Quarterly Commentary

M&G Investments

M&G Property Fund

Property

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.

In South Africa, the FTSE/JSE Capped SWIX Index posted an 8.2% return in rand and somewhat stronger than other emerging markets. Gains were propelled by a strong 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.

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.

Performance

The M&G Property Fund returned 14.8% compared to the All Property Index return of 15.9% for the quarter. For the year ending 31 December 2023, the fund returned 13.1% outperforming the benchmark's return of 10.7%.

Overweight positions in SA Corporate, NepiRockcastle and Hammerson contributed to relative returns, as did underweights in Hyprop, Burstone and Resilient.

Underweight positions in Lighthouse Capital, Redefine and Shaftesbury detracted from relative performance, as did overweight positions in Vukile, Dipula B and Stor-Age.

Strategy and positioning

In terms of positioning, we find good value in offshore names with strong fundamentals, such as NEPI Rockcastle, Sirius Real Estate and Hammerson. In South Africa, we prefer high-yielding mid- and small-capitalisation REITs such as Dipula B, SA Corporate and Octodec. However, large-cap, high beta SA property stocks such as Growthpoint and Redefine now offer compelling value in terms of yield and re-rating potential should bond yields and interest rates decline in 2024.

The fourth quarter of 2023 saw several REITs report results showing a stabilisation in SA property fundamentals. Retail-focused REITs saw vacancies reach new lows and reversions turn positive. Office market vacancies are stable at the expense of persistent negative reversions. We expect nominal net property income growth across SA portfolios to be offset by higher interest rates as hedges expire, resulting in muted earnings growth over the short to medium term.

Amongst the offshore names, Sirius Real Estate completed an oversubscribed bookbuild, raising 15% of their market capitalisation at a small discount to net asset value. Proceeds will be used to acquire a portfolio of assets in the UK and Germany embedded with significant value-unlock potential. Spanish and Central Eastern European retail property owned by some of SA's listed REITs reported strong trading performances, benefiting from the high inflation and growing footfall. This bodes well for rental growth potential.

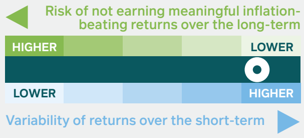
For 2024, we anticipate that the recent lower global inflation will be sustained and that interest rate cuts are on the horizon. These dynamics, combined with our view that rentals have stabilised and can grow (at least nominally), create an environment in which SA listed property can re-rate. We have positioned our fund to benefit from these tailwinds, while not compromising our criteria for high quality stocks with attractive risk-adjusted total return prospects that are underpinned by healthy free cash flow generation.

At 31 December 2023, the fund ranks number one over three years in its ASISA category, according to Morningstar.

Annualised performance	A class	Benchmark	D class
1 year	13.1%	10.7%	13.7%
2 years	6.8%	4.2%	7.2%
3 years	17.2%	14.6%	17.7%
Since inception	17.0%	15.4%	-

Disclaimer

Risk profile



Fund facts

Fund managers

Yusuf Mowlana
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ASISA category

South African – Real Estate – General

Benchmark

FTSE/JSE All Property Index

Inception date

9 July 2020

Fund size

R265 392 549

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Invest now

Application forms

An electronic copy of this document is available at www.mandg.co.za

Sources: M&G and Morningstar