Chris Sickle
Chief Executive Officer

Letter from the CEO

After the strong investment returns produced by the global recovery from Covid-19, the developments of the past quarter have proven how volatile financial markets can be, as well as the increasing impact of globalisation. As an excellent example from the second quarter (Q2) of 2022, US Treasuries, considered a global safe-haven, experienced substantial losses as investor sentiment rapidly turned negative, the highly uncertain conditions provoking a confluence of concerns over higher inflation and interest rates, as well as slower growth.

Investor pessimism and risk aversion escalated notably during Q2, 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 major 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 – both equities and bonds – giving investors nowhere to hide apart from cash investments, and marking the S&P 500's worst performance for the first six months of the year since 1970 (down 20%).

South African markets were less insulated from the global inflation and growth concerns than the previous quarter amid the fall in commodity prices and as economists predicted more aggressive local interest rate hikes ahead, extending further over the next two years, plus even slower growth ahead. Stage 4-6 loadshedding also weighed on growth prospects. However, local bond and equity losses were somewhat less severe than developed markets, more in line with those in other emerging markets. Finally, the rand weakened notably against the US dollar and other major global currencies, which would have enhanced quarterly returns from foreign-currency investments. Details on Q2 2022 market performance and our investment views are available in our latest **Market Observations** report from CIO David Knee.

M&G portfolio performance

Against this backdrop, on a relative basis our funds generally continued to deliver robust excess returns, falling less than their benchmarks or peers during the quarter. This was driven in the main by very strong performance from South African equity stock selection, and more specifically from two primary sources: An underweight exposure to basic materials in favour of oil and chemicals; and second, an increased allocation to Naspers, where an announcement of share buybacks sent the share prices of Naspers and Prosus soaring just before quarter-end. Naspers returned over 40% in the quarter.

At the same time, our global asset allocation in our multi-asset funds also continued to help protect the downside for client returns to some extent, given our continued preference for global cash assets compared to global equities and bonds.

However, the negative absolute returns from almost all assets, local and global (except cash), coupled with the acceleration in inflation from higher food and energy prices impacted negatively on our funds targeting inflation-plus returns.

Global allocations and global asset choices

During the quarter we engaged with many of our clients, both institutional and individual, on our views on the optimal strategic offshore allocation for portfolios with different investment objectives. This followed the change in the Regulation 28 offshore investment limit earlier this year to 45% from 30%. We hosted a very well-attended webinar on this topic, in which Portfolio Manager Sandile Malinga presented the findings of our latest in-depth asset allocation research. We also held numerous in-person engagements with many of our larger clients discussing this. The key message was that, for our own South African Balanced portfolios, for example, our research has shown that the optimal longer-term offshore allocation is approximately 25% -- lower than what some may have predicted. You can read more details about our findings in this edition of **Table Talk**.

This is not to downplay the role of global exposure for our clients. In fact, it is more important than ever for investors to get both their total global allocation and the underlying global holdings right. The right underlying holdings were yet another significant focus for us during the quarter in terms of which global investments we believe are currently most attractive for our clients. We hosted many of our top local clients at a day-long, in-person event at our M&G Investments offices in London in June, where six of our global portfolio managers took to the stage to share our latest views on such diverse topics as: the global macroeconomic outlook, global fixed income, sustainable investing, listed infrastructure, Japanese equities and using artificial intelligence. Clients came away with a deeper understanding of the current forces at play in global financial markets and our latest positioning across our range of M&G Global Funds, among other subjects.

We plan to bring you more of these global events and insights, both in person and online, as the decisions around global investing become increasingly complex and important for South African investors. This past quarter's market developments have certainly demonstrated this.

M&G High Yield Bond Fund changes to M&G Bond Fund

Also during Q2, we received approval from the Financial Sector Conduct Authority (FSCA) to change the name of the M&G High Yield Bond Fund to the M&G Bond Fund. While the fund's investment objective and mandate haven't changed, the new name is a more accurate descriptor, resulting from evolving conditions in the local bond market. Gareth Bern, our Head of Fixed Income, explains more about this change and the market developments in our **SA Bond update**.

CSI developments

Here I'd like to provide an update on some of our Corporate Social Investment (CSI) initiatives, given how much has happened in recent months. We believe that education is fundamental in alleviating poverty and transforming communities in our country -- hence all of our CSI programmes have education at their core.

First, although our time with the South African Education Project (SAEP) has come to an end, I'm proud to inform you that the refurbishment of the three informal day-care centres in Philippi

Township we helped to finance has been successfully completed. They now have the necessary infrastructure to become legally registered Early Childhood Development centres, and therefore able to receive financial support from government. We also helped to provide the principals and staff of these centres with training.

Replacing SAEP as our flagship beneficiary is the South African Medical and Education (SAME) Foundation, an NGO that works with primary and secondary schools across South Africa. Following the devastating floods that struck parts of Kwa-Zulu Natal, the SAME Foundation embarked on a disaster relief campaign to help repair certain schools identified by the Department of Basic Education. Here we donated desks to the value of R600,000 which will directly benefit just under 2,000 children in the area.

At the same time, we have extended our long-standing partnership with LEAP Science and Maths Schools. The organisation offers free education to students from high-need communities, who have mathematics, physical science and English as mandatory subjects. This year, we donated R300,000 towards the organisation's Gauteng operations, covering teaching, tuition fees, educational material, rent of school properties, etc.).

For the LifeMatters Foundation, we were able to contribute R300,000 towards their Academic Portfolio, which provides literacy and numeracy intervention to under-performing Grade 2 and 3 learners. The donation fully funded a learning centre in Capricorn outside Cape Town, with the balance split across several schools in the Western Cape.

A final existing beneficiary of ours is Fun Learning for Youth (FLY), a non-profit organisation providing mathematics tutoring to secondary school learners in underprivileged communities. This year we committed just over R300,000 for the tuition, board and living expenses of five university learners who are studying towards their undergraduate and post-graduate degrees.

Managing your investments

Given the opposing forces at work in global financial markets, the past quarter has yet again been one of the most difficult periods in recent memory for investment managers, particularly in global fixed income assets. In hindsight it is clear that many investors underestimated the seriousness of the impacts caused by the extended, unprecedented wave of production shutdowns and supply chain dislocations under the Coronavirus crisis, exacerbated by the inflationary pressures of the Russia-Ukraine war and its sanctions. Our articles on the **semiconductor industry** and **Resources sector** in this edition of the magazine bring more perspective to these disruptions.

Amid the current uncertainty and high levels of negative daily "noise" in financial markets, I would like to urge clients not to sell or switch their investments at such cheap prices and consequently lock in losses. We have managed these conditions on far too many occasions, sadly, and will not react by panicking. Instead, we will continue to apply our tried and tested investment philosophy and process. We promise to remain true to what we know best, which is to value companies according to the known facts and carefully construct and manage our client portfolios with both the downside risks and upside return potential in mind.

The good news is that, in our view, SA government bonds offer excellent value for income investors, and for higher-risk investors, the JSE has many well-managed SA companies with very attractive valuations to choose from. In this higher-risk environment, apart from attractive valuations, we also prefer to hold those stocks with defensive qualities such as sustainable earnings and strong balance sheets, and those with the proven ability to cope well with inflation. We believe our portfolios are still well-positioned to capture the returns on offer as sentiment improves; they are still on track to deliver to their investment objectives.

Sincerely,

Chris Sickle

Chris joined M&G Investments in 2019 as Chief Financial Officer and took over from Bernard Fick as Chief Executive Officer in October 2021. He is primarily responsible for all aspects of M&G Investments Southern Africa's operations, including Namibia. With over 22 years of asset management experience, Chris previously worked for Ernst & Young (EY) as the Regional Managing Partner in the Western Cape and was a member of the EY Africa Executive Board. His qualifications include: B.Com Accounting (University of the Western Cape); B.Acc.Sc (Hons) (University of South Africa); Chartered Accountant (SA).