M&G SA Equity Fund

Equity

Q1 2025

Market overview

The new year started off quite differently to the expectations that shaped the outlook heading into 2025. After a strong performance by US equities in 2024, markets were optimistic that a new Republican administration would further fuel US exceptionalism.

However, the situation unfolded quite differently than anticipated in the first quarter. The heightened uncertainty and volatility due to the unpredictable nature of US trade policy has dampened growth expectations and weighed on US markets and the dollar. Trump's new term has been nothing short of chaotic and market moving as participants try to decipher the impact of regulations on asset prices and the economy in general.

Globally, tariff talks and the potential trade war were key drivers of market moves for the quarter, as well as regional dynamics around policy shifts.

Global equity (as measured by the MSCI All Country World Index) fell 1.3% during the quarter. US equities fared the worst in the major regions, with the Nasdaq showing the biggest fall (-10.3%) on the back of the moves in tech stocks. The S&P and Dow Jones lost 4.3% and 0.9% respectively for the quarter (all in US dollars). Global bonds fared relatively better with 2.6% (Bloomberg Global Aggregate Bond Index, in US dollars).

Emerging markets, as measured by the MSCI Emerging Market Index, showed positive performance of 2.9% for the quarter, outperforming the developed market counterparts that delivered -1.8% (MSCI World). In emerging markets, Brazil's Bovespa (16.8%), China (15.9%) and South Africa (8.7%) performing strongly during the quarter (all in US dollars). In Turkey, some country-specific market moves due to widespread anti-government protests in the region in March led the Turkish equity market to be sold off, ending the quarter on -8.9% (in US dollars).

In South Africa, the FTSE/JSE All Share Index returned 5.6% (in rand) on the back of strong performance in the precious metal and mining space. The resource sector rallied 33.7% in the quarter, with gold and PGM names delivering strong returns due to those commodities being up significantly in the month of March. The strong rally in SA equity for the quarter has been very concentrated in a few bigger names, such as gold companies, Naspers/Prosus, MTN and a few other rand-hedge stocks, like British American Tobacco and Richemont. Industrials delivered 3.1% while financials ended the quarter down 1.8%. Property had a challenging quarter with -4.2% (as measured by the All Property Index).

SA cash, as measured by the Short-Term Fixed Interest (SteFI) composite, returned 1.9% for the quarter. SA bonds had a more muted quarter but managed to add small gains of 0.7% as per the All Bond Index. Concerns around the budget have led to a steeper yield curve with yields on long-dated bonds rising somewhat during March compared to flatter levels on the short-end of the curve. For inflation-linked bonds, the Composite Inflation-Linked Bond Index also delivered 0.7% for the quarter, with a similar steepening of the curve for those instruments (all in rand).

Fiscal uncertainty increased following the delay of the National Budget Speech, initially scheduled for 19 February, due to coalition disagreements. The budget was eventually re-presented on 12 March, with the proposed 2% VAT hike scaled back to 50 basis points over the next two years. The most significant impact was the effect this had on the Government of National Unity (GNU), as the ANC and DA clashed over the budget proposal, undermining the stability of the government.

On the economic front, South Africa's GDP showed modest growth of 0.6% q/q in Q4 2024, narrowly avoiding a technical recession, following a contraction of 0.3% in Q3. Annual consumer price inflation held steady at 3.2% y/yr in February 2025. As expected, the South African Reserve Bank (SARB) kept the repo rate unchanged at 7.5% in March, maintaining a cautious stance after the rate cut in January.

Performance

The M&G SA Equity Fund delivered a return of 5.1% (F class, net of fees) for the first quarter of 2025, underperforming its benchmark which delivered a return of 5.8%. For the 12 months ended 31 March 2025, the Fund returned 20.4% (F class, net of fees), underperforming its benchmark by 2.5%. Over the 3-year period ending 31 March 2025, the Fund return was 7.7% per annum, underperforming the benchmark by 0.5% per year.

During the first quarter of 2025, new US policies, particularly tariffs, increased the level of market uncertainty, which we think will cause risk premiums to rise across the world. In the short term, we may see risk premiums shrink for a few "safe haven" assets, like gold and US treasuries, but generally we think risk premiums and credit spreads could rise across the board. The broad-based tariffs that that were announced against most of the US trading partners will also likely cause countries to question the word "partner". This may cause countries to re-evaluate how much capital they deploy into US treasuries.

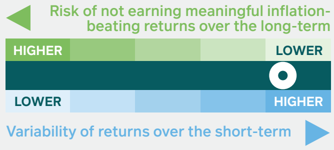
We have witnessed countries such as China redeploying the capital from their maturing US treasury holdings into other assets, such as gold over the last few years.

We think that the macroeconomic uncertainty together with the gold price rally into the face of rising real US Interest rates and the large central bank buying of gold from China warrants a more risk-conscious approach to this difficult-to-value asset. For this reason, we are holding a larger gold company position than would normally be the case at this point in the cycle where gold miners

Annualised performance	B class	Benchmark[1]	F class
1 year	21.8%	22.9%	20.4%
3 years	9.0%	8.2%	7.7%
5 years	20.7%	18.7%	19.3%
7 years	9.0%	8.2%	7.8%
10 years	8.2%	7.1%	-
20 years	13.4%	12.4%	-
Since inception	14.6%	12.9%	-

[1] The Fund's benchmark changed from the FTSE/JSE All Share Index (TR) to the FTSE/JSE Capped SWIX All Share Index (TR) on 1 July 2017.

Risk profile



Fund facts

Fund objective

To provide broad-based exposure to South African shares that offer value and medium- to long-term growth. The portfolio managers seek to invest in companies where returns can be achieved from any or all of (a) growth in earnings, (b) growth in dividends and (c) a re-rating by the market of the company's share price.

Investor profile

Investors with a higher risk tolerance who are looking for out-performance of the South African equity market, while limiting volatility relative to the fund's benchmark. The recommended investment horizon is 7 years or longer.

Investment mandate

The Fund can invest in any company listed on the JSE that meet the portfolio managers' value criteria. The Fund seeks out value by attempting to capture all components of return over time, including high dividend yield, earnings growth and possible market re-rating. The Fund will not invest in any foreign markets. The intended maximum limits are Equity 100%, Property 10% and Foreign 0%.

Fund managers

Ross Biggs
Chris Wood
Aadil Omar
Leonard Krüger

ASISA category

South African - Equity - SA General

Benchmark

FTSE/JSE Capped SWIX All Share Index

Inception date

21 September 2000

Fund size

R41 367 529 011

Please note that the B Class is only available to large retirement funds and institutional investors. The F Class was launched on 01/07/2016.

Sources: M&G Investments, Morningstar & Deutsche Securities are earning elevated margins. The material and relatively fast move lower in Chinese bond yields has also increased the relative attractiveness of gold to the Chinese market. Our overweight position to Angogold, which was up by 67% in the quarter, was the second largest contributor to performance over the last quarter. This outperformance was however more than offset from the fund not holding Harmony Gold which was up by 77% in the quarter.

The fund's overweight position in MTN was the largest contributor to performance over the quarter. The market has been very concerned about the risks of doing business in Nigeria, where MTN has a significant business. While we do not disagree that investing in Nigeria requires a higher risk premium, we think that MTN presents excellent value and continues to be one of the larger overweight positions in the fund. MTN is trading on a dividend yield of over 6%, which we think should be able to grow over the next five years. MTN has been steadily reducing debt levels on its balance sheet by realising non-core assets like their tower assets. We think that this process will not only ensure a stable and growing dividend but will also reduce any balance sheet risk. In our opinion, the current MTN Group share price is attributing low value for MTN Nigeria, despite it historically being the group's largest contributor to both operating profit and group value. The market has chosen to focus on the near-term negative impacts of the weaker naira on MTN Nigeria's operating costs – primarily its tower leases – and appears to assume that none of the increased cost can either be recovered from the consumer or shared with its service providers. Our view is that profit margins in Nigeria will recover both through the renegotiation of tower lease contracts and the recent regulatory approval for an industry-wide tariff increase. We are witnessing substantial price increases in many businesses in Nigeria currently as companies attempt to restore their profit margins post the significant currency depreciation. The underlying demand for voice and data services continues to be robust across most of MTN's markets, including Nigeria, while there is upside opportunity from the scaling of the Group's mobile money offering. Our quarrel with the market therefore on MTN is that it is focusing on the short term rather than the long term. In January 2025, the Nigerian Telecoms regulator announced that they would allow for telecoms operators to take up to 50% price increases. This caused substantial outperformance of MTN in January 2025.

While global turmoil and the associated volatility has affected assets around the world, the South African political developments unfolding simultaneously have only added to investors' concerns. Parliament's adoption of the 're-drafted' national budget without the support of the DA has significantly increased the risk that the GNU unravels in its current form. This uncertainty caused a reversal in the first quarter of some of the rally that we had seen in SA-exposed companies during 2024.

The retail sector in particular fell in the last quarter. The fund not holding Mr Price was the third largest contributor to performance. This outperformance was however offset by the Fund's overweight positions to Spar and TFG Group.

Mr Price has long been regarded as a good quality business, which has consistently grown. We think that this growth though is getting a lot harder for the business because of a much more competitive market in South Africa with the entry of more competitors aimed at Mr Price's customer base. Mr Price has been trying to grow by investing in businesses outside its core business and this has substantially reduced the return on equity that the core business generates. We think Mr Price is expensively valued and see better opportunities in the market.

We continue to have an overweight position to Spar. The Board and the Executive team of Spar have moved swiftly to address the key operational challenge in the core South African business, which was caused by a poor software implementation in the main distribution centre in Spar's biggest region, KwaZulu Natal. Loyalty levels from franchisees have improved and we think the South African business of Spar will return to earning the good returns that we have seen it deliver in the past. We think that the return of the group's focus to its key South African and Irish businesses will generate good returns for shareholders. Encouragingly, the Board has also announced a review of the Swiss business, which currently earns a return well below its cost of capital. We think that through these initiatives, Spar should be able to deliver good earnings and rerate off what we think is a very low rating for the quality of this business.

We continue to think that Banks sector looks relatively more attractive than the retail sector and we remain overweight the banks sector. South Africa has a very well-regulated banking sector and credit risk within the large banks have generally been very well-managed through cycles. We think that good earnings and dividend growth in the banking sector should provide a good opportunity to generate alpha within this sector by being overweight relatively undervalued banks. We continue to be prefer Standard Bank, ABSA and Investec, which are substantially cheaper than Capitec.

We think that South African banks continue to trade at undemanding valuations.

When evaluating the future cash flows of a business, it is also important to consider both the operational and financial leverage within the company. Where there is slowing growth, high fixed costs and operational leverage can mean a fall in profits. High debt and financial leverage can similarly impact cash flows negatively. A combination of both high operational leverage and financial leverage can be fatal to a company in a recessionary environment. The risk of increasing company bankruptcies is rising.

It is worth mentioning that when we construct our portfolios, we do not do so based on a particular view or outcome as we think it is not possible to consistently predict what oil prices or inflation rates might do for instance. We rather look to construct portfolios with many different and diversified ideas, all of which we think have favourable pay-off profiles. In this way, we hopefully have portfolios which can deliver good returns under many different economic environments.

We acknowledge that while it is very difficult to forecast the future and we do not make any attempt to do this, we do spend a lot of time thinking about the economic cycles that various sectors are in, and where valuations are. In this way, we aim to make money for our clients through these cycles and continue to try and buy companies that have proven dividend and cash flow track records and can withstand the normal upheavals that occur in markets over time. We aim to continue building risk-cognisant portfolios that seek to add value through stock selection relative to the benchmark.

We look to construct portfolios with many different and diversified ideas, all of which we think have favourable pay-off profiles. There are many high-quality South African companies with sound business models and strong, well-capitalised balance sheets that are trading at undemanding valuations. We're in a position where we have flexibility to add attractive assets opportunistically. We are, however, mindful of the possibility of further market surprises and are ready to take advantage of opportunities that arise.

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Application forms

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Strategy and positioning

In our view, the tariffs that Trump is imposing are bringing increased uncertainty to consumers, businesses and investors across the world. The longer this uncertainty persists, the more likely businesses are going to delay and reduce investment; and the more likely that global growth will slow, and returns on capital will deteriorate as operational gearing kicks in. Risk premiums are likely to rise in this environment. The cost of capital is rising.

We continue to think that the South African equity market is attractively valued over the medium term due to the prevailing levels of pessimism reflected in share prices and valuations. The Price to Book of the JSE remains close to 1.8X as at the end of March 2025, which we think is an attractive valuation level even given the heightened uncertainty in the market. We think that the South African rand is also attractively priced. In a recession scenario, these valuation levels together with sound stock picking should provide some margin of safety.

The focus of the fund continues to be on finding companies that are undervalued, and which can grow earnings and dividends over the long run. While we navigate this complex market environment, we continue to stay true to our long-term, prudent, valuation-driven investment philosophy supported by rigorous risk control. We strongly believe this approach leads to sustainable investment performance over time.

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Sources: M&G Investments, Morningstar & Deutsche Securities