M&G Equity 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.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. Gains were propelled by a 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. 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 growth disappointed and equities were in the red.

In the US, the Fed's December forecasts for 2024 showed inflation falling gradually toward its 2% target amid a slowdown in growth, without steep job losses -- in other words, a "soft landing" as investors have hoped for. Unemployment is seen rising to 4.1% from its current 3.7% level, still low from a historic perspective, and GDP growth is forecast to average 1.3% for the year. Meanwhile, at 3.1% y/y, November CPI was in line with expectations and down from October's 3.2% y/y, helped by lower energy prices over the period. For the quarter, the Dow Jones produced 11.7%, the Nasdaq 13.1%, and the S&P 500 13.8% (all in US$). The Nasdaq was the top-performing developed equity market in 2023 with a remarkable return of 44.6%.

In the UK, the Bank of England (BoE) kept its main interest rate unchanged at 5.25% at its December meeting, saying its next move would remain data-dependent, but the market is pricing in the start of rate cuts from June 2024. November CPI fell sharply to 3.9% y/y from 4.6% in October. The UK economy is on the verge of recession, having recorded zero (0%) GDP growth in Q3 2023, and with the BoE downgrading its growth forecast for 2024 to 0% from 0.5% previously. For Q4 2023, the FTSE 100 returned 14.4% in US$, and for the 12 months it produced 14.4%.

In the eurozone, inflation continued to fall during the quarter, with the latest November CPI at 2.4% y/y nearing the ECB's 2% target rate. However, the central bank's latest forecasts show inflation improving only very slowly going forward and averaging 2.7% in 2024 from 5.3% in July. GDP growth in the area registered a paltry 0.1% y/y in Q3 2023, and is expected to remain very subdued at 0.8% y/y in 2024. In contrast to the Fed, the ECB remained hawkish, continuing to warn of upside inflation risks from energy prices and labour costs, and discounting the possibility of interest rate cuts in the foreseeable future. In European equity markets, France's CAC 40 returned 10.5% in Q4 and 24.4% for 2023 as a whole, while Germany's DAX delivered 13.6% in Q4 and 24.5% for the year (all in US$).

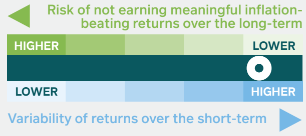
After impressive growth in the first half of the year, Japanese GPD shrank by a more-than-expected 2.9% in Q3 2023 (annualised, revised) as consumer and business spending contracted and real wages fell due to prolonged relatively high inflationary conditions. The sharp slowdown came despite the Bank of Japan maintaining its ultra-easy monetary policy, which had provided firm support previously and also helped push the local equity market to 33-year highs in December. The latest conditions suggested that the BOJ will continue to keep interest rates exceptionally low, in line with the central bank's goal of keeping inflation sustained at around 2% and avoiding deflationary conditions. The Nikkei returned 11.4% (in US$) for Q4, and 22.6% in 2023.

During the three months, the Chinese economy gained traction with Q3 GDP growth reported at a stronger-than-expected 4.9% y/y (vs 4.4% y/y forecast). Although this means that the government is likely to meet its 5% GDP growth target for 2023, the absolute level of growth has continued to disappoint. The country's exports remained under pressure from relatively weaker foreign demand, but looser monetary policy from the People's Bank of China (PBOC) has added stimulus through lower bank rates for its medium-term lending facilities.

There was positive news with November data showing industrial production grew faster than expected at 6.6% y/y (versus 5.6%), up from 4.6% y/y in October, and retail sales growth of 10.1% also improving significantly from 7.6% the previous month. Pent-up consumer demand continues to underpin the expansion, along with consumer services, while the property sector remains in crisis and youth unemployment high. Chinese markets were still in the red in Q4, with Hong Kong's Hang Seng returning -3.7% and the MSCI China -4.2%, both in US$. For the year, the Hang Seng produced -10.6% and the MSCI China posted -11.0%.

Annualised performance	A class	Benchmark	B class	F class
1 year	3.5%	7.3%	3.8%	4.8%
3 years	15.1%	11.9%	15.5%	16.4%
5 years	12.1%	9.1%	12.6%	13.2%
7 years	9.6%	6.8%	10.0%	10.6%
10 years	8.6%	6.2%	9.1%	-
20 years	15.4%	12.0%	-	-
Since inception	15.5%	12.6%	-	-

Risk profile



Fund facts

Fund managers
Chris Wood
Yusuf Mowlana

ASISA category
South African - Equity - General

Benchmark
ASISA South African - Equity - General Category Mean

Inception date
2 August 1999

Fund size
R5 662 979 214

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

Sources: M&G Investments and Morningstar

With the exceptions of China and Turkey, larger emerging equity markets performed very strongly over the quarter. Brazil's Bovespa soared with a return of 18.6%, followed by South Korea's KOSPI with 13.9%, the MSCI South Africa at 12.7% and the MSCI India at 12.0% (all in US$). The MSCI Turkey fell 12.1% (in US$).

Performance

The fund returned 5.4% for the quarter and 3.5% for the year. This was lower than the returns earned by the benchmark, the average fund performance in the sector, of 6.2% and 7.3%, respectively, over the same periods. This was a somewhat disappointing outcome for the fund, which came after a three-year period of significant outperformance.

In analysing the performance of the fund for the year, the largest detractors for the year were underweight positions in FirstRand, Goldfields and Sanlam, as well as overweight positions in Multichoice and Impala Platinum and Northam. Contributing to performance were overweight positions in Textainer and Datatec, as well as underweight positions in Anglo American, Sibanye, Anglo Platinum and Transaction Capital.

Strategy and positioning

During the quarter, the Chinese government announced further regulatory measures to curb addictive behaviour in relation to online games. This resulted in an immediate sell-off of Tencent and other gaming-related companies, which in turn led to the Naspers and Prosus share prices declining. The fund has an overweight exposure to these companies. Shortly after this announcement, the regulator reaffirmed its support for the gaming sector and approved several games for publication. Tencent also used the lower share price as an opportunity to buy back its own stock, which we view as attractive in its own right.

Multichoice also staged a recovery after poor share price performance as a consequence of a weaker performance from its South African business, in addition to the market's skepticism in relation to its heavy investment into its online streaming capability via the new Showmax service. Canal Plus, a French company, has built a 33% stake in the business and we expect significant value creation for our unit holders in the medium term.

Post a poor production update, Anglo American, a company which the fund held in an underweight position, fell sharply, highlighting a weaker production outlook than the market expected. The fund's current preferred global mining exposures are to BHP and Glencore. Within the mining space, the fund has an underweight position to the PGM sector as well as the gold sector, given weaker free cash generation when compared to the other holdings of the fund, including Exxaro and Thungela.

Within the banks, Investec, Absa and Standard Bank are preferred to FirstRand, Nedbank and Capitec, while the fund's only insurance exposure is indirectly via Reinet and its investment in Pension Insurance Corporation.

During the quarter, the real estate sector enjoyed a strong recovery on the prospect of lower interest rates. SA corporate was among the sector's best performers over the past three years.

The fund managers see the past year as a disappointment and not indicative of future relative performance. As always, we will seek to find superior opportunities within the opportunity set and would like to thank our investors for their support. □

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