

M&G Namibian Inflation Plus Fund

Multi-asset

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, emerging market equities returned 7.9% (MSCI Emerging Markets Index) and global bonds produced 8.1% (Bloomberg Global Aggregate Bond Index, both in US\$).

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.

Global bonds experienced a very volatile year, marked by rapid shifts in the interest rate outlook 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 returned 5.7% for the year.

United States

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 13.1%, the Nasdaq 13.8%, and the S&P 500 11.7% (all in US\$). The Nasdaq was the top-performing developed equity market in 2023 with a remarkable return of 44.6% (in US\$).

UK

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%.

Eurozone

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\$).

Japan

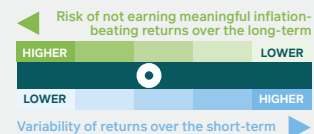
After impressive growth in the first half of the year, Japanese GDP shrank by a more-than-expected 2.9% in Q3 2023 (annualised, revised) as consumer and business spending contracted and real wages fell due to prolonged relatively high inflationary conditions. The sharp slowdown came despite the Bank 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.

China

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

Risk profile



Fund facts

Fund managers

David Knee
Michael Moyle
Sandile Malinga
Leonard Krüger

Morningstar category

Cautious Allocation

Objective

Namibian CPI+4% over a rolling 3-year period

Inception date

15 September 2003

Fund size

N\$2 374 877 026

Annualised performance

	A class	Objective	B class
1 year	12.6%	9.8%	13.1%
3 years	10.2%	9.6%	10.7%
5 years	8.6%	8.3%	9.0%
7 years	7.7%	8.6%	8.2%
10 years	7.8%	8.8%	8.2%
20 years	10.4%	9.4%	-
Since inception	10.4%	9.3%	-

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%

Emerging markets

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% (both in US\$).

South Africa and Namibia

In South Africa, at its 23 November policy meeting the SA Reserve Bank voted unanimously to keep the repo rate steady at 8.25%, as expected. Governor Lesetja Kanyago still sounded relatively hawkish regarding inflation, but noted that growth was likely to remain muted due to ongoing energy and logistical constraints (at ports and railways) weighing on economic activity and adding to the costs of doing business. Q3 2023 GDP contracted more than expected at -0.7% y/y (versus -0.2% forecast), with output declining in agriculture, mining and construction, while services output expanded. Looking ahead, the SARB projected GDP growth at 0.8% for 2023, 1.2% in 2024 and 1.3% in 2025. Besides local headwinds to growth, China's ongoing slower growth presents challenges for SA's commodity exports.

Headline November CPI declined to 5.5% y/y from 5.9% y/y in October, largely on the back of energy price decreases. However, after falling in Q3, surveyed inflation expectations for 2024 rose to 5.7% from 5.5% in Q3, according to the BER. Consumer confidence remained in the doldrums, as the FNB/BER Consumer Confidence Index registered -17 points in Q4 from -16 points in Q3.

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%). South African bonds delivered an impressive 8.1% for the quarter. 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. 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.

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. 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.

In Namibia, the Bank of Namibia left its main repo rate unchanged at 7.75% at both its October and December policy meetings, broadly following the SARB to maintain the N\$ peg to the rand. In its December Economic Outlook, the central bank forecast 2023 growth at 3.9% following the strong 7.2% expansion seen in Q3 2023, helped by a surge in mining and quarrying, as well as higher-than-expected oil and gas exploration activity. GDP growth for 2024 is seen decelerating to 3.4% due to softer global demand for commodities and an expected contraction in agricultural production, plus a slowdown in consumer and business spending amid high interest rates. The Bank reported increases in both uranium and gold production in 2023, and a decline in diamond

production versus the very high levels of 2022. Namibian CPI fell to 5.7% y/y in November from 6.0% in October, and is seen averaging 5.9% in 2023 and 4.8% in 2024.

Following a long consultative process, the Namibian government expects to introduce a new N\$18/hour minimum wage in Q1 2024, and will be implementing a 5% salary increase for government workers, despite its drive for fiscal consolidation. During the quarter, groundbreaking began on Africa's first decarbonised iron plant, powered exclusively by green hydrogen. The Hyllon Oshivela Project in western Namibia is partly funded by the German government.

Namibian assets broadly outperformed their SA peers for the quarter, escaping much of the elevated risk associated with South Africa. Namibian bonds recorded further gains thanks to improving government deficit projections and lower bond issuance, as well as higher demand due to the localisation regulations, with yield spreads versus SA bonds continuing to narrow. Namibia's IJG All Bond Index delivered 6.7% over Q4, while the IJG Money Market Index returned 2.1%.

Namibian equities saw strong gains in Financial and Industrial counters during the quarter amid the global rally: the NSX Overall (All Share) Index returned 4.7%, with Financials producing 14.1%, Industrials delivering 10.7% and Resources 2.1%. For the 2023 year, losses in the heavily weighted Resources sector dragged down the strong performances of other sectors: the NSX Overall (All Share) Index recorded a 5.8% return, as Financials posted a 31.1% return, Industrials 28.6% and Resources -21.4%. With its direct peg to the rand, the N\$ also depreciated sharply against the major global currencies, as noted above.

Performance

The fund returned 5.2% over the quarter (net of fees in N\$), and for the 12 months to 31 December 2023 it returned 12.6% (net of fees in N\$). Since its inception in 2003, the fund has delivered a return of 10.4% per annum compared to 9.3% per annum from its objective over the same period.

The fund's exposure to SA bonds and global equities added the most value to its absolute performance for the quarter, followed by global bonds, Namibian bonds, SA equities and Namibian ILBs. In fact, there were no asset class detractors from absolute performance. The fund holds no SA ILBs.

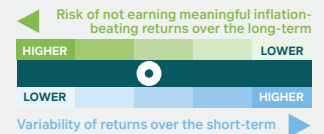
Within specific equity exposure, our holdings in many different stocks added to absolute fund performance in Q4 given the strong rally. The largest included Standard Bank, First Rand and Investec, as well as Gold Fields, Textainer, Exxaro and Naspers (despite its sharp sell-off at the end of December). The few detractors from performance included Sasol (given the decline in the oil price over the period), Namibian Breweries, Oryx Properties and Anglo American Namibia.

Strategy and outlook

Starting with our view on offshore vs local asset allocation, during the quarter we increased our offshore exposure and reduced our total SA exposure: we trimmed our SA assets across equity and bonds and used the proceeds to buy global equities and increase our cash holdings. However, we continued to prefer more attractively valued SA assets compared to their global counterparts.

Within our **global holdings**, during Q4 we bought more global equity out of our SA holdings, so that our position moved from slightly underweight to slightly overweight at quarter-end as the global growth outlook improved. Following the strong November rally in global bonds, we also took profits on a portion of our 30-year global bond exposure so that our portfolios moved from slightly overweight to slightly underweight, and duration also fell from modestly over- to underweight at quarter-end.

Risk profile



Fund facts

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David Knee
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Morningstar category

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In **global equities**, the MSCI ACWI 12-month forward P/E rose to 16.8X at quarter-end from 15.9X at the beginning of the quarter as stock prices gained ground. We increased our weighting on the back of the modest improvement in the interest rate outlook; however, we remain concerned that US equities remained priced for a perfect "soft landing" outcome in 2024. As such we have moved only modestly overweight from our previously slightly underweight exposure, and remained tilted away from the relatively more expensive US market. Equity markets that we prefer for their cheaper valuations include the UK, Japan, China and other emerging markets.

Within **global bonds**, November's sharp rally offered an opportunity for us to take profits on our holdings of 30-year US Treasuries, UK gilts and German bunds, thus reducing our overweight position in global bonds. Portfolio duration also fell. We used the proceeds to buy global equity and increase our global cash position. We continue holding moderate levels of local currency sovereign EM bonds where the real yields are high and the currency is trading at fair-to-cheap levels.

The M&G Namibian Balanced Fund was underweight **global corporate credit** at quarter-end, based on our view of credit spreads as unattractive for the risk involved versus their government counterparts.

The fund still favoured **SA and Namibian equities** at the end of the quarter, although we did take some risk off the table by selling SA equities into the quarter's rally and using the proceeds to buy global equities and increase our Namibian cash holdings. SA equity valuations (as measured by the 12-month forward Price/Earnings ratio of the FTSE/JSE Capped SWIX Index) rose to 10.0X from 9.5X at the beginning of the quarter. Local equity market conditions during the year favoured stock picking, given the wide dispersion in valuations across the market, and even within sectors. Some of the top stock holdings that made the most meaningful contributions to performance over the past 12 months included banking shares Standard Bank, FirstRand and Investec, Namibian financial group Capricorn, Oryx Properties, Textainer and Naspers.

Standard Bank and Investec: The M&G Balanced Fund has been overweight SA banks for some time, recognising that they are among the only businesses to benefit from rising interest rates as they receive more income from debtors and government bond holdings. There is a risk that debtors may default as interest rates rise, but at M&G we recognised that SA banks had been conservative in their lending practices in the run-up to, and during, the Covid pandemic, and had over-provided for bad debt in the economic downturn resulting from Covid, as well as in the conversion to a new accounting standard (IFRS 9). They had also had to comply with stricter lending regulations post the introduction of the National Credit Act in the late 2000s, giving them very healthy balance sheets at the beginning of 2023. Yet their valuations reflected the prevailing high uncertainty around inflation, interest rates and growth in SA and globally. Sentiment deteriorated further during the second quarter of the year after the emergence of the US regional banking crisis and rescue of Swiss banking giant Credit Suisse. Yet the banks consistently reported stronger-than-expected earnings and profits, successfully weathering the poor local conditions and helping lift their share prices. Among our bank holdings, Standard Bank and Investec were the standouts over the year.

Global shipping container lessor **Textainer** has been a preferred holding for several years, having benefited significantly from the recovery in global trade following the Covid pandemic. It possessed a sufficiently strong balance sheet that enabled the company to participate in the trade recovery post covid and increase its container fleet substantially. As an early mover, the company took advantage of the extended container shortages due to the dislocations in global trade to lease out the acquired containers at favourable lease rates for longer lease durations. This was financed with fixed rate debt that helped it withstand the higher interest rate environment. In the slowdown, the management team demonstrated discipline, not pursuing market share at all costs and rather focusing on share buybacks and shareholder returns. In October this year, the group announced an all cash buyout offer by US alternative investment firm Stonepeak at a 46% premium to its share price, sparking equivalent share price gains in Textainer and adding excellent value to our client portfolios.

We maintained our tilt away from **SA and Namibian listed property**, preferring to hold other equities that we consider offer better value propositions for less risk. Conditions in the local property sector remain uncertain given the rising local interest rate cycle (many property companies are reliant on finance to expand their portfolios) and relatively weak growth prospects, among other fundamental factors.

We also sold some of our overweight holdings in **SA nominal bonds**, taking profit into the rally over the period. Still, we maintained our significant preference for these assets in the fund. From a yield of over 12% at the start of the quarter, the 10-year SA government bond rallied by over 100bps to close the quarter at a yield of around 11%. We continue to believe SA nominal bond valuations are attractive relative to other fixed income assets and to their own longer-term history, and will more than compensate investors for their associated risks over time.

Meanwhile, yield spreads between SA and **Namibian bonds** continued to narrow over the quarter, with more Namibian bond yields trading below their SA counterparts. In our view, Namibian bonds are not attractive, offering an inadequate yield differential compared to South African bonds, and as such we are holding more SA bonds than Namibian bonds in the fund. We hold no SA ILBs in the portfolio, but the fund does have a small exposure to **Namibian ILBs** for their diversification benefits, which added good value during the quarter.

Lastly, we added to our **Namibian cash** holdings during the quarter after trimming some of our other SA exposure, but also used some of the cash to purchase global equities. Given our very underweight positioning prior to this, the fund remained tilted away from SA and Namibian cash at quarter-end. Yields on cash-type instruments have become more attractive for investors following the SARB's and BoN's steep interest rate hikes in 2023. □

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