting rates again. Meanwhile, S&P Global downgraded the sovereign credit rating outlook to negative from stable, citing load-shedding and the fragile economy as the primary drivers.

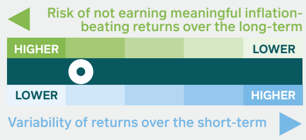
The Bank of Namibia (BoN) lifted its own repo rate by 25bps to 7.0% on 15 February and is widely expected to follow the SARB with a 50bp rate hike when its MPC meets on 19 April, to rein in inflation (with February CPI rising to a high 7.2% y/y), continue anchoring inflation expectations, and guard the N$ peg against the rand. The SA repo rate is currently 75bps above that in Namibia, putting greater pressure on the N$ to depreciate.

Also during the quarter, investors welcomed the 2023 National Budget's improved fiscal trajectory and the government's plans for Eskom debt relief, as markets reacted marginally favourably. Eskom remained in the spotlight for much of the period as its departing CEO reported high levels of corruption within the utility, prompting more intensive investigations from journalists and the government.

Annualised performance

Annualised performance	A class	Benchmark	B class
1 year	7.5%	6.3%	7.9%
3 years	5.6%	5.3%	5.9%
5 years	5.5%	6.2%	5.8%
7 years	6.0%	6.7%	6.4%
Since inception	6.0%	6.7%	-

Risk profile



Fund facts

Fund managers
David Knee
Roshen Harry

Morningstar category
Africa Fixed Income

Benchmark
IJG Money Market Index

Inception date
19 June 2014

Fund size
N$7 960 924

Sources: M&G Investments, Morningstar & Deutsche Securities

The Namibian government turned its attention to a possible downsizing of the public service in order to reduce its wage bill and improve the national budget deficit. The Government Institutions Pension Fund (GIPF) is concerned about such a move, as it would exacerbate the 2.4% decline seen in its membership during the 2022 financial year. In March, Namibian civil servants demanded an 8% salary increase, well above current inflation.

Meanwhile, South Africa was grey-listed by financial watchdog FATF, so that more scrutiny of the country's international transactions is necessary to root out money laundering and financing of terrorism. Higher costs and administrative hurdles will likely result, experts said, and banking shares fell 2% in reaction to the announcement. Bonds and the rand were little moved, however.

During the quarter Namibia's real GDP growth for 2022 was reported at 4.6%, reflecting gradual improvement and a rebound from pandemic conditions, with growth recorded across all primary, secondary and tertiary industries, although the construction sector and private sector credit growth were still weak. Growth was boosted by a strong recovery in diamond mining, as well as a record N$13.2 billion in foreign investment into the oil sector for offshore exploration during the first nine months of 2022. The BoN's March economic update projected 3.0% GDP growth for 2023 and a 2.9% expansion in 2024.

For the quarter, SA nominal bonds (the FTSE/JSE All Bond Index) delivered 3.4% in rands, while inflation-linked bonds (ILBs) produced 0.9% and cash returned 1.7%. Namibian bonds (the IJG Bond Index) returned 4.3% over Q1 and a strong 13.1% for the 12 months to end March, and the IJG Money Market Index delivered 1.8% for the three months and 6.3% for the 12-month period. Weakness in Listed Property during the quarter was acute with the All Property Index returning -4.8%. Finally, despite some late-March gains on the back of the SARB's larger-than-expected rate hike, the rand and N$ moved weaker against the major global currencies, losing 4.8% against the broadly weaker US$, 7.3% against UK sterling and 6.5% versus the euro over the quarter.

Performance

The fund delivered 1.8% (net of fees) for the first quarter of 2023, which exactly matched its benchmark return. For the 12 months ending 31 March 2023, the fund returned 7.5% (net of fees), outperforming its benchmark by 1.1% over the same period.

During the first quarter, exposure to SA nominal bonds made the largest contribution to absolute fund returns, with SA floating-rate instruments also adding further value. SA inflation-linked bonds and money market assets made relatively minor contributions, while SA listed property was the only detractor from performance. The fund maintains a constructive view on short-dated nominal and inflation-linked bonds, which we believe will outperform cash returns over the medium term.

Inflation-linked bonds made the largest contribution from Namibian assets to the fund over the quarter. They were followed by the contribution of money market assets. Floating rate notes and call cash made relatively minor contributions.

Strategy and outlook

In Q1 2023, the fund continued to hold at least 45% of its assets in Namibia by investing in the M&G Namibian Money Market Fund and Namibian government bonds. The remainder of the fund is invested in the M&G Enhanced Income Fund. Currently, the fund has no exposure to global assets.

We maintained our very modest positioning in **SA listed property** in Q1 2023. Conditions in the local property sector remain uncertain given the rising local interest rate cycle (many property companies are reliant on finance to expand their portfolios) and relatively weak growth prospects, among other fundamental factors.

The portfolio still has a preference for holding short-dated **SA nominal bonds**, which we believe will outperform over the medium term relative to cash. Some of the exposure was termed out a little further out along the yield curve over the past quarter. We continue to believe SA nominal bonds remain attractive relative to both other income assets and their own longer-term history, and will more than compensate investors for their associated risks in the medium term.

The fund maintains some exposure to front-end **SA inflation-linked bonds (ILBs)**. Yields remain relatively attractive compared to their own history and our long-run fair value assumption, but compared to nominal bonds, their valuations are less attractive, and they have a lower return potential. Some of the exposure was termed out a little further out along the yield curve recently.

Lastly, the cumulative impact of the SARB's interest rate increases over the cycle, has improved the relative attractiveness of cash. Although, the fund remains tilted away from **SA cash** currently, the opportunity to increase cash holdings at favourable levels over the quarter was taken. □

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