

M&G Income Fund

Income

Q2 2022

Market overview

Investor concerns over a major slowdown in global growth, and therefore corporate earnings, escalated during the second quarter (Q2) of 2022, especially in June. This came as steep interest rate hikes in the US and strict Chinese Covid-19 lockdowns, as well as the ongoing destructive Russia-Ukraine war, led to downward revisions in economic growth expectations for the world's biggest economies. Further rises in energy and food prices also led to more speculation over extended inflationary pressures and stagflation and/or recession, even as other commodity prices lost ground. This combination of factors resulted in losses across most financial markets – equities, nominal bonds and inflation-linked bonds.

South African markets were less insulated from the global inflation and growth concerns than in the previous quarter. This was due to the fall in commodity prices, accelerating inflation, and forecasts for more aggressive local interest rate hikes in July, plus even slower growth ahead. Stage 4-6 loadshedding also weighed on growth prospects. The South African Reserve Bank (SARB) lowered its GDP growth forecast for 2022 to 1.7% from 2.0% previously.

However, local bond losses were somewhat less severe than developed markets, and more in line with those in other emerging markets. Amid growing inflationary fears, SA's All Bond Index lost 3.7%, but inflation-linked bonds (ILBs) delivered 2.9% and cash returned 1.2%.

With CPI rising to 6.5% y/y in May – the first time since January 2017 that it has broken through the upper limit of the SARB's 3%-6% target range – the SARB hiked the repo rate by 50bps at its May meeting to 4.75%. The Bank is widely expected to hike by another 100bps at a minimum this year in an effort to both fight inflation and to keep our interest rate differential versus the US as high as possible in a bid to avoid more pressure on the rand and SA bond yields.

Performance

For the second quarter of 2022, the fund delivered a return of 1.4% (net of fees), while its benchmark, the STeFi Composite Index, delivered 1.2%. For the 12 months ended 30 June 2022, the fund returned 5.1% (net of fees), outperforming its benchmark by 0.9%.

The return generated by the fund's holdings in floating-rate instruments was boosted by the 64bps increase in the JIBAR rate over the quarter. Our inflation-linked bond position, in the form of the I2025 government bond, performed well due to the sharp

increase in inflation over the period. Our overall duration position, however, hindered performance, given the 3.7% fall in the FTSE/JSE All Bond Index over the quarter.

Strategy and positioning

We believe that the magnitude of interest rate increases currently priced into the market seems excessive. For example, the NCD market is currently pricing in a 300bp rise in the repo rate over the next year. This is the increase that is required for a one-year floating NCD to provide the same return as the 7.5% available from a fixed NCD. Given that the Reserve Bank's MPC meets six times a year, the market is therefore effectively pricing in a 50bp increase at every meeting. Although this is certainly not impossible, we believe it's unlikely, even after taking into account the acceleration in local inflation that we have seen in recent months.

We, therefore, believe it makes more sense to have exposure tilted towards fixed-rate to the extent that fund mandates allow. Our positioning in the fund is consistent with this view, with a duration position of around 291 days, which experienced little change over the quarter, and is probably on the high-end of where most category peers are positioned.

Credit trends

The second quarter of 2022 saw a total issuance volume (excluding government issuances) of R30bn, which was 14% above the R27bn issued in the previous quarter, but still below the R38bn issued in the second quarter of 2021.

The make-up of issuance for the quarter followed established trends, with the majority being floating-rate notes and banks being the largest sector for issuance. Although auctions made up the majority of issuance over the quarter, we continue to see meaningful volume being done via private placements. The largest issuer during the quarter was Standard Bank, which raised R4bn in a senior unsecured issuance in April.

Credit spreads have broadly come in, largely reverting to pre-pandemic levels. We believe this to be partly due to more prevalent participation from banks (either to replace maturing instruments in their high-quality liquid asset portfolios or to accumulate instruments for secondary market-making purposes), or as a result of a limited pipeline of other investable assets available to banks. □

Annualised performance

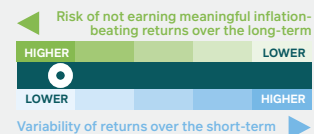
	A class	Benchmark	D class
1 year	5.1%	4.2%	5.2%
2 years	5.9%	4.1%	6.0%
3 years	5.5%	5.0%	5.7%
5 years	6.8%	5.9%	7.0%
Since inception	6.9%	6.1%	-

Disclaimer

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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

6 December 2016

Fund size

R605 366 448

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Application forms

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