Quarterly Commentary

M&G Investments

M&G Namibian Inflation Plus 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.

While the growth outlook improved in several key economies, making equities more attractive, risk aversion still made itself apparent over the quarter. Global equity returns outperformed bonds, while developed equity markets outperformed emerging equity markets. For the three months ended 31 March 2023, the MSCI All Country World Index returned 7.3%, the MSCI World Index (developed markets) delivered 7.7%, and the MSCI Emerging Markets Index produced 4.0% (all in US$). Bonds also posted meaningful gains: the Bloomberg Global Aggregate Bond Index delivered 3.0% (in US$). Global property stocks continued to generate among the weakest returns, with the FTSE EPRA/NAREIT Global REIT Index returning 1.4% (US$).

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 global credibility, while the rand reacted by strengthening below the key R18/1USD level, at least temporarily. The SA forward rate market is now pricing in a further 50bps 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 Feb, 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 South African 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.

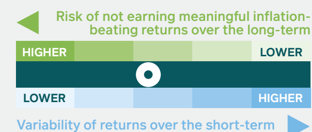
The Namibian government turned its attention to a possible downsizing of the public service in order to reduce its wage bill and improve the national budget deficit. The Government Institutions Pension Fund (GIPF) is concerned about such a move, as it would exacerbate the 2.4% decline seen in its membership 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

Annualised performance	A class	Objective	B class
1 year	10.1%	11.1%	10.6%
3 years	11.8%	8.8%	12.2%
5 years	7.5%	8.3%	7.9%
7 years	6.7%	8.7%	7.1%
10 years	8.0%	8.7%	8.4%
Since inception	10.4%	9.3%	-

Risk profile



Fund facts

Fund managers
David Knee
Michael Moyle
Sandile Malinga
Leonard Krüger

Morningstar category
Cautious Allocation

Objective
Namibian CPI+4% over a rolling 3-year period

Inception date
15 September 2003

Fund size
N$2 218 588 975

Sources: M&G Investments, Morningstar & Deutsche Securities

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.

The SA equity market was dented by risk aversion and weakness in Listed Property and Resources stocks during the quarter, and impacted by the global sell-off in Financials, but buoyed by Industrial shares. The FTSE/JSE All Share Index (ALSI) returned 5.2% in Q1, while the more locally exposed Capped SWIX delivered 2.4% (both in rands). Industrial counters returned 13.6%, while Financials produced 0.4%, Resources -4.4% (Resources 10 Index) and the All Property Index -4.8% (all in rands).

In Namibia, the NSX All Share Index returned -1.8% during Q1 and -11.1% for the 12 month period to end March, dragged down over the quarter by the Resources sector with a -6.8% return as commodity prices were broadly weaker over the period. Healthcare was the strongest performer with 6.8%, Financials produced 3.8% and Industrials delivered 0.2% for the quarter.

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. 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 returned 4.1% over the quarter (net of fees in N$), and for the 12 months to 31 March 2023 it returned 10.1% (net of fees in N$). Since its inception in 2003, the fund has delivered a return of 10.4% per annum compared to 9.3% per annum from its objective over the same period.

The fund's global equity holdings added the most value to the fund's absolute performance for the quarter, by far, thanks to the gains across developed equity markets. Global bonds were not far behind, while South African bonds, Namibian bonds and Namibian ILBs also added meaningful value. The fund's small exposure to SA listed property was the only asset class detractor from absolute fund performance for the quarter. The fund holds no SA ILBs.

In terms of specific equity exposure for the quarter, among the strongest positive contributors to absolute returns were the fund's holdings in Namibian Breweries, Naspers/Prosus, Oryx Properties, and Richemont. Top detractors from absolute performance included Implats, Northam Platinum, Glencore and Thungela.

Strategy and outlook

Starting with our view on **offshore asset allocation**, during the quarter our overall level of global exposure remained the same, as we continued to prefer SA assets versus their offshore counterparts due to their more attractive valuations.

Within **global bonds** we maintained our neutral positioning, recognising that although bond valuations continue to become more attractive, and are appealing in certain markets, broadly speaking we believe they are trading around their long-term fair value. As such, we do not think they are offering adequate potential return for the risks involved in the uncertain global environment. We do have a preference for 30-year US Treasuries, as good equity diversifiers, as well as sovereign EM bond markets where the real yields are high and the currency is trading at fair-to-cheap levels.

In our view, **global equities** are also trading around their long-term fair value, and not offering adequate compensation for the elevated risks to corporate earnings we see going forward. We therefore remained neutral in global equities, and are selective. Additionally, we are still leaning away from US equities as expensive versus other markets.

Our **global cash** holdings continue to partially cushion our funds, as well as providing some liquidity to take advantage of new market opportunities that could arise. We are mindful of the risks that exist globally in terms of slower economic growth, rising interest rates and embedded inflation – any negative surprises present downside risks for corporate earnings and bond prices.

The M&G Namibian Inflation Plus Fund still favoured **SA and Namibian equities** at the end of Q1. During the quarter, our overall weight in this asset class changed little. SA equity valuations (as measured by the 12-month forward Price/Earnings ratio of the FTSE/JSE Capped SWIX Index) re-rated slightly over the quarter, rising from around 9.2X to around 9.5X at quarter-end. Much of this re-rating was attributable to share price gains, as earnings estimates changed only marginally.

The fund remained tilted away from **SA and Namibian listed property** in Q1 2023, as we prefer exposure to other shares that we believe offer better value propositions and diversification for less risk. During the quarter we trimmed our SA listed property holdings in favour of SA cash, given that the latter's valuation improved relative to that of the former. Conditions in both property markets 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.

Fund performance also benefitted from our ongoing preference for **SA and Namibian nominal bond**s during the quarter (on a relative basis) due to their positive returns, despite a very volatile period. We trimmed our SA bond holdings in the fund into SA cash. In our view, valuations remain attractive relative to both other income assets and their own longer-term history, and will more than compensate investors for their associated risks. Namibian bonds present slightly more credit risk due to the more precarious state of Namibian government finances, and as such we are holding more SA bonds than Namibian bonds, and are also holding SA nominal bonds to offset the risk of our Namibian ILB exposure.

During the quarter we trimmed our weight in **Namibian ILBs** in favour of Namibian cash as the valuation of the latter improved relative to the former. ILBs do still offer attractive future returns for investors that are guaranteed if they are held to maturity and offer diversification benefits for the portfolio. The fund holds no **SA ILBs**.

Lastly, despite the SARB's and BoN's interest rate hikes during the quarter, the fund remained tilted away from **SA and Namibian cash** as our least-preferred local asset class, given the extremely low base rate off which the central banks have hiked. However, we did add to the fund's cash holdings during the quarter as its relative valuation became more attractive versus listed property and bonds on a risk-adjusted basis. □

Contact us

info@mandg.co.za

mandg.co.za

0860 105 775

Invest now

Application forms

An electronic copy of this document is available at www.mandg.co.za

Disclaimer

MandG Investments Unit Trusts (Namibia) Ltd (Registration number: 2007/609) is an approved Management Company in terms of the Unit Trusts Control Act, 1981.

Unit trusts are generally medium- to long-term investments. The value of units may go down as well as up and past performance is not necessarily a guide to the future. A schedule of fees and charges and maximum commissions is available on request from the Management Company. Commission and incentives may be paid and if so, would be included in the overall costs. Fluctuations or movements in exchange rates may cause the value of underlying international investments to go up or down. Different classes of units may apply to the portfolio and are subject to different fees and charges. Unit prices are calculated on a net asset value (NAV) basis, which is the total value of all the assets in the portfolio including any income accrual and less any permissible deductions from the portfolio divided by the number of units in issue. Fund valuations take place at approximately 14h30 Namibian time each day and forward pricing is used. Purchase and repurchase requests must be received by the manager by 13h30 (09h00 for the Money Market Fund) Namibian time each business day. In calculating performance figures initial charges are not taken into account. Annual service charges are deducted in all calculations. Performance figures are sourced from Morningstar and are based on lump sum investments using NAV prices with gross income reinvested.

Sources: M&G Investments, Morningstar & Deutsche Securities