Quarterly Commentary

M&G High Interest Fund

Income

This fund is capped to new investors.

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 bonds produced 8.1% (Bloomberg Global Aggregate Bond Index (in US$) in Q4, while South African bonds delivered an impressive 8.1%. This saw the yield on the 10-year SA government bond tumble from just over 11% at the start of the quarter to 9.8% by the end. The year proved to be a very volatile one for global bonds, marked by rapid shifts in the interest rate outlook and investor sentiment that pushed the yield on the benchmark 10-year US treasury bond to 5% (briefly) in October and left it trading around 3.8% at year-end, presenting opportunities for active investors to harness attractive above-inflation yields. Ultimately, global bonds as an asset class returned 5.7% for the year.

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. However, SA bonds notably outperformed their global counterparts for the year, helped by their cheap valuations at the start of 2023, delivering a 9.7% annual return.

Credit trends

Total credit issuance (excluding government issuances) in Q4 2023 proved to be very strong with R55.4bn issued compared to R29.2bn in the previous quarter (Q3 2023). The Q4 issuance compared to the same quarter in the prior year was up a healthy 14% (Q4 2022: R48.7bn issued). Full-year 2023 issuance was also robust at R164bn compared to full-year 2022 of 141bn, an increase of 16%. The full-year 2023 issuance of R164bn was 27% ahead of RMB Credit Research's estimate for 2023 issuance as compiled at the start of 2023. According to ABSA's Credit Research team total outstanding issuance, excluding government debt, has grown by 4.0% year-on-year.

The make-up of issuance for the quarter followed established trends -- issuance being almost exclusively floating-rate notes, with auctions accounting for just over 68% of placements by volume.

Data compiled by ABSA's Credit Research team indicates that banks have been the largest sector for new issuance in 2023 with around 55% of total issuance, while as at the end of December 2023 bank exposures comprised 50% of SA listed credit in issue. The Big 5 SA banks issued R23.9bn of new bonds in the quarter with the largest issuer being Standard Bank who raised in total just over R8bn across three separate auctions of Senior (R2.45bn), Tier 2 Sub-debt (R3.64bn) as well as Additional Tier 1 Sub-debt (R2.0bn).

There was one new issuer in the SA debt capital market in the fourth quarter in the form of a Residential Mortgage Backed Securitisation (RMBS) from FNB called Lehae. Across the five classes of notes that were on offer in the auction a total of R2.04bn was successfully placed -- only marginally less than what was targeted. The notes were placed within guided spread levels except for the Class C note which went five basis points (bps) below guidance.

Fixed-rate spreads closed the quarter +4 bps wider over the fourth quarter of the year. Floating-rate credit spreads moved lower by -4 bps, driven by -9 bps tightening of Senior Financial credit spreads.

Over the past quarter we were successful in our bids for new bonds issued by Absa and Standard Bank.

Performance

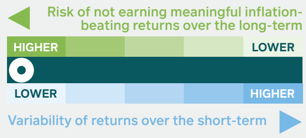
The lack of duration in the fund over the past quarter meant that it did not benefit much from the strong bond market return over the past quarter. Nevertheless, it returned a healthy 2.0% over the period (Class A, net of fees), marginally behind the benchmark's 2.1%, thanks to the relatively high level of short-term interest rates. Over the calendar year of 2023 the fund delivered 8.4%, comfortably ahead of the 8.1% benchmark return.

Strategy and Positioning

The SARB again elected to hold rates steady this quarter, with the last change in the repo rate having come in May of 2023. The Negotiable certificate of Deposit (NCD) market have taken

Annualised performance	A class	Benchmark	X class	D class
1 year	8.4%	8.1%	8.5%	8.6%
3 years	6.0%	5.7%	6.1%	6.2%
5 years	6.0%	5.9%	6.1%	6.2%
7 years	6.6%	6.4%	6.7%	6.8%
10 years	6.6%	6.4%	6.7%	6.9%
Since inception	6.4%	6.2%	-	-

Risk profile



Fund facts

Fund managers

Roshen Harry
René Prinsloo

ASISA category

South African - Interest Bearing - Short Term

Benchmark

STeFI Composite Index measured over a rolling 12-month period

Inception date

8 December 2010

Fund size

R14 093 115 178

Sources: M&G Investments and Morningstar

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their cue from the SARB and the NCD curve is also little changed over the past quarter. Floating NCD spreads have, however, increased slightly, and when you view the fixed and floating rate interest rates together, this indicates that the market now appears more positioned for rate cuts ahead. Indeed, the NCD market appears to be pricing in about 50bps of cuts over the next two to three years. This seems like a reasonable outlook to us, and we therefore don't have a strong preference for one interest rate class over the other.

The Forward Rate Agreement (FRA) market appears more aggressive in its expectation of interest rate cuts. It is now pricing in around 100bps over the next two years. This has been one of the big changes that took place over the past quarter – at the start of the quarter the FRA market was implying a largely unchanged interest rate trajectory.

The most significant change in the fund over the quarter was its size, with the assets under management (AUM) growing from around R9.5bn to approximately R14bn. This was due to our multi-asset funds increasing their allocation to cash (which comes predominantly from their investments in this fund), partly as a result of the more attractive interest rates on offer lately. We elected to invest a significant portion of the new assets in some of the more liquid investments on offer to us, such as relatively short-term NCDs, as these assets are less likely to be sold at a loss, should these clients choose to rotate out of cash again at some point. This means that there was somewhat of a decline in the duration of the fund, and consequently also a slight reduction in the fund's yield.

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Application forms

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Sources: M&G Investments and Morningstar