Quarterly Commentary

M&G Investments

M&G Global Balanced Fund

Global Multi-Asset USD-denominated

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. For the quarter ended 30 June 2022, the MSCI All Country World Index returned -15.7%, the MSCI Emerging Markets Index produced -11.4%, and the Bloomberg Global Aggregate Bond Index delivered -8.3% (all in US$).

In the US, inflation hit 8.6% y/y in May, the highest since 1981 and above market forecasts of 8.3% y/y. At the same time, US economic growth shrank by 1.6% y/y in Q1 2022 as consumer incomes and corporate profits were hit by higher prices for food and energy and the end of Covid-related stimulus payments. The US Federal Reserve's 75bp rate hike in June was an aggressive response to this accelerating inflation, a move which prompted more market-watchers to predict a recession ahead. Many noted that, given that inflation has largely stemmed from supply-side factors, higher interest rates were not likely to be as effective in curbing inflation as with demand-driven factors. Fed policymakers now see rates reaching 3.4% in 2022, well above the 1.9% forecast in March, as well as increased chances of recession.

US Treasury bonds sold off sharply as a consequence of the deteriorating inflation and interest rate outlook, resulting in an unusually volatile market: the Bloomberg Aggregate US Treasuries Index returned -9.2% in US$, after the -6.2% recorded in Q1. Meanwhile, US equity markets were deeply in the red for the quarter: in US dollars, the Nasdaq delivered -22.3%, the Dow Jones produced -10.8% and the S&P 500 returned -16.1%. The S&P 500, the broadest benchmark for the US equity market, produced its worst performance for the first six months of any year since 1970, down 20.0%.

In the UK, the Bank of England implemented another interest rate hike in June, taking its main bank rate to 1.25%, the highest level in 13 years. This came against inflation of 9.1% y/y in May. However, the central bank remained less aggressive on its outlook for rate hikes compared to the Federal Reserve. For Q2 2022, UK equities were also deeply in the red: the FTSE 100 returned -11.2% in US dollars.

Meanwhile, the European Central Bank (ECB) largely stuck to its Q1 plans, saying it would accelerate the winding down of its bond purchases from July, and signalling an upcoming 25bp rate hike. This was largely in line with market expectations. The Bank also revised its economic growth outlook lower to 2.8% for 2022 (from 3.7%) and 2.1% for 2023 (from 2.8%). Despite an acceleration in Q1 GDP growth to 5.4% y/y in the Eurozone, market watchers are more worried about a coming recession in the region due to its less-flexible economic structure; it continues to recover more slowly from the Coronavirus crisis than the US and UK. In France, the CAC 40 returned -14.4%, while Germany's DAX delivered -16.7% for the quarter in US dollars.

In Japan, the Bank of Japan (BOJ) continued to be the only major central bank to maintain an ultra-easy monetary policy during the quarter, as it left its policy rate unchanged at -0.1%. The market continues to forecast no interest rate hikes through 2023. Japan's Q1 2022 GDP growth was reported at -0.5%, slower than the 1.0% expected, and the equity market also lost ground with the Nikkei returning -15.1% in US dollars for the quarter.

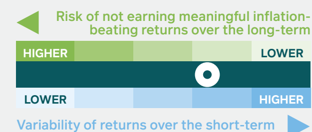
Chinese investors became more upbeat towards the end of the quarter as Covid infection rates started to slow, allowing the government to ease some of its ultra-strict lockdown conditions in Shanghai and certain other areas. The country recorded better-than-expected GDP growth of 4.8% y/y in Q1, up from 4.0% y/y the previous quarter, and the latest data showed a surge in manufacturing and non-manufacturing PMI in June, accelerating to 51.7 (up from 48.1) and 54.7 (up from 47.8) respectively. The People's Bank of China (PBOC) left interest rates unchanged at its June meeting, in line with expectations. The central bank is concerned not only about growth, but also about the widening divergence between local and US interest rates, which has put Chinese bonds and the yuan under selling pressure. For the quarter, Hong Kong's Hang Seng produced 0.7%, while the MSCI China returned 3.5%, both in US dollars.

Other large emerging equity markets were in the red for the quarter, all in US$ terms, with Brazil's Bovespa the worst performer at -25.4%. The MSCI South Africa was close behind with -22.9%, while South Korea's KOSPI was down 20.8%, the MSCI India fell 13.5% and the MSCI Turkey recorded a -10.9% return.

Energy prices continued their rise, but at a moderated pace: Brent crude oil gained 6.4% during the quarter after experiencing some softness in June. Year-to-date the price is up some 47% in US dollars. Looking at precious metals, gold fell 6.0% for the quarter, while platinum lost 7.7% and palladium was down 13.2%. Other industrial metals prices lost between 20-30% amid heightened worries of a global growth slowdown.

Annualised performance	B Class	Benchmark
1 year	-13.2%	-14.4%
2 years	5.8%	4.3%
3 years	2.5%	3.6%
Since inception	2.7%	4.5%

Risk profile



Fund facts

Investment manager
M&G Investment Management Limited (UK)

Fund managers
Craig Simpson

Morningstar category
Flexible Allocation

Benchmark
65% MSCI All Country World Index TR (Net), 5% FTSE EPRA/NAREIT Global REIT Index, 25% Bloomberg Global Aggregate Bond Index, 5% US 1m Treasury Bill

Inception date
19 June 2017

Fund size
USD 39.7 million

Sources: M&G Investments, Morningstar & Deutsche Securities

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Performance

For the second quarter of 2022, the fund returned -12.5% (net of fees), outperforming its benchmark by 0.6%. Over the 12 months ending 30 June 2022, the fund generated a return of -13.2%, outperforming its benchmark by 1.2% over the same period.

Contributing to absolute performance over the quarter was the fund's exposure to Chinese equities. Main detractors from absolute performance over this period came from US and broad global equity exposure, European corporate bonds and emerging market hard currency government bonds.

Strategy and positioning

During the period we started a new position in 30-year US Treasuries after a sell-off which saw their yields rise to levels that we think somewhat reflect the nature of the inflation issue. This had the effect of reducing the fund's underweight duration position. In our view, these long-dated bonds may help in the event of an economic growth shock or equity market panic.

In light of the high levels of uncertainty at present, the fund has an elevated cash weighting, which also provides the scope to respond to opportunities that may arise in turbulent markets.

The upward movement of interest rates and rate expectations remains a key issue for investors. Developed market government bond yields have risen sharply, with meaningful policy tightening now priced in. Policymakers appeared determined to bring inflation under control and it remains to be seen whether it will be possible to raise interest rates aggressively without causing an economic slowdown.

At present, we have a relatively neutral view on bonds. They have fallen in value considerably since the start of the year when we thought they were unattractive. However, given the wide range of potential outcomes in this challenging environment, we generally remain cautious, while recognising that pockets of value may appear.

Global equities have retreated too as recession risks have increased. In this uncertain environment, we will continue to look for opportunities to add equities where we feel investors have become too pessimistic about the economic outlook and prices look attractive.

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Application forms

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Sources: M&G Investments, Morningstar & Deutsche Securities