M&G Dividend Maximiser Fund

Equity

Q4 2023

Market overview

The final quarter of 2023 saw a synchronized rally across global bonds and equities as falling inflation in many economies led central banks to continue to pause or effectively end their interest rate hiking cycles and start to look towards rate cuts, particularly in the US. And, although a growth slowdown is still expected in 2024, this and the gradually improving outlook buoyed investor sentiment, resulting in strong gains in November and renewed bullishness in December, to end the year with unexpectedly good asset performance.

December's returns were dominated by the US Federal Reserve's unexpectedly positive forecasts at their 13 December policy meeting as, besides leaving interest rates on hold, they clearly indicated their expectations for three 25bp interest rate cuts in 2024, as well as forecasting a "soft landing" for the US economy. They also added that they didn't want to make an error by "waiting too long" to begin lowering rates. This was very good news for both equity and bond markets, helping bolster the 2024 outlook despite the uncertainty still surrounding the cumulative negative impact from the steep rate hiking cycle. Other large central banks also left interest rates on hold at their December policy meetings as expected.

Global equity (as measured by the MSCI ACWI) delivered 11.0% in Q4 and emerging market equities returned 7.9% (MSCI Emerging Markets Index) both in US$. In South Africa, the FTSE/JSE Capped SWIX Index posted an 8.2% return in rand and somewhat stronger than other emerging markets. Gains were propelled by a strong 15.9% rebound in the All Property Index over the quarter and 11.8% from Financials, while Industrials delivered 5.9% (hit by a sharp fall in Naspers/Prosus shares in December) and Resources stocks were flat (0%). Meanwhile, the rand gained 2.7% against a weaker US dollar in Q4, but in total lost 8.2% against the US dollar, 14.1% versus the UK pound and 12.1% against the euro in 2023.

For 2023 as a whole, global equities returned an excellent 22.2% in US$ and 32.3% in rand (due to rand depreciation), with gains fairly concentrated around a handful of giant global AI-related US companies, termed the "magnificent seven": Apple, (up 54%), Amazon (up 77%), Alphabet (up 57%), Nvidia (up 246%), Meta (up 184%), Microsoft (up 57%) and Tesla (up 130%). These outpaced other US shares and, indeed, most other equity markets for the year, making the US meaningfully more expensive than its global counterparts. This also reflected the relative vitality of the US economy versus most other large economies. By contrast, Chinese tech stocks were deep in the red, with Tencent losing 54% for the year, Meituan -54%, JD.com -50% and Welbo Corp -44%.

South African assets were weighed down in 2023 by ongoing general pessimism over the country's weak growth prospects, loadshedding and uncertain government finances, exacerbated by the higher risks associated with the grey-listing of SA in global financial transactions and incidents like the "Lady R" and hosting of the BRICS Summit. This manifested in rand weakness, equity underperformance against the MSCI EM Index and continuing low valuations on SA stocks and bonds. The FTSE/JSE ALSI returned 9.3% and the more domestically-focused FTSE/JSE Capped SWIX Index posted 7.9% for the year.

Performance

The M&G Dividend Maximiser Fund delivered a return of 6.0% (net of fees) for the fourth quarter of 2023, marginally underperforming its benchmark (the average of the general equity funds) by 0.2%. For the year ended 31 December 2023, the fund returned 8.7% (net of fees), outperforming its benchmark by 1.4%. It is particularly pleasing to report that over the three-year period ending 31 December 2023, both the absolute and relative performance of the fund has been strong, with an absolute return of 15.2% per annum over this period, outperforming the benchmark by 3.3% per year.

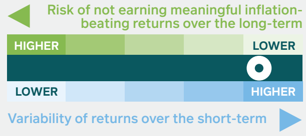
The fund's dual focus of buying undervalued companies with strong cash flows and dividends remains core.

The fund's large overweight position to Textainer Group Holdings was the largest contributor to performance for the quarter and the year. The share price increased by almost 29% in the last quarter and by 77% over the last year in Rands. Textainer is one of the worlds' largest container leasing companies and leases containers to shipping companies. We have held a large active position in Textainer in the fund for over three years and actively built the position at very attractive share prices when the outlook for the shipping market looked difficult and the market worried about global shipping during COVID. At the time we purchased the shares, the company was not paying dividends, after having suspended paying dividends in 2016. We thought that despite the lack of dividends, that the company was of high quality, exceptionally well-managed and that even in the event of a shipping slowdown, that cash flows would be strong. We therefore thought that it would be highly likely that the company would be able to pay a sustainable dividend in the future. We are exceptionally impressed with how the company's management has allocated capital over the last three years. Not only were they able to resume paying dividends in 2021, but the company was able to buy back almost a quarter of the company over the last three years at extremely attractive prices. These buy-backs resulted in accelerated returns for the shareholders who remained invested in the company.

Despite the market worries during COVID, the container leasing market emerged from the pandemic in an exceptionally strong position. As a result of the disruptions to global trade and then the strong resumption of trade, shipping lines were desperate to lease containers to ship goods at the very high shipping rates that persisted post COVID. The profitability of shipping lines was

Annualised performance	A class	Benchmark	T class	B class	F class
1 year	8.7%	7.3%	9.5%	9.0%	9.8%
3 years	15.2%	11.9%	15.8%	15.5%	16.1%
5 years	11.8%	9.1%	12.3%	12.2%	12.6%
7 years	9.2%	6.8%	9.7%	9.6%	10.0%
10 years	8.3%	6.2%	-	8.7%	-
20 years	15.2%	12.0%	-	-	-
Since inception	15.4%	12.6%	-	-	-

Risk profile



Fund facts

Fund managers
Ross Biggs
Kaitlin Byrne

ASISA category
South African - Equity - General

Benchmark
ASISA South African – Equity - General Category Mean

Inception date
2 August 1999

Fund size
R4 228 166 709

Awards
Raging Bull: 2006, 2008
Morningstar/Standard & Poor's: 2007, 2009

Sources: M&G Investments and Morningstar

M&G Investments

exceptionally high and the opportunity cost to not have containers to supply customers was substantial. Container leasing companies used these strong markets to sign much longer leases with shipping companies with the result that future cash flows became even more predictable. These longer leases will ensure that profitability and cash flows are more stable going forward.

The stability and predictability of future cash flows from the largest container leasing companies caught the attention of large infrastructure funds. The result was that Textainer's largest competitor was bought out in 2023, and during the last quarter, Textainer also received a bid from a large infrastructure fund called Stonepeak at a substantial premium to the share price. We view the take-out offer as fair and have sold a large part of the fund's position in the company post the offer being announced.

The second largest contributor to performance for this quarter was the fund's underweight to Sasol. We held Sasol in an overweight position in the past as we think it has been attractively valued but have reduced this position over the last year in this fund due to the variability in the dividend flow from the company and our preference within the chemicals sector for Omnia, which produces mining explosives and chemicals, as well as fertilizers. Omnia we think is a high quality company and has an exceptionally strong balance sheet and the ability to pay high and sustainable dividends.

The largest detractor from performance for the quarter was the funds' underweight position to the gold sector and in particular the underweight positions to Anglogold and Goldfields. We have fairly consistently been underweight to the gold sector in this fund due to the very poor cash flows generated by gold companies and consequently the very poor dividend growth that gold companies have exhibited over a long period of time.

We are also of the view that given the high real interest rates on offer currently, it makes the hurdle rate for an investment in gold much higher. Investors, instead of buying gold which earns no return, could instead buy inflation-linked bonds yielding good positive real rates. We however do retain small holdings of Anglogold and Goldfields in the fund given the current elevated political risk around the world together with increased gold buying by some central banks. The gold sector underweight remains one of the larger sector underweights in the fund.

The second largest detractor from performance in the quarter was the funds' underweight to FirstRand Bank. While we rate FirstRand and Capitec more highly in terms of quality banks, we cannot ignore that that they are substantially more highly rated than other banks in the sector. For this reason, we continue to be overweight Standard Bank, ABSA and Investec and underweight FirstRand and Capitec.

While South African banks continue to trade at decent valuations, we have reduced our overweight position over the last year due to the increase in share prices post COVID as well as the increase in bond yields which have resulted in South African banks trading closer to fair value.

ABSA has shown a steady improvement in operating performance and is generating a Return on Equity of 17% which is up substantially from the high single-digit returns it was generating just a few years ago. Although its share price has performed relatively well versus the other banks, we think that it is still undervalued and it remains one of the top overweights in the banking sector. Investec has been a top contributor to performance over the last three years for the fund and continued to outperform over the last quarter. Investec is a company that we have held for a number of years in the fund and we continue to view it as a good quality company, still trading on a depressed multiple. We think the management of Investec has done a good job in optimising capital allocation post the demerger with Ninety One asset management and are now more focused on shareholder returns.

We think that the banks that we own are trading on undemanding valuations, especially given that earnings and dividend growth is currently exceptionally strong.

We acknowledge that while it is very difficult to forecast the future and we do not make any attempt to do this, we spend a lot of time thinking about the economic cycles that various sectors are in, and where valuations are. In this way, we aim to try make money for our clients through these cycles and continue to try to buy companies that have proven dividend and cash flow track records, and which can withstand the normal upheavals that occur in markets over time. We aim to continue building risk-cognisant portfolios that seek to add value through stock selection relative to the benchmark.

Strategy and positioning

We remain optimistic regarding the South African equity market returns over the medium term due to the prevailing excessive levels of pessimism reflected in share prices and valuations. The Price to Book of the JSE remains close to 1.6X as at the end of December 2023 which we think is a very attractive valuation level.

South African assets appear to be undervalued relative to emerging and developed markets. The higher interest rates and bond yields in the United States and many developed and emerging markets during 2023 compared with 2022 meant that equity valuations faced a much higher hurdle rate over the last year. The pace of interest rate increases however slowed in 2023 and there is general optimism that rates may start to decline into 2024. The US 10-year bond yield for instance reduced by over 1% in the last quarter of the year and this has been generally supportive of equity markets.

Over the last two years, we have substantially reduced the offshore allocation of the fund as we thought that the SA market and currency represented very good value. Today, we continue to think that emerging markets and African equities represent particularly good value, and we think the SA rand is still attractive. The fund has approximately 17% allocated offshore.

The focus of the fund continues to be on finding companies that are undervalued and which are paying good dividend yields with the potential to pay growing dividends over the long run. We are confident that we have built a portfolio of attractively priced stocks that in aggregate is cheaper than owning the index, yet still capable of delivering attractive underlying growth independent of the economic cycle in which we find ourselves.

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Application forms

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Sources: M&G Investments and Morningstar