

M&G 5% Target Income Fund

Target Income

Q1 2025

Market overview

The new year started off quite differently to the expectations that shaped the outlook heading into 2025. After a strong performance by US equities in 2024, markets were optimistic that a new Republican administration would further fuel US exceptionalism.

However, the situation unfolded quite differently than anticipated in the first quarter. The heightened uncertainty and volatility due to the unpredictable nature of US trade policy has dampened growth expectations and weighed on US markets and the dollar. Trump's new term has been nothing short of chaotic and market moving as participants try to decipher the impact of regulations on asset prices and the economy in general.

Globally, tariff talks and the potential trade war were key drivers of market moves for the quarter, as well as regional dynamics around policy shifts.

Global

Global equity (as measured by the MSCI All Country World Index) fell 1.3% during the quarter. US equities fared the worst in the major regions, with the Nasdaq showing the biggest fall (-10.3%) on the back of the moves in tech stocks. The S&P and Dow Jones lost 4.3% and 0.9% respectively for the quarter (all in US dollars).

Global bonds fared relatively better with 2.6% (Bloomberg Global Aggregate Bond Index, in US dollars).

Emerging and Developed Markets

Emerging markets, as measured by the MSCI Emerging Market Index, showed positive performance of 2.9% for the quarter, outperforming the developed market counterparts that delivered -1.8% (MSCI World). In emerging markets, Brazil's Bovespa (16.8%), China (15.9%) and South Africa (8.7%) performing strongly during the quarter (all in US dollars). In Turkey, some country-specific market moves due to widespread anti-government protests in the region in March led the Turkish equity market to be sold off, ending the quarter on -8.9% (in US dollars).

South Africa

The FTSE/JSE All Share Index returned 5.6% (in rand) on the back of strong performance in the precious metal and mining space. The resource sector rallied 33.7% in the quarter, with gold and PGM names delivering strong returns due to those commodities being up significantly in the month of March. The strong rally in SA equity for the quarter has been very concentrated in a few bigger names, such as gold companies, Naspers/Prosus, MTN and a few other rand-hedge stocks, like British American Tobacco and Richemont. Industrials delivered 3.1% while financials ended the quarter down 1.8%. Property had a challenging quarter with -4.2% (as measured by the All Property Index).

SA cash, as measured by the Short-Term Fixed Interest (SteFI) composite, returned 1.9% for the quarter.

SA bonds had a more muted quarter but managed to add small gains of 0.7% as per the All Bond Index. Concerns around the budget have led to a steeper yield curve with yields on long-dated bonds rising somewhat during March compared to flatter levels on the short-end of the curve.

United States

Growing concerns over tariff threats had a significant impact on US equity markets. Escalating trade tensions, particularly with China, triggered fears of a renewed trade war, which weighed heavily on investor sentiment.

The US administration's threats to impose additional tariffs on key imports spooked investors, leading to heightened volatility in major stock indices. Sectors most vulnerable to tariffs, such as manufacturing, technology, and consumer goods, experienced sharp declines, while companies reliant on global supply chains saw their stock prices suffer. The uncertainty surrounding trade policies not only impacted corporate earnings expectations but also increased the risk of a broader economic slowdown, contributing to a cautious outlook for US equities during the quarter.

The dominance of the "Magnificent 7" began to unravel following the release of China's low-cost AI model, DeepSeek, and growing concerns over their high valuations. This, combined with uncertainty around trade wars, meant the group faced a rough quarter, with a 15% decline, led by Tesla, Apple and Nvidia.

Meanwhile, US consumer price inflation eased to 2.8% year-on-year in February, down from 3.0% in January. However, market observers believe this decrease is temporary, as long-term inflation expectations continued to rise. In line with expectations, the Federal Reserve kept the federal funds rate unchanged at 4.50%.

Both the US equity market and US dollar sold off on concerns around the potential impact trade wars could have on the US economy. US equity markets ended the quarter down with the NASDAQ being the worst performer delivering -10.3%, the S&P 500 with -4.3% and the Dow Jones with -0.9%.

United Kingdom

The UK's economic landscape saw Labour Chancellor Rachel Reeves announce a £4.8 billion cut in welfare spending and a crackdown on tax avoidance, alongside a downward revision of the 2025 growth forecast from 2% to 1%. Inflation showed signs of easing, with the UK's Consumer Price Index (CPI) dropping to 2.8% y/y in February, slightly below the expected 2.9%. This, coupled with a 25-basis point rate cut by the Bank of England in February as policymakers responded to growing

Fund facts

Fund objective

To target an annual income return of 5%, with a secondary objective of growing capital. While a 5% annual income return is targeted, the actual income return may vary.

Investor profile

Income drawing investors who want to invest in a fund that aims to earn 5% income per year. Subject to this income return being achieved, investors also want capital growth over time. The relatively high targeted income return means there's an appreciable possibility that the real value of capital after targeted income drawdowns will not be maintained over the long term.

Investment mandate

The Fund invests in a flexible mix of local and foreign equity, bonds, property and cash. The Fund can also invest in derivatives and other collective investment schemes. The Fund is not managed to conform to the regulations governing retirement fund investments (Reg.28). Besides a max. total equity exposure of 85%, the Fund is not limited in its allocation to asset classes, currencies or geographies.

Income distribution

The income earned from the Fund's underlying assets will be distributed quarterly. Typically, investors will reinvest these distributions. Regular drawdowns, which could be made monthly, quarterly, half-yearly or yearly, will be funded through the sale of units.

Fund managers

Sandile Malinga  
Michael Moyle  
Leonard Krüger

ASISA category

Worldwide - Multi-Asset - Unclassified

Primary objective

5% Income return p.a.

Inception date

2 April 2019

Fund size

R188 816 939

Annualised performance	A class	CPI	B class
1 year	17.2%	3.2%	17.6%
2 years	10.2%	4.4%	10.6%
3 years	8.9%	5.2%	9.3%
5 years	12.0%	4.8%	12.4%
Since inception	7.6%	4.7%	-

economic concerns, added to the market's optimism.

While European markets faced volatility due to tariff worries and trade tensions, hopes for a European-led peace initiative regarding Ukraine lifted sentiment, benefiting the FTSE 100, despite underlying economic challenges.

The FTSE 100 Index posted an impressive 9.4% gain (in US dollars) for the quarter.

#### The Eurozone

European equity markets outperformed their US counterparts, with Financials delivering particularly strong performance.

Germany was a key driver for the region's market performance for the quarter. The country's decision to lift the debt ceiling benefited defence-related shares, as increased spending in that sector led to outperformance compared to other areas of the market. Further to this, political stability following Germany's elections added to investor optimism, boosting market sentiment and helping the DAX deliver robust returns of 15.8%. France's CAC 40 also delivered a respectable 10.4% (all in US dollars).

Eurozone inflation showed signs of moderation, with the Consumer Price Index (CPI) for February coming in at 2.3% y/y, slightly below expectations, but still within range. The European Central Bank (ECB) cut interest rates by 25 basis points to 2.5%, signalling a potential for further cuts, and also lowered its economic growth forecast for the fourth consecutive time, now projecting 0.9% growth for 2025.

#### Japan

Escalating trade tensions, tariffs and shifting monetary policy contributed to market volatility and weighed on markets in Japan for the quarter. The announcement of a 25% tariff by the US on auto imports sparked major concerns in Japan, due to the country's large auto export sector. In addition, public dissatisfaction with fiscal policies erupted in protest action against the Ministry of Finance.

Japan's annual consumer price index slowed to 3.7% y/y in February 2025 from 4.0% y/y in January, slightly above the expected 3.5%. In a widely expected move, the Bank of Japan maintained its benchmark interest rate at 0.5%.

Against this challenging backdrop, the Nikkei was down 5.3% (in US dollars) for the quarter.

#### China

Despite tariff jitters, AI enthusiasm boosted tech stocks. Markets were boosted by the surprise release late in January of China's low-cost AI model, DeepSeek, sparking the tech rally. China also announced stimulus plans to boost consumption, which were well-received by the market.

Meanwhile, CPI contracted by 0.7% y/y in February 2025. The People's Bank of China (PBOC) maintained its key lending rates, keeping the one-year Loan Prime Rate (LPR) at 3.1% and the five-year LPR at 3.6%. This decision aligned with market expectations.

Boosted by positive sentiment and the latest AI developments and stimulus announcements, the Hang Seng delivered a strong 15.9% for the first quarter (in US dollars).

#### Commodities

In the flight to safety against the backdrop of geopolitical and trade tensions, investors flocked to gold, driving up prices and ending the quarter as a standout performer. Commodity prices were further supported by China's latest stimulus measures. Gold and silver ended the quarter north of 19% and copper rallied to 11.1% (in US dollars). The PGM sector also saw increases with platinum, palladium and rhodium prices all rising. On the soft commodity side, coffee was the star after rising 18.75% during the quarter.

#### South Africa

Fiscal uncertainty increased following the delay of the National Budget Speech, initially scheduled for 19 February, due to coalition disagreements. The budget was eventually re-presented on 12 March, with the proposed 2% VAT hike scaled back to 50 basis points over the next two years. The most significant impact was the effect this had on the Government of National Unity (GNU), as the ANC and DA clashed over the budget proposal, undermining the stability of the government.

On the economic front, South Africa's GDP showed modest growth of 0.6% q/q in Q4 2024, narrowly avoiding a technical recession, following a contraction of 0.3% in Q3. Annual consumer price inflation held steady at 3.2% y/yr in February 2025. As expected, the South African Reserve Bank (SARB) kept the repo rate unchanged at 7.5% in March, maintaining a cautious stance after the rate cut in January.

Despite concerns over tariffs, the rand strengthened on dollar weakness. The JSE All Share Index (ALSI) posted a solid 5.9% gain for the quarter in rand terms, and in US dollar terms, it rose by 9%, outpacing both developed and emerging markets. This rally was largely driven by a stronger performance in the resources sector, on the back of the surge in gold and platinum group metal (PGM) prices.

#### Currency

The US dollar weakened against a basket of major currencies in the quarter. The rand strengthened 2.5% to the US dollar but weakened against both the euro (-1.5%) and pound sterling (0.5%), but in a very orderly manner.

#### Performance

The M&G 5% Target Income Fund returned 2.3% (A class, net of fees) for the first quarter of 2025 and 17.2% (A class, net of fees) for the 12-month period ending 31 March 2025.

In terms of asset allocation this quarter, the fund's SA equity position contributed the most to performance on an absolute basis. The fund's positions in SA bonds and cash also added value. Given SA property's challenging quarter, the fund's allocation to this sector detracted from absolute returns.

The fund's positions in international equity and fixed income returned positively. However, its allocation to international cash detracted from performance given the US dollar weakened against some major currencies during the quarter.

Within SA equity, the strong rally for the quarter was very concentrated in a few bigger names and the fund's position in MTN (up 34%) was the top contributor to performance. The next biggest positive contributor this quarter was AngloGold Ashanti (up 66%) on the back of strong performance in the precious metal and mining space. Gold was significantly up in the month of March. However, our holdings in The Foschini Group (down

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-26%) detracted from performance.

## Strategy and positioning

The start of the year saw the South African market outperform global peers when looking at both the local equity and bond market. We saw very strong moves in the SA equity market as measured by the FTSE/JSE Capped Swix Index, which returned 5.9% for the quarter against the -3.8% fall in global equities as measured by the MSCI All-Country World Index (both in rand). The bond market was more subdued, adding 70bps, but this was also ahead of the flat performance for the Bloomberg Global Aggregate Bond Index (in rand).

Our broad preference continues to be overweight South African domestic assets and underweight foreign exposure. We have seen some earnings expectations upgrades in our market during the quarter, but it has mostly been limited to a few sectors, such as precious metals & mining and communication services. The effect is that our market still screens cheap when looking at pure fundamentals, such as price-to-book (1.79x) and forward price-to-earnings ratio (10.10x). On the bond side, we still see value as real bond yields are trading in excess of our fair value and we continue to hold an overweight to nominal bonds across all our funds. Fundamentals for the local property sector have also improved somewhat on the back of a retracement in price for that asset class after very strong positive performance in 2024.

Within our global positioning in our funds, we are currently neutral equities, overweight bond duration and cash, and underweight property and credit exposure. We kept our overall positioning fairly intact during the quarter.

The valuation for the MSCI All Country World Index 12-month forward P/E ratio reduced from 18.35x at the start of the year to 17.25x by the end of the quarter. This is mainly due to the downward move in US equity markets, with the S&P ratio moving from above 22x at the start of the year to closer to 20x by the end of March.

Out of interest, this ratio reduced drastically for the so called "Magnificent 7" stocks from 34.5x to 28.7x in the first three months of 2025. This can be explained by various factors such as the news end January on DeepSeek AI developments in China being at reduced cost and increased efficiency compared to US counterparts, as well as the impact of tariffs on global trade and the US economy. At the same time, we saw the forward P/E ratio for World excluding the US, as well as emerging markets move slightly higher on the back of relative price outperformance.

We made no changes to our global equity positioning in our funds on the back of these moves, as we believe there's still room for the trend to continue. As such, we continue to have a short position to the US market, counter-balanced by long positions to China, Mexico, South Korea, and a few other developed and emerging countries.

On the bond side, we continue to hold our existing position to long-dated US treasuries in our funds with an overweight duration position. We also still maintain our position to Brazilian bonds, which we added at the end of last year. New positions we engaged with in the asset class were adding UK gilts and German bunds during the sell-off in global bond markets during the first few weeks of January. We have seen a retracement in yields to lower levels for the former since adding the position to the funds, while for German bunds we saw a significant sell-off in yields in March due to a raise in the debt ceiling in that region post their election. As at the end of the first quarter, bund yields have retraced back to

the levels where we engaged the position at the start of the year.


We maintain our underweight position to global corporate credit given that credit spreads are still trading at very compressed levels, even after moving slightly higher recently. We continue to view the risk-reward for holding those instruments as unappealing.

Moving on to our holdings in local asset classes, we have cut our SA equity position to neutral in our funds on the back of the significant outperformance of our market compared to other markets during the first quarter. We view this as a tactical trade due to relative market moves but still see SA equities as fundamentally cheap when looking at valuation metrics such as the 12-month forward P/E ratio (10.1x) and Price-to-Book ratio (1.79x).

We have kept our property positioning unchanged during the quarter, after making use of market opportunities during the previous year to reduce the underweight we have in place to that asset class. At present, we still have a small underweight to neutral position to property in our funds, consistent with where we started the year.

In terms of bonds, we continue to hold a reasonable overweight to SA nominal bonds in our funds, given that fundamentals for that asset class are mostly unchanged from where we ended 2024. We still see real yields currently at attractive levels and have made no significant changes to our holdings across funds during the first quarter of the year.


Our house-view portfolios continue to have no meaningful exposure to SA inflation-linked bonds (ILBs) as our preference has been for nominal bonds in favour of ILBs, even after the strong outperformance we saw in nominal bonds during 2024.

Finally, our portfolios remain tilted away from SA cash as we see better risk-adjusted returns from deploying excess cash into nominal bonds at this stage. Real cash yields continue to offer relatively high returns after the rate-cutting cycle ended up being very shallow, but we view the extra return on offer in bonds as sufficient to compensate us for the additional level of risk involved in holding the asset class. 

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