M&G Investments

Quarter 3 2022

Consider this

No party for global brewers post-Covid

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Contents

Chris Sickle
Chief Executive Officer

Letter from the CEO

Global financial markets sold off sharply in the third quarter of 2022, but especially in September as negativity around global growth gathered steam, spurred by aggressive central bank interest rate hikes (and steeper forecasts) led by the US Federal Reserve. Central bankers vowed a stiff fight against surprisingly high inflation data and growing signs of second-round price effects, despite acknowledging the "pain" caused to consumers and businesses. The chances of recession increased meaningfully, and economists, analysts and investors like ourselves are now considering the possibility that this disruption marks a longer-lasting global shift back towards a paradigm of higher inflation and interest rates last prevalent in the early 1980s. In such conditions, the investment strategies of the past are not likely to be as effective going forward. Read more on our thoughts on this topic in the accompanying article by our CIO David Knee.

The deteriorating environment was felt across all asset classes and regions. Investors fear emerging economies will be obliged to increase interest rates more in line with the US than dictated by their own local conditions, leading to excessive growth slowdowns or stagflation. A final notable feature of the quarter was significant US dollar strength on the back of prospects of even higher US interest rates, with the greenback reaching multi-decade highs against the pound sterling and euro, and moving about 10% stronger versus the rand.

The South African Reserve Bank followed the US with a total of 150bps of interest rate hikes during Q3, both to curb local price pressures and to ensure the interest rate differential between SA and the US doesn't become too wide, therefore protecting against rand weakness. South African equity returns were in the red but did manage to lose less than both the MSCI ACWI (global) and the MSCI emerging market indices during the quarter. Resources and Listed Property stocks were relatively hard-hit, with the former dragged down by falling global commodity prices. South African bonds continued their outperformance of global bonds so far in 2022, delivering marginally positive returns and helped by their attractive yields on both an absolute and relative basis. Finally, SA inflation-linked bonds (ILBs) were in negative territory. Details on Q3 2022 market performance and our investment views will be available in our latest Market Observations report.

M&G portfolio performance

Against this backdrop, on a relative basis our flagship funds outperformed their benchmarks or the average of their ASISA category peers over the past 12 months. Their absolute returns remained in positive territory for the 12-month period as well. Globally, our underweight positioning in global bonds helped fund performance, as did our neutral stance in global equities. Global cash holdings also provided a cushion for client returns.

Our SA equity selection has also continued to add relative value over the 12-month period, as has our overweight holding in SA bonds. However, our funds targeting inflation-plus returns were impacted negatively by higher inflation and the prevailing low-to-negative absolute return environment.

Celebrating women and diversity

August was Women's Month in South Africa, and at M&G Investments we celebrate diversity and inclusion, which includes a conscious effort to promote gender equality in our business every day. It is a well-known fact that the investment industry globally is traditionally a male-orientated one, and South Africa is no different. However, we are pleased to see that over the last few years, more and more females are carving out successful careers for themselves in our industry. For us, diversity and inclusion are key tenets for our success.

We are proud to play a positive role in the careers of the 85 females (of whom 60 are Black) now in our company, representing 48% of our staff. Thirteen of the 38 staff employed across our investment teams are female, and in our Exco, three of the 8 members are female, of whom two are Black.

This helps make M&G Investments a diverse place to work, demonstrating our commitment to gender transformation in the investment industry and the country as a whole. This focus on an inclusive culture has enabled us to attract and retain female talent across our teams. We encourage our people managers to engage with their staff around goals and career paths, helping ensure that our people are in the right place and in the right role irrespective of their gender. We tap into the passions of our people and assist with any development or training required to achieve their goals. This not only benefits our staff, but allows us to retain and grow our talent, which we require to achieve our purpose of helping our clients live the lives they want and retire with dignity.

Additionally, on 24 September we celebrated Heritage Day by honouring the different cultures and cuisines represented in South Africa. Our staff cooked dishes to be shared, representative of their family heritage, through which we were able to raise approximately R24,000 to donate to The Haven Night Shelter, a non-profit providing care, food and shelter for the homeless in the Western Cape. M&G Investments matched the staff contributions, through which we were able to provide safe beds to 347 homeless people for five nights.

More online security enhancements

A part of managing our clients' money, it is fundamental that we ensure that your funds and details are safeguarded, especially in this environment of cybercrime. We are aware of ongoing fraud attempts across the local financial services industry and ask that you be extra cautious when engaging online in money-related matters. As part of our ongoing efforts to ensure the protection of our clients' personal information, from 9 September 2022 we started sending a confirmation email to all clients following any online changes made to their static details on record. This is in addition to the SMS and telephonic notifications we send after having processed clients' requested changes. Financial advisers are now able to view and track their clients' online instructions and notifications to us as well.

Outlook

In escalating their fight against persistent inflation, global central bankers have warned that consumers are likely to feel more pain going forward before conditions improve. Economies could fall into recession or experience stagflation. In our view, it is best for investors to know that they are likely to experience ongoing volatility and further possible market downturns in the months ahead, and to be prepared for these and not panic. Remember that the global economy and financial markets always move in cycles, and that eventually we will come out of the current downturn and into a new growth cycle and market upturn. A key to investment success is not to miss out on the upturn when it does materialise – whenever that may be.

We have already seen falls in the global oil price and slowing food inflation, with consumer inflation thought to have now peaked in the US. Meanwhile, SA asset valuations have cheapened further, with current measures indicating double-digit prospective returns from SA equities and bonds over the next three to five years. Of course, no one knows when exactly these returns will materialise and in what fashion, but they provide a healthy margin of safety that should reward investors well for the risks they are taking over time.

Despite this cheapness, we have opted not to add more to our overweight SA equity and bond positions in our houseview portfolios, nor have we added to our global equity exposure, given the increased risks to company earnings, bond yields and economic growth. We prefer to see further de-ratings before increasing our holdings. We have also kept our neutral stance in SA listed property for the same reasons.

As our clients, you should know that we manage your funds with the goal of consistently performing through full market cycles, both the up and the down, and we are still confident that our funds are on track to meet their goals based on the excellent valuations at which we've bought our holdings. Patience is what is required now to weather the current downturn, taking advantage of selective opportunities until the Fed signals an end to its rate hiking cycle.

Sincerely,

Chris Sickle
Chief Executive Officer

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).

Pieter Hugo
Chief Client and Distribution Officer

Table Talk

Key take-aways

- The choice of retirement vehicles is largely guided by an investor's income needs: should you lock in a perpetual, guaranteed income that rises with inflation (but cannot be changed) with a guaranteed life annuity, or take a chance and hope for higher returns by accepting what the markets deliver with a living annuity?
- A guaranteed life annuity is typically more expensive and leaves no inheritance, but it avoids investment risk (should your market returns be inadequate), sequence risk (should market losses be timed inconveniently) and longevity risk (should you outlive your income). All of these are assumed by the life assurer, so you'll never have to worry about receiving a minimum income.
- The investor assumes all the above risks with a living annuity, but it is generally cheaper, offers upside to your income when markets rally, and any remaining value is passed to beneficiaries. It is also more flexible; you can adjust your underlying investments and your drawdown levels regularly.

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I'm about to retire and I'm concerned that my retirement savings won't be sufficient to draw a sustainable income for the rest of my life. I'm considering using my retirement benefit to purchase either a guaranteed life annuity or a living annuity. What are some of the main factors I should consider before deciding on which product to purchase?

A

Introduction

Good question. Many South Africans find themselves facing a similar dilemma. In fact, a recent study found that 90% of South African retirees are unable to maintain their current standard of living when they retire. Unfortunately, it's often only at the point of retirement when investors realise that they have insufficient capital, which also happens to be a time in the lifecycle when there are fewer options available to recover from a capital deficiency.

The decisions you make today could therefore have a significant impact on the quality of the remainder of your life. For this reason, we strongly encourage seeking the advice of a good independent financial adviser to help you structure a sound retirement plan. To help facilitate this discussion and give you some insights into the main choices available to you at retirement, we've highlighted some key features of the two post-retirement vehicles you mentioned, as well as the various factors that you'll need to consider when deciding on which option to choose.

Option 1: A guaranteed life annuity

The main benefit of a guaranteed life annuity is that it offers longevity insurance. This means that when you retire you will receive a regular income that is guaranteed to continue for the rest of your life. When purchasing a guaranteed life annuity, you essentially “hand over” your retirement savings to the life insurer. The life insurer then carries the risk of you outliving your capital. Another major benefit is that the life insurer assumes all the investment risk, which includes the risk of low growth on your underlying assets, as well as sequence risk, both of which we explain in more detail below.

In terms of disadvantages, arguably the most notable drawback is that there is no capital payable to your beneficiaries in the event of your death. This can be mitigated by either taking out a joint-life annuity (which is payable until the death of the last joint-life) or by adding a guaranteed term to your annuity income, whereby if you die within a specific period your spouse or nominated beneficiary will receive a regular income for the remainder of that term. Adding these options increases the cost of the annuity, and they are effectively funded by reducing your monthly income.

Another disadvantage is that your income amount is fixed, which means you do not have the flexibility of changing it in the future if your financial situation changes. There is also the risk that pensioner inflation could increase above the annual increase option that you selected when purchasing your policy. This typically relates to costs associated with old age, such as unexpected medical expenses.

Option 2: A living annuity

A defining feature of a living annuity is its flexibility. You have full control in selecting the underlying assets that you invest in, and the value of your investment is directly linked to the performance of your chosen underlying assets. This is particularly beneficial if you're looking to grow your post-retirement capital over time. Unlike pre-retirement investments, your asset allocation is also not restricted by Regulation 28 of the Pension Funds Act, which means that your portfolio can hold more than 75% in equities or more than 45% offshore. In terms of your income rates, you also have the flexibility to draw an income of between 2.5% – 17.5% p.a., which you can change once a year on the anniversary of your investment. In the event of your death, the balance of your remaining capital can be paid to your nominated beneficiaries – which is especially attractive for those wanting to leave behind an inheritance for their loved ones.

Arguably, the main disadvantage of a living annuity is that you take full responsibility for all associated risks. Your ability to draw an income lasts for as long as you have sufficient capital (longevity risk). Because your investment is market-linked, the value could go down in periods of poor market performance (investment risk). Another risk is the possibility of drawing an income during a depressed market, which could potentially erode the value of your capital over time (sequence risk). If the rate at which you draw an income exceeds the growth of your underlying investment, you run the risk of eroding your capital and running out of money before you die. Your annual income might also not be able to keep up with inflation.

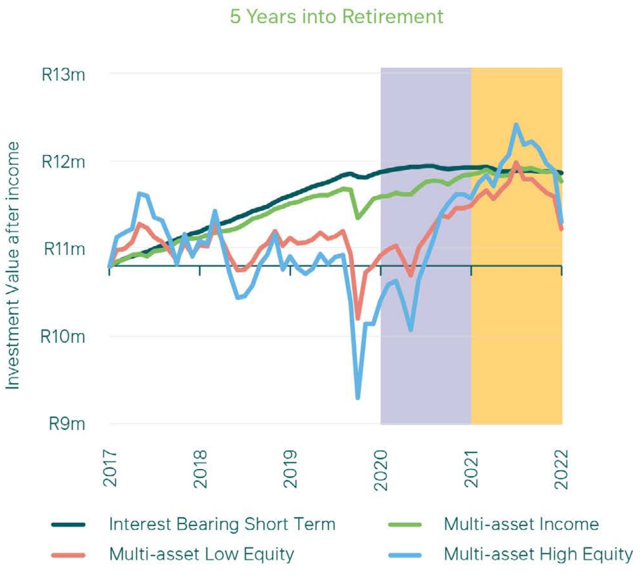
Choosing the right asset allocation for your living annuity investment

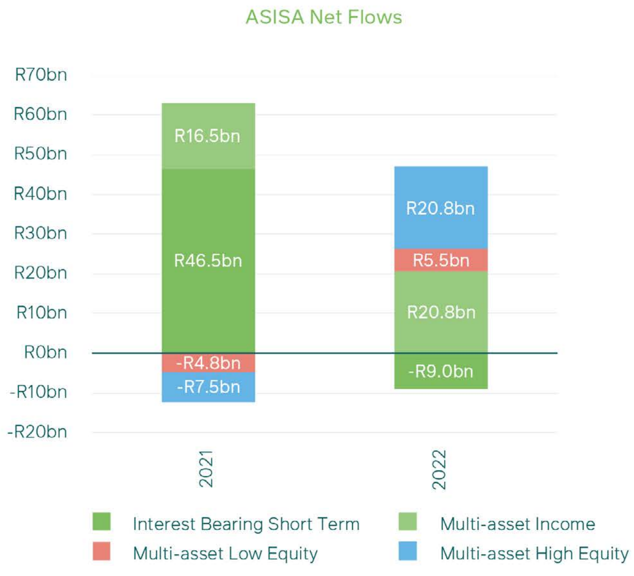
If you decide to incorporate a living annuity into your post-retirement plans, you'll need to ensure that you have sufficient exposure to growth assets (particularly equities) to help reduce longevity risk. When holding equities, it's important to understand exactly how this asset class works, particularly regarding short-term volatility. Being able to tolerate volatility is vital to mitigate the impact of poor investor behaviour, which involves buying and selling assets at the wrong time, thereby eroding future returns and negatively impacting your future income stream.

To demonstrate this, Graph 1 shows the average performance of multi-asset and interest-bearing funds over the past five years.

Graph 1: Investors chasing the best short-term performance

Investment value after income





Based on a 75% replacement ratio = 4.5% drawdown rate
Source: Morningstar and ASISA

From this, we can see that investments with a higher weighting to equities were significantly more volatile compared to other asset classes. When comparing the ASISA net flows into the various funds over this period (the bar graph on the right-hand side), a few observations become apparent:

- In the period after higher-equity investments **underperformed** (the purple-shaded area), investors switched out of their higher-equity investments in favour of fixed-income investments that had better short-term performance (the green shaded bars of the ASISA Net Flows graph on the right-hand side).
- In the period after higher-equity investments **outperformed** (the yellow-shaded area), investors switched out of their fixed-income investments in favour of higher-equity funds that had better short-term performance (the blue and pink shaded bars of the ASISA Net Flows graph).

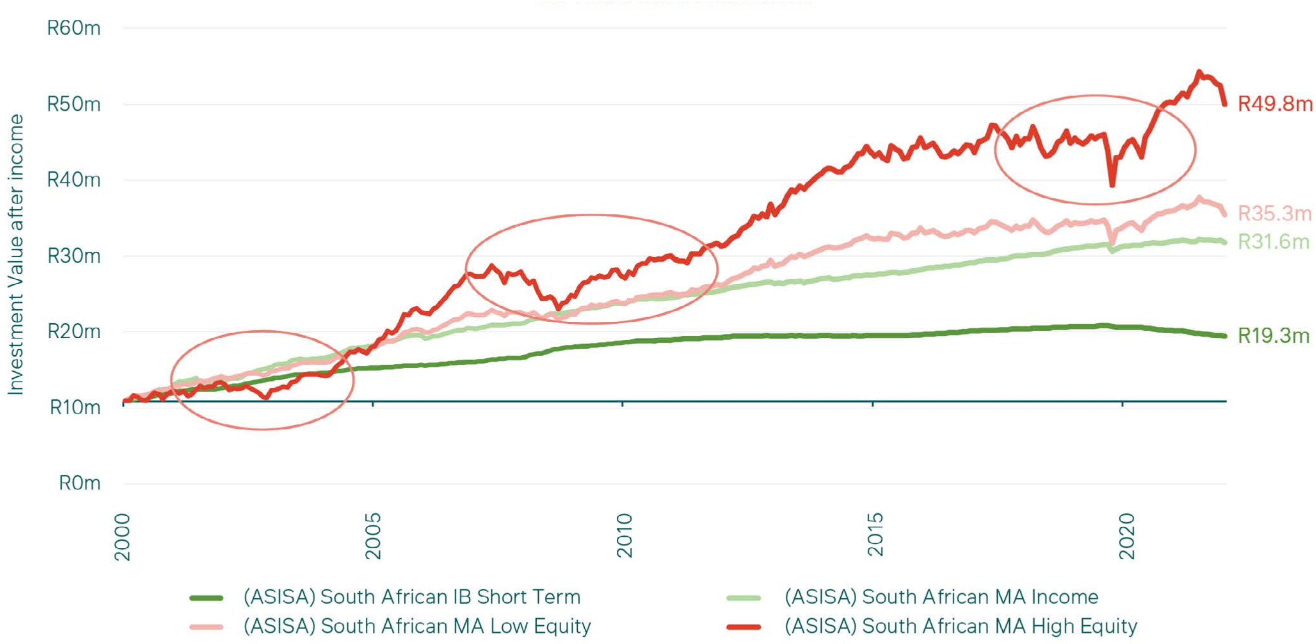
This shows how investors effectively chased short-term performance with the hope that it would continue into the future, instead of sticking to their long-term plans. This behaviour would have resulted in investors locking in their losses, missing out on the rebound that followed the sharp sell-off, and an increased risk of running out of money as a result of eroding capital.

What history has taught us

Graph 2 shows the same data as Graph 1, but extended over 22 years. What it demonstrates is that volatility is a natural part of investing, especially in high-equity funds. Over time this volatility is "smoothed out" and the performance line angled upwards. High-equity investors who rode out the sell-off would have been rewarded, while investors holding fixed-income assets would have experienced less volatility over the short term, but also significantly less inflation-beating growth over the long term.

Graph 2: Time "smooths out" volatility in high-equity investments

22 Years into retirement



Based on a 75% replacement ratio = 4.5% drawdown rate
Source: Morningstar

Deciding which option is right for you

If you're purely looking to mitigate longevity risk, you'll need to decide whether you want the security of a guaranteed income for the rest of your life, or if you're comfortable with market volatility and want to grow the value of your capital by purchasing a living annuity with sufficient exposure to growth assets, whereby you manage your own investment risks. Another option we often see involves the purchasing of a living annuity for the first few years of retirement, and then using the remaining benefit to purchase a guaranteed life annuity. However, research suggests that this latter option is typically a sub-optimal strategy.

Regardless of which post-retirement vehicle you choose, it's important to have a good understanding of the options available to you and the pros and cons of each. It's worth remembering that the decisions you make now will have a significant impact on the quality of your future.

Pieter joined M&G Investments in 2015 as Managing Director of M&G Investments Unit Trusts and Head of Retail Business. In 2019 he was appointed as Chief Client & Distribution Officer. With 23 years of industry experience, Pieter previously worked for one of the country's largest financial services groups in a range of senior management positions. He holds a B.Comm (Maths) degree from Stellenbosch University, and is a Fellow of the Institute of Actuaries (UK) and the Actuarial Society of South Africa. He completed the General Management Program at Harvard Business School in 2010 and during 2020 completed a course in Behavioral Finance from Duke University.

Analysis

David Knee
Chief Investment Officer

A new financial equilibrium ahead?

Key take-aways

- Developments such as the Covid-19 lockdowns, Russia-Ukraine war, Brexit and US-Chinese competition have all challenged the more open, globalised trends of the past four decades.
- Any reversal of these trends is likely to be an uneasy one for investors, with financial markets already reflecting sharp disruptions that have heightened risks and volatility.
- Although asset values are cheap across most areas, investors need to carefully assess the downside risks that have risen almost as quickly as inflation and interest rates. Extra caution is merited on all fronts.
- M&G has refrained from adding to our global and local equity positions, as we believe valuations need to cheapen further to compensate for the elevated risks.

In his book *Homo Deus, A Brief History of Tomorrow*, Professor Yuval Harari ponders a future for Humankind where knowledge is the new wealth and data the new religion. Computers, algorithms, and artificial intelligence create potential existential threats to life as we know it. Genetically and mechanically enhanced humans form a super race that would bode ill for those unable to afford an ‘upgrade’. You could at this point be forgiven for wondering if the author had abandoned his study of history for a career script-writing for the Terminator series, but this would be an error. Outlandish views of the future have a greater chance of being right than some notion of a tweaked version of today. Our human nature naturally inclines us to anchor to the recent past and extrapolate it far into the future. This tendency only serves to magnify the effects of the inevitable disturbances to the expected timeline.

Current global macroeconomic and political events have all the hallmarks of such a disturbance. I am reminded of when the Deathstar obliterated Alderaan in the first Star Wars movie and the perturbation in The Force was felt billions of light years away. The ‘balance’ was thrown out. Today our sense of financial balance has been built on 40 years of successful inflation fighting, falling real interest rates, rising globalisation, and increasing profit shares of GDP. In society, the corollaries have been massive reductions in global poverty, sharply rising real incomes but commensurate increases in global inequality. The net effect of all this is perhaps neatly summarised in one example: despite a five-fold improvement in living standards since 1950, people in Japan report being no happier now than then. Which raises the awkward question, how might we feel in a world of rising interest rates and rising inflation? And what might the path to this new equilibrium imply in terms of economic and market outcomes?

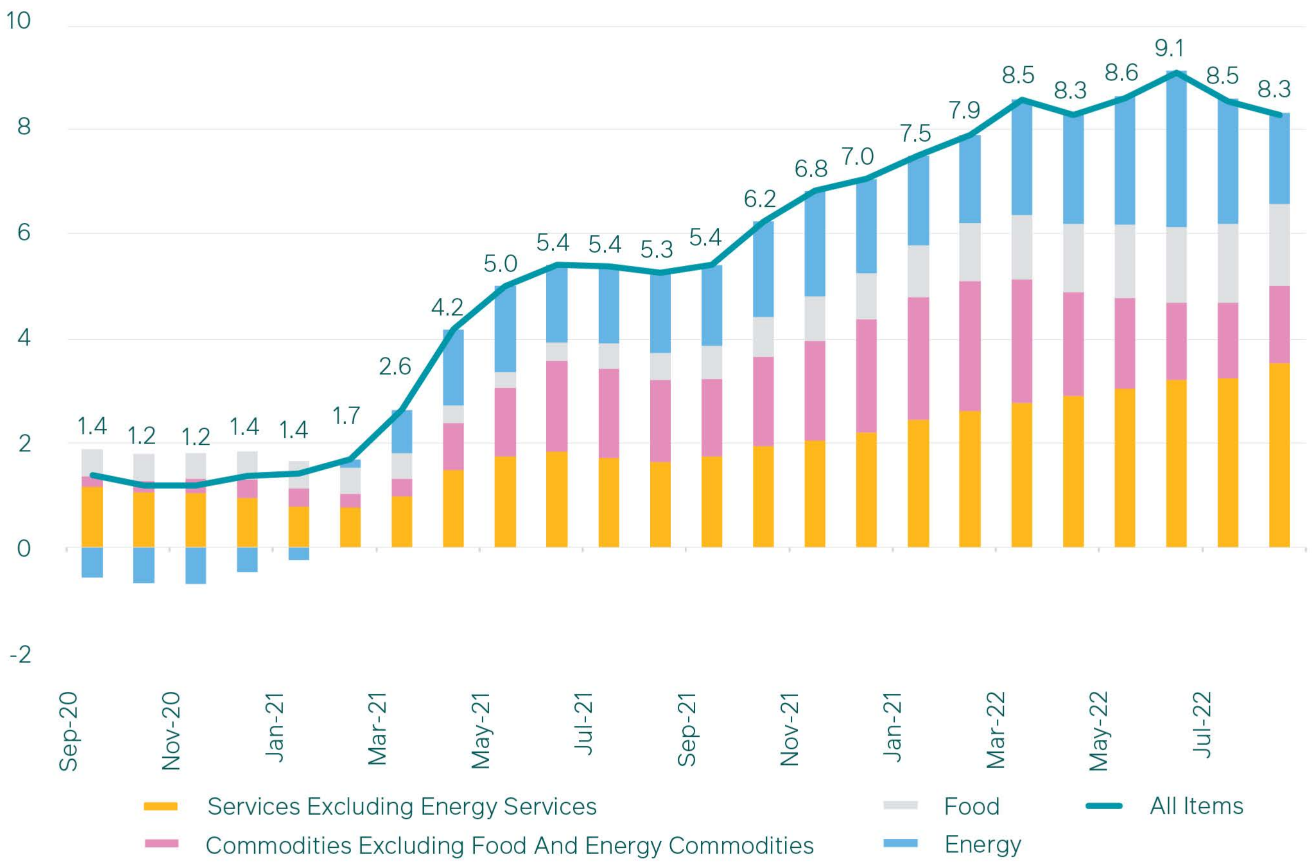
An uncertain path ahead

Of course, the answer is “we don’t know”. But I suspect at the very least, if that is where we are headed, the journey there isn’t going to feel good. In just a few months, economists have slashed their forecasts for 2023 European growth from +2.5% to +0.7%, with a clear bias to cut more. Equity and bond markets (and global central banks) have had to pivot from a view (which I shared, by the way) that inflation was a “transitory, supply bottleneck-driven phenomenon”, to a “don’t worry it’s just a temporary energy and food shock”, to an understanding that the primary engine at work here is now demand. Over 60% of the US inflation basket is rising at an annual rate of 4% or more. Excluding food and energy, US core inflation is zipping along at 6%, the highest since 1982.

Graph 1 illustrates how core goods and services, excluding the energy and food components, have still accounted for a substantial portion of the uplift in inflation; doubtless the US

Graph 1: Underlying drivers of US CPI may prove sticky

Components of US CPI inflation YOY%



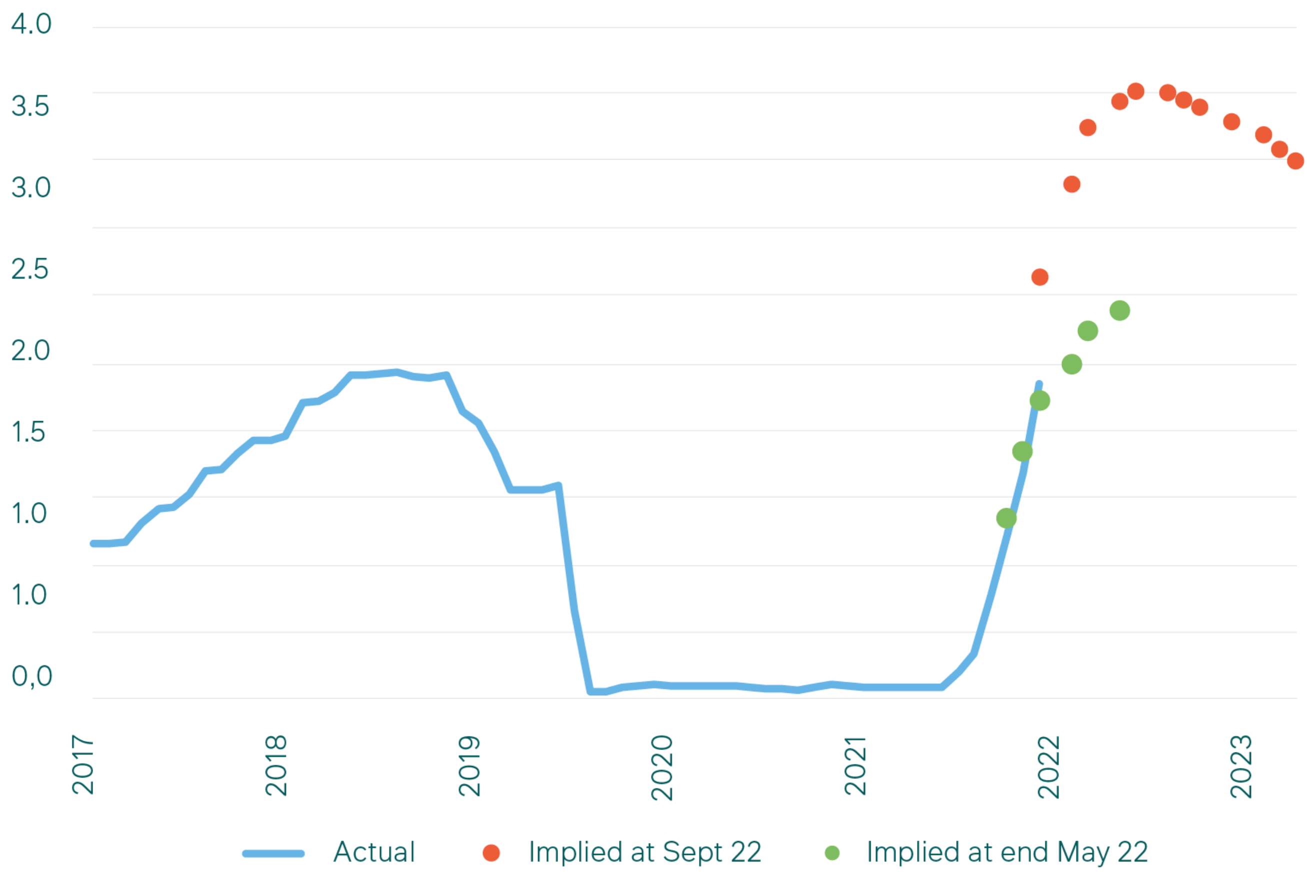
Source: Bloomberg, US Bureau of Labor Statistics

Federal Reserve is concerned that acceleration in these core components will unhinge long-term inflation expectations. Thoughts only a couple of months ago that we might see rate cuts before the end of 2023 have slipped from minds, leaving only a sense of unease that we don't have a grip on what's going on at all, and how could we have had such childish fantasies.

The result is intense market volatility, with sharp moves with each economic data release and with every speech by a Federal Reserve Governor. This is clear in the shift in Graph 2, which

Graph 2: US interest rate expectations rise sharply

US Rate Expectations



Source: Bloomberg, US Bureau of Labor Statistics

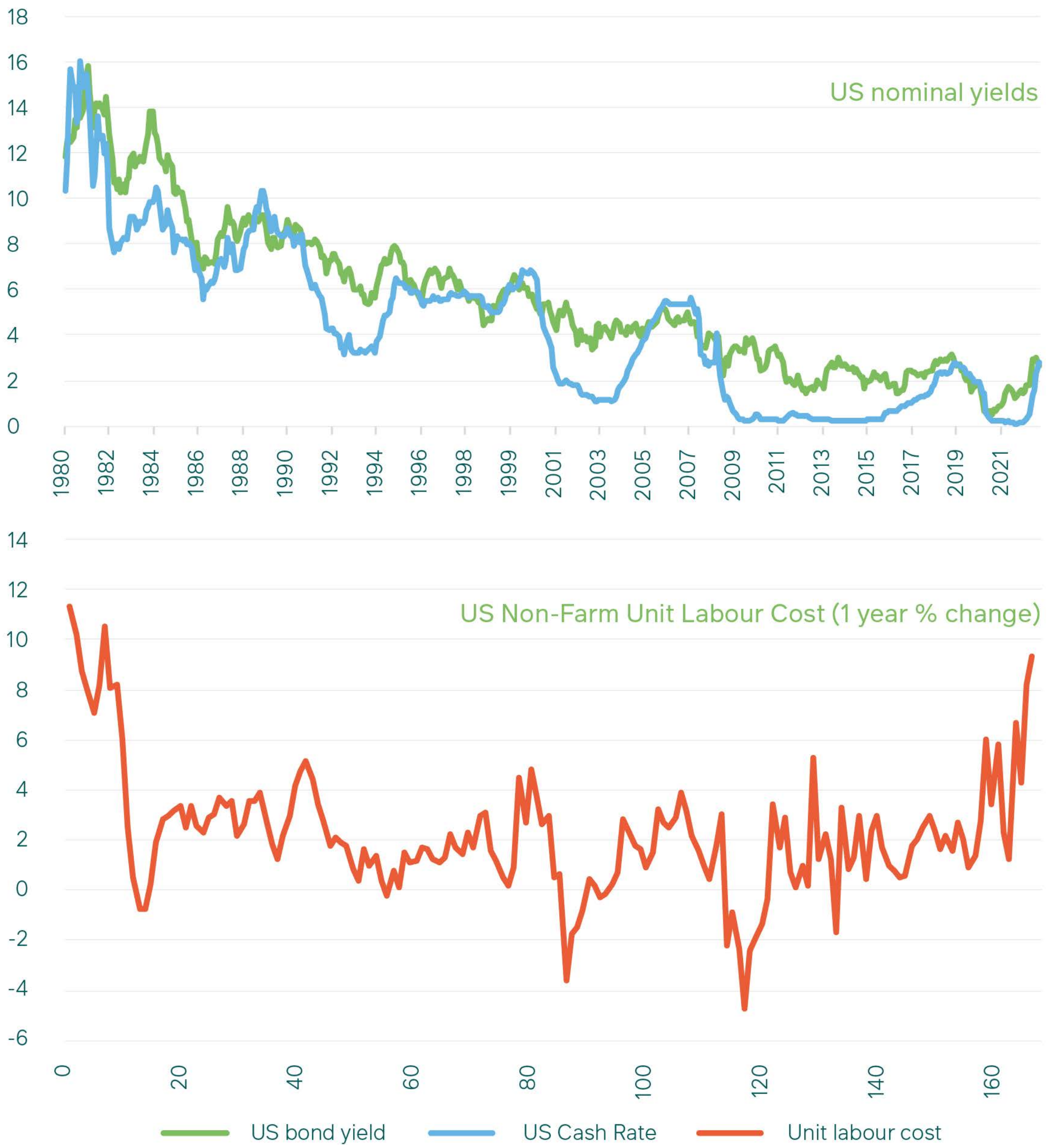
shows the move in short-term interest rate expectations in just the past three months. At the end of May, the forecast embedded in Fed Funds Futures contracts implied rates at 2.9% by mid-2023; that forecast is now for rates at 4.5%. The graph also highlights that investors expect rates will gently decline from there on. This may well happen, but equally, if inflation fails to fall back to more normal levels, further rate increases might still be needed, or at the very least, cuts are postponed.

Compounding our general unease, wasn't it only the other day we thought that governments would be able to borrow at zero or negative nominal interest rates forever, and who cared two hoots about government debt when investors paid you to borrow? What happens if, in order to re-anchor inflation, cash rates need to return firmly into positive territory and debt is no longer "free"? Total indebtedness has not reduced at all since the Global Financial Crisis (GFC), so if rising rates enforce fiscal discipline and debt paydown in corporates and households, the result could be highly negative.

Keeping an eye on labour costs

Key to the question of whether inflation is likely to become unanchored are near-term developments in unit labour costs, as shown in Graph 3. Wages per unit of productivity are a critical input cost for businesses, and therefore, when wages persistently rise faster than output, an underlying inflationary dynamic is likely to build that might prove painful to reverse. With the latest US Non-Farm Unit Labour Costs rising at 9.3% versus a year ago (also the highest rate since 1982), focus on this is understandable.

Graph 3: US labour costs rising at fastest pace since 1982



Source: Bloomberg, US Bureau of Labor Statistics

History may have something to tell us here, in that sticky wages were a key problem in the late ‘80s, the late 90s, and prior to the GFC, too. After a profoundly painful recession in the early ‘80s, Western labour markets were zinging along by 1988. On each of these occasions, the Federal Reserve had to raise interest rates until they were above (or very close to) the rate of growth in nominal GDP before an economic slowdown manifested and wages and inflation dropped. Needless to say, these episodes tended to go hand-in-hand with substantial rises in unemployment. The challenge right now is that nominal GDP is expanding at over 9% and interest rates are only at 2.5%. Nominal GDP will slow as inflation peaks and falls, but it still might leave a substantial gap that higher rates would need to fill if previous cycles repeat this time around.

We don’t know if this will happen. Inflation might instead fall sharply. In the past two decades, there was little obvious relationship between wages and unemployment, with a common explanation being that globalisation had broken local wage-setting frameworks and replaced it with a disinflationary impulse, courtesy of low wage rates in emerging markets. Factories and call centres were established in Asia and Eastern Europe, cementing a contract whereby advanced economies received cheap goods and services and in return, emerging economies generated jobs and rising living standards. This win-win relied on a stable geopolitical environment, in which in particular, peace prevailed.

Old global paradigms dented - or broken?

Russia's invasion of Ukraine and China's sabre-rattling and recent blockade of Taiwan have, at the very least, dented this contract. On-shoring and self-sufficiency in key goods like energy, food and defence are narratives that are building support, aided by the supply chain disruptions as countries emerged from pandemic lockdowns. Reducing Europe's dependency on Russian energy is now a top political imperative and may well drive Europe into outright recession next year. In the US, Congress recently passed a bill providing US$50 billion of support for the US semi-conductor industry, recognising that the country doesn't want to be held to ransom if Taiwan is prevented from supplying these vital inputs for the global economy. As a by-the-by, there are about 200 chips in one Javelin anti-tank missile.

Exercising caution in global equities

Against all of this uncertainty, how does one invest? If the advanced economies nudge into recession in 2023, equity earnings are at risk. The magnitude of any earnings downgrades would be amplified if interest rates are still rising due to sticky inflation. At M&G we absolutely consider this as a risk scenario and we examine the robustness of our portfolios should it prevail. But this is not our starting point. The outlook can be challenging, but valuations can compensate for the prevailing risks -- not all risks or scenarios of course, but if valuations offer decent levels of protection against adverse outcomes and compelling returns in muddle-through or favourable outcomes, then the right investment action, in our view, is to stay invested. This is our conclusion in terms of global equities. Valuations have become significantly more exciting given the market declines this year. Many markets are very cheap in all circumstances except a hard recession, and even then pricing suggests losses would be short term and not permanent. Hence we have been happy to keep a neutral weighting in this asset class, despite the risks.

SA equities: It's about tomorrow, not yesterday

The narrative around South Africa equities is rather different. Since March 2013, just before the Taper Tantrum, the FTE/JSE Shareholder Weighted Index (SWIX) has delivered 8% per annum to investors, bonds 7% and cash 6%. Inflation over the near-decade-long period averaged 5%. Suffice to say, real returns have been disappointing and investors feel they haven't been compensated for the volatility. Little wonder that it has been cash and near-cash funds that have taken R400 billion of inflows in the past four years or so, while General Equity funds have seen zero. Of course, you would have done blindingly well pivoting from cash to equities in April 2020, but no one was inclined to do so, according to the unit trust flow data. It's a point that we make often at M&G: you are unlikely to be able to time the market successfully, and when it feels most difficult to pivot, the odds are that it will actually have been the best time to do so going forward.

Still, investing is all about tomorrow, despite the fact that how we feel about our portfolios and their positioning is all about yesterday. The fact that South African equities have disappointed hasn't been because they have lacked earnings growth. Indeed, aggregate earnings have tripled since March 2013. So what happened? There are two key drivers in our view: First, the market was on an expensive multiple in early 2013. The world thought interest rates would be held at zero forever and then

Ben Bernanke thrust his spanner into the wheel with his taper announcement. SA equities (and the rest of the world) needed to normalise valuations. But the second driver has been a shift in risk appetite, both as a global phenomenon and due to idiosyncratic SA factors.

Slowing SA growth, rising indebtedness, credit rating downgrades, corruption, load shedding, riots, water rationing, grey listing and many other issues have driven risk appetites down. While each of these factors is worthy of an article in its own right, in our view the net result is they have caused a disconnect to emerge between the earnings-producing ability of SA companies (with much of those earnings coming from outside SA, remember) and their valuations. The market is currently close to the cheap valuation levels it reached in the GFC. There are never any guarantees in markets, and a global recession next year could delay things somewhat, but from this starting point the odds are massively in favour of above-normal returns from our own equity market. With the growth and inflation risks around the world that were highlighted earlier, this isn't the time to be maxing out risk positions, but valuations support an overweight stance in our view, with further capacity to add to this if growth does temporarily slow into next year.

David joined M&G Investments in December 2008 as Head of Fixed Income, and was appointed as Chief Investment Officer in July 2016. Alongside his CIO role, he is also joint Portfolio Manager of several funds as well as a member of M&G Investments Asset Allocation Committee. With 30 years of industry experience, David has worked in a range of senior roles within the fixed income space, both in South Africa and abroad. His qualifications include: BSc (Economics), LSE; MSc (Economics), Birkbeck College; Associate of the Society of Investment Professionals (ASIP).

iStock-1093593288

Maryna Roesch
Equity Analyst

Something brewing?

Key take-aways

- Defying analyst predictions, spirits outperformed beer sales during Covid-19 and its aftermath as consumers opted to drink premium and super-premium brands at home despite lower incomes, continuing both the “premiumisation” and “slow volume growth” trends in the global market.
- Brewers have also faced a stronger US dollar, higher barley and energy costs, as well as supply chain disruptions. So rather than cost-cutting, they must focus on obtaining higher prices to improve their bottom lines. Also, developing countries where growth has greater potential have become more important than ever.
- We see Nigerian brewers as sound long-term investment cases given these companies’ greater growth potential and relatively cheap valuations currently. While we are very aware of country-specific risks, they benefit from the expertise of their global parents, among other upsides.

As has been true for most companies, the Covid and post-covid periods have been a challenging time for brewers. In South Africa, brewers were particularly hard-hit by the total ban on alcohol sales, a relatively rare phenomenon elsewhere in the world, and have subsequently seen large cost increases that have impacted their bottom lines. How have brewing companies fared amid these large demand and supply disturbances compared to their competitors and, as investors, where do we see value?

As has been true for most companies, the Covid and post-covid periods have been a challenging time for brewers. In South Africa, brewers were particularly hard-hit by the total ban on alcohol sales, a relatively rare phenomenon elsewhere in the world, while supply chain disruptions and lockdowns elsewhere led to large cost increases that have impacted brewers' bottom lines. How have brewing companies fared amid these large disturbances compared to their competitors and, as investors, where do we see value?

Spirits versus beer

At the start of the Covid-19 pandemic, there was a large amount of uncertainty on how the global beer industry would be impacted. The general consensus was that spirits and beer would both experience reduced demand, resulting from travel restrictions and social distancing measures. However, as bars and restaurants were closed, the decrease in on-premise consumption was expected to be worse, together with downtrading into lower value categories due to lower consumer disposable income. As such, spirits, which is a category more exposed to the on-premise channel (i.e., it is consumed more in bars and restaurants and on social occasions), was expected to fare worse than beer.

Fast forward to 2022, and the words of Danish physicist Niels Bohr have once again proven true: "it is very difficult to predict — especially the future."

While it is true that we saw a change in channel mix and a shift to "off-premise" or at-home consumption, several trends have emerged that were unforeseen and certainly not knowable.

One such trend was the exacerbation of premiumisation and the relative outperformance of the spirits market, as at-home consumption of premium and super premium spirits cushioned the fall in on-premise spirits sales. Surprisingly, consumers opted to spend their earnings on more up-market brands. In South Africa, post the lockdowns and alcohol bans, it became clear that demand was merely delayed and not destroyed. Brewer margins were also under pressure as the change in mix to off-premise consumption and cans rather than returnable glass bottles led to a global shortage of aluminium. Enter the tragic Russia-Ukraine war, and a new challenge emerged in the form of increased barley costs and an increase in energy prices. Add to this the backdrop of a strong US dollar and it is clear that brewers are facing one of the more challenging periods in their history. So where to from here?

Growth is harder to come by

Given our three- to five-year investment time horizon at M&G Investments, it is important to assess these trends and the current environment against the long-term history of the brewing industry to determine where we are in the cycle.

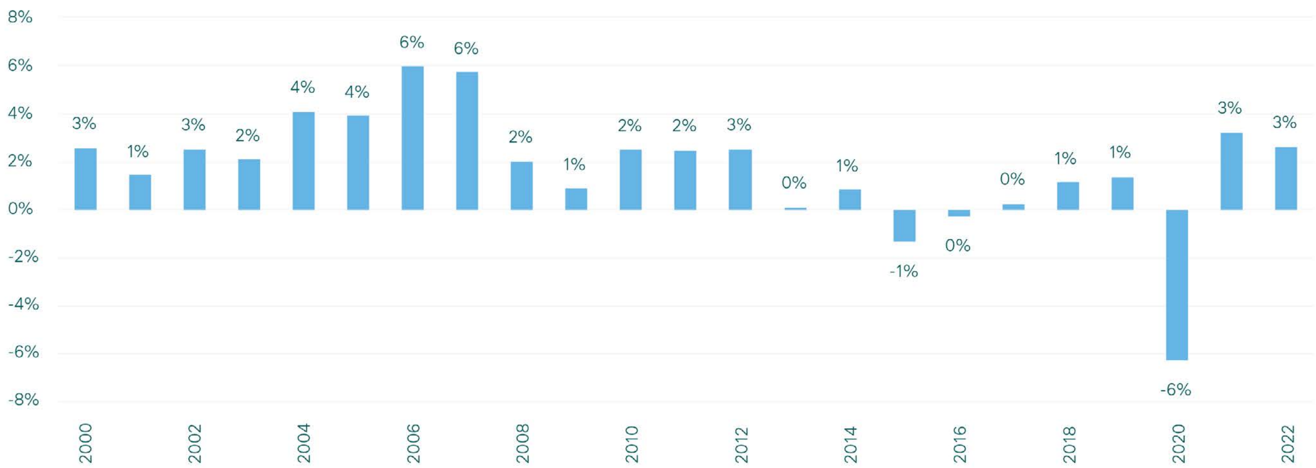
The global beer market is very consolidated, with the top five companies accounting for more than 56% of global market share. This compares to a highly fragmented spirits market, where the top five companies account for less than 31% of global market share, according to Morgan Stanley. Overall, the global beer market is mature, and looking at longer-term industry trends, volume growth has been hard to come by.

Given the size of the largest players and the concentration in the beer market, consolidation has also become harder to accomplish. Combine this with the global trend of premiumisation, and the global spirit players have emerged as clear winners in the post-Covid world with beer brewers' market share theirs for the taking.

Looking at the problem beer brewers face simplistically, growth is a function of volume and price.

Graph 1: Global beer volume growth has struggled for over a decade

Global Beer Volume Y/Y Growth



Source: Global Data, Morgan Stanley, y/y % growth in hectolitres 2000-2022

It is clear from Graph 1 that there has been very little volume growth in the global beer market over the last decade. This is a result of markets maturing and spirits and other beverages commanding a larger share of throat in mature markets.

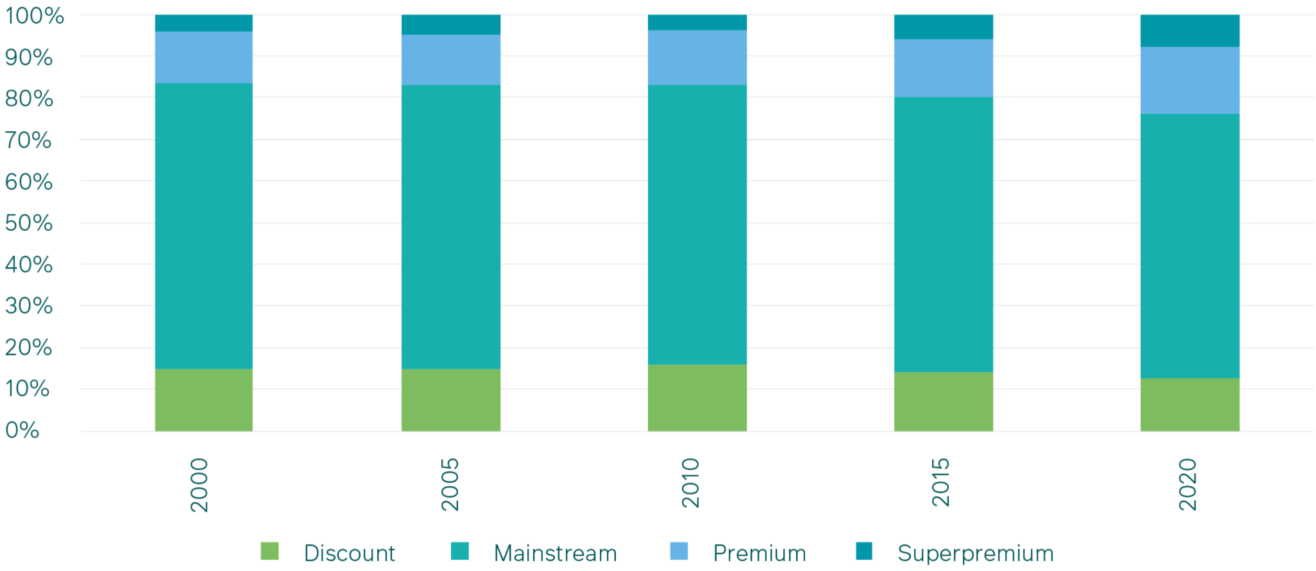
Growth for the brewers must therefore come from price, either directly through price increases or indirectly through a change in sales mix by selling more of their pricier brands.

Premiumisation to the rescue?

This is where premiumisation comes into play. This trend is nothing new, but has become more important as beer companies have reached maturity in most of their markets. When a market premiumises, not only does share of throat shift from value or mainstream brands to premium or super-premium brands, but there is generally a shift from beer to spirits and other categories. Beer companies need to work harder and spend more just to maintain the same level of volumes. The brewer has to shift from being a traditional manufacturer and distributor, to becoming a consumer-focused brand protector and builder.

Graph 2: Premium beer taking market share from mainstream and discount segments

Market share evolution- premium and above have been gaining volume share from mainstream and discount beer globally



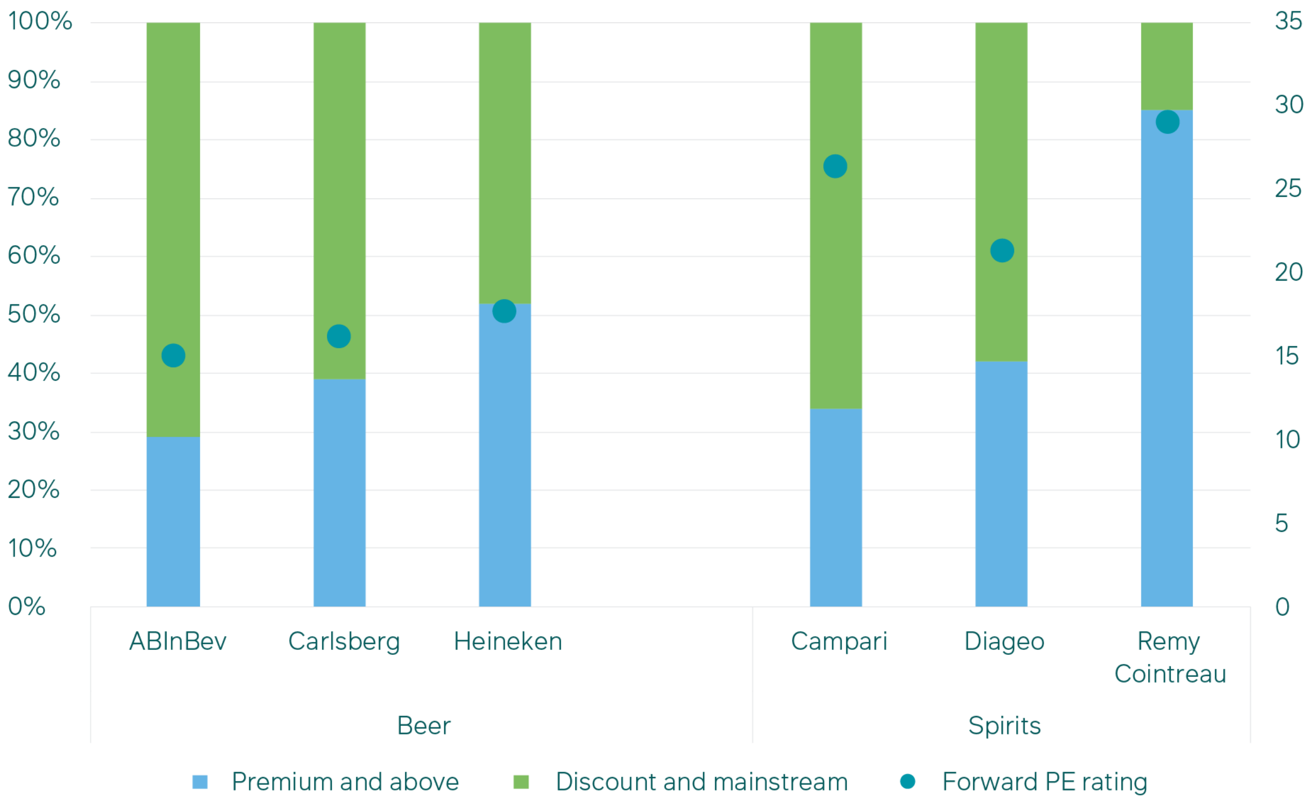
Source: Morgan Stanley

Graph 2 shows how more expensive beer brands have gradually been gaining ground from cheaper brands over the past 20 years. Premiumisation normally goes hand-in-hand with lower volumes and mainstream market share loss, but the company's margin is protected to some extent as premium products demand a much higher selling price. Premium and super-premium products are more profitable than mainstream products, where differentiation is minimal, and consumers are more sensitive to price increases.

Not only do premium products come with a higher selling price, but the market is willing to attach a higher valuation multiple to companies that are more indexed to the premium and super-premium segments, as opposed to mainstream. In addition, spirits companies have in recent years commanded a valuation premium compared to their beer counterparts. Graph 3 highlights how the likes of Diageo, Remy Cointreau and Campari are trading at higher forward price/earnings (P/E) valuations than AB InBev, Carlsberg and Heineken. Also, Heineken's higher mix of premium and super-premium products merits a higher market rating than its lower-market peers.

Graph 3: Global spirits companies rated higher than brewers

Beer vs Spirits players



Source: Morgan Stanley, Category data as of 2021; Forward price/earnings (PE) as of 20/9/2022

What about inflation?

Another element of price growth is inflation. Historically, brewers have generally been able to "price up with inflation" with relatively inelastic demand from consumers. Therefore, an inflationary environment is not necessarily negative for brewers, as higher selling prices are rather sticky and margin expansion can occur once cost headwinds eventually subside. In markets where this has not been the case and brewers have not been able to price with inflation, severe margin pressure has been evident.

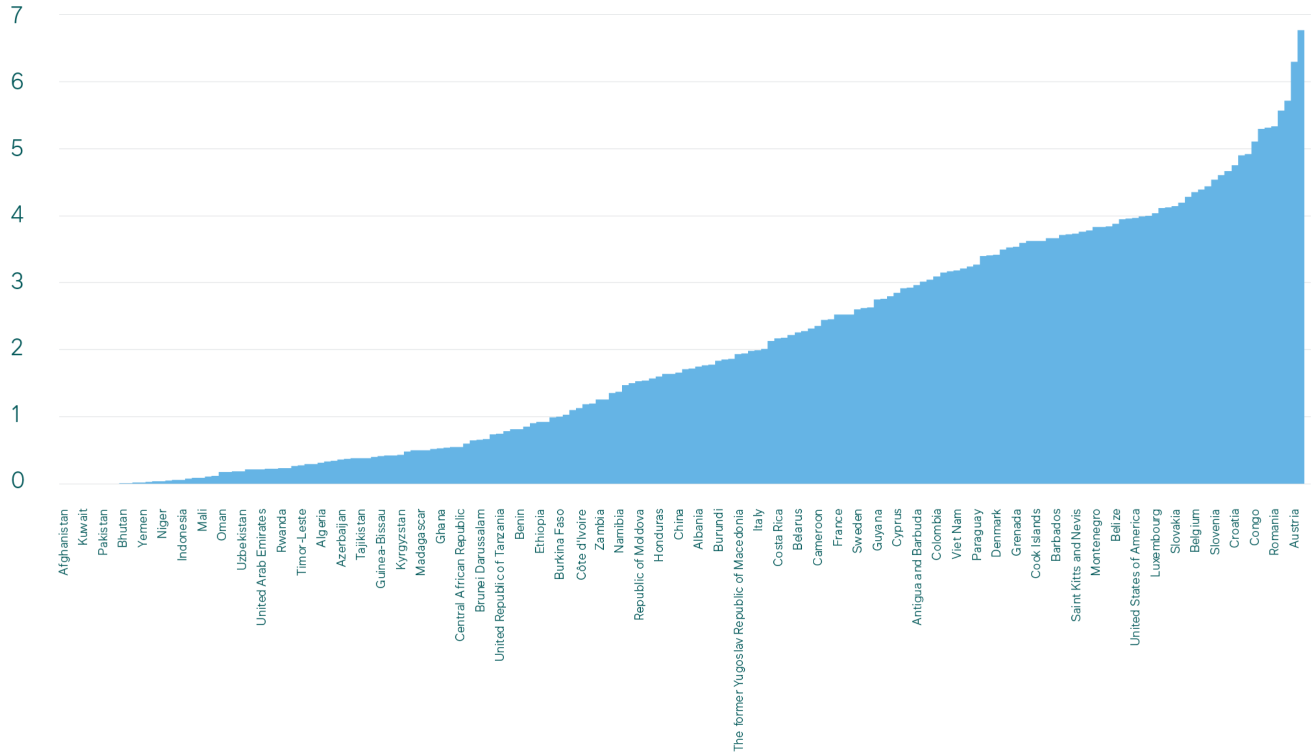
What's brewing in Africa?

Bringing the argument closer to home, in a global landscape where volumes are not growing, Africa has emerged as an important growth market, as its demographics are key to unlocking future volume growth for the industry. It is therefore no surprise that the global beer players ABI, Heineken and Castel, and the spirits player Diageo are well represented in Africa.

The largest market on the African continent is Nigeria. It is still in its early maturity market phase, with low per capita consumption and favourable demographics. From Graph 4 it is clear that there is still significant room for per capita beer consumption growth, with Nigerian drinkers consuming less than one litre of beer annually compared to their Polish counterparts at nearly seven litres (as measured in litres of pure alcohol).

Graph 4: Big potential for beer sales growth in developing countries

Annual per capita beer consumption (in litres of pure alcohol)



Source: Morgan Stanley

Understanding the Nigerian beer market

The formal brewer market in Nigeria is dominated by three large players: Nigerian Breweries, the largest player in the market with more than 55% market share, a subsidiary of Heineken; Guinness Nigeria, a subsidiary of global spirits player Diageo; and International Breweries, a subsidiary of AB InBev.

The Nigerian market has been a case study in value destruction. At the height of the market cycle in 2013, the combined market capitalisation of the three large brewers was almost US$12 billion. Today, these brewers are valued at less than US$2 billion.

This has in large part been due to the continuous depreciation of the Naira and a lack of US dollar earnings growth, with around 50% of brewing raw material costs directly or indirectly linked to the US dollar. In order to protect margins in a market experiencing currency weakness, a lack of dollar availability and high local inflation, it is imperative to be able to put through price increases.

Up until recently In the Nigerian market, this has not been possible. Instead, a weak consumer environment and capacity additions led to a price war that destroyed the profitability of these brewers. This was clearly not sustainable. At the low levels of profitability at which these brewers operated, it was hard to justify continuing operations at all, as the cost of capital in Nigeria by far exceeded the returns earned. This scenario is now reflected in the companies' very low share prices.

Taking advantage of value

In the M&G Africa Equity Fund, we own a handful of African brewing companies, with our largest overweights being in Nigerian Breweries and Guinness Nigeria. Where appropriate, other M&G unit trusts also have exposure to these stocks via underlying holdings in the M&G Africa Equity Fund.

At the height of the pandemic, Nigeria Breweries traded below US$50 on an enterprise value per hectolitre basis. This is far below our deemed replacement value of US$200 per hectolitre of brewing capacity, and does not reflect the value of its distribution network, in-country malting plants, brand strength or latent growth in the market.

Our interest was piqued when it became clear that rationality was returning to the market and that the brewers were able to increase selling prices across the board. This, together with volume growth, led to improved profitability levels that are not reflected in the share prices.

We increased our position in Guinness Nigeria when it became clear they were executing on their strategy to focus on their core capabilities of spirits and stout, and exiting the overcrowded lager market. International Breweries and Nigerian Breweries were also able to push through price increases, and because of the significant operational leverage in these companies, the impact on returns was immediate.

Without getting into the details of the Nigerian macro environment, which is a topic for another day, it is important to note that we do not wear rose-coloured glasses when it comes to Nigeria. We continue to foresee challenges in this market as the structural issues in the economy remain, and the country has not fully benefitted from the higher oil price environment due to low production levels caused by a lack of investment.

However, even after taking all these risks into account, we, like the global brewing companies who have recently added incremental in-country capacity, recognise the attractiveness of the market and potential for long-term growth. Recent deals such as the Heineken-Distell transaction or Diageo's announced sale of its

Cameroon subsidiary to Castel were done at valuation levels much higher than where the Nigerian brewers currently trade, highlighting the attractiveness of these assets.

Like brewing itself, the value to be unlocked from these shares might be a long and exacting process, but at today's very attractive valuation levels, we believe the odds are skewed in our favour to achieve outsized returns in the medium to long term. □

Maryna joined M&G Investments in November 2018. As an Equity Analyst, she is responsible for covering certain South African and African stocks, predominantly in the Consumer, Telecommunications and Industrial sectors. Prior to joining M&G Investments, Maryna completed her articles at KPMG where she was responsible for Advisory, Auditing and Technical Accounting engagements for both listed and unlisted companies. Maryna holds B.Com Accounting (cum laude) and B.Com Accounting (Honours) degrees from the University of Pretoria and is a qualified Chartered Accountant (SA).

Simon Kendall
Portfolio Manager

Is gold a disappointment?

Key take-aways

- Despite falling what may seem to be a disappointing 6% year-to-date in US$ terms, gold has performed better when priced in non-US$ terms and has outperformed many other assets.
- A stronger US$ and rising US and global interest rates pose headwinds for gold, which does not pay interest. Another headwind is the existence of pockets of traditional assets that have offered other investment opportunities. These factors help explain why gold's performance may not be as disappointing as it appears at face value.
- For M&G Investments, while we recognise the diversifying property of gold bullion in general, its lack of cash flow tends to preclude it from our investment framework. And, while gold equities can be valued on cash flows, we tend to avoid these stocks because their fundamental driver, the price of gold, undermines this.

Normally an environment beset by macroeconomic risk (particularly of the inflationary kind), geopolitical risk (as reflected in the Russian invasion of Ukraine and the associated energy crisis in Europe and globally), and thirdly the potential for financial contagion risk (from various causes, most notably the bubbling Chinese property crisis), would have built the conditions for gold to perform. Against this backdrop, its 6% price decline year to date is disappointing, at face value.

Table 1: Global asset returns disappoint in 2022

Crypto 100 Index	TLT Bond ETF	MSCI World Equity	EMB Bond ETF	S&P 500 index	Global EM Equities
-61%	-22%	-19%	-19%	-17%	-17%
BBG Industrial Metals	**HYG Bond ETF**	**ZAR vs US$**	**Gold Price US$**	**DXY US$ Index**	**BBG Energy Index**
-16%	-12%	-8%	-6%	14%	69%

Source: Bloomberg data 1 Jan – 5 Sept 2022

Defending the safe-haven case

In defence of the safe-haven case for gold, various factors stand out. First, the US dollar (US$) itself has been an outperforming asset, even as US Treasuries have experienced their worst year-to-date performance in history amid rising US inflation and interest rates. While a strong dollar is often a reflection of safe-haven demand as cash flees riskier assets like equities, commodities and emerging markets, gold has nevertheless been a relative outperformer itself; as becomes clearer when considering the gold price in non-US$ currencies.

Besides a stronger US$ being a headwind to the US$-denominated gold price, rising US and indeed global interest rates are a material challenge to gold. While gold broadly responds favourably to negative real interest rates (generally viewed as the strongest driver of the gold price), as presently occurring due to elevated inflation, the non-interest paying characteristic of gold hurts its competitive position against cash in the short-term (carry trade opportunity costs).

In summary, gold can be viewed as a default, uncorrelated and unanchored asset, which comes into its own when all alternative "mainstream" asset classes fall by the wayside. In that regard, bonds have performed poorly in an apparent inflection of a multi-decade bull market, equities entered a bear market earlier this year (but have since experienced a robust recovery with the US S&P 500 up around 15% off its Q2 lows), and the property investment case suffers from post-Covid adjustments and the rising interest rate risk.

Among commodities, industrial metals have generally started to price in recession risk, as prices gravitate towards their marginal cost, although energy commodities have benefitted from supply disruption amid realisations of catastrophic underinvestment and under-preparedness for a transition to renewables.

Thus pockets of mainstream investment opportunities still exist, and the relative strength of the US economy and labour market in particular puts paid (at least so far) to the stagflationary conditions that would simultaneously disrupt the case for these assets and pave the way for gold.

A word on crypto

Some market participants have viewed cryptocurrencies as an alternative to gold, variously as a non-fiat currency, potential inflation hedge and uncorrelated asset. The quadrupling of this asset's market cap to above US$3.0 trillion from 2020 to 2021 is thus likely to have taken some shine from gold. However, its subsequent two-thirds loss, as risk assets have fallen and inflation surged, does serve to distinguish the uniqueness of gold. It is also worth noting that the estimated value of the crypto market at its peak was material relative to gold at approximately US$11.0 trillion.

What about gold miners?

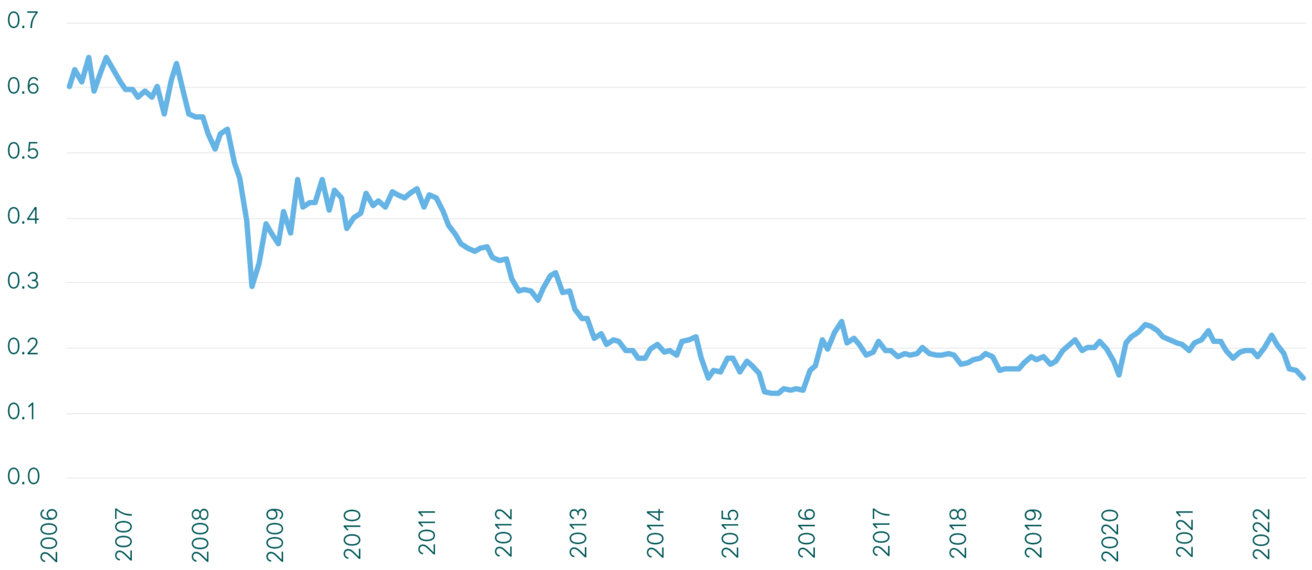
In terms of the case for the miners, gold equities have experienced a long period of low cost escalation and thus responded well to the Covid-induced monetary stimulus. In the larger context, global gold equities materially underperformed the gold price in the decade up to 2016, particularly as costs rose and equity ratings fell. The equation for gold equites to perform is (simplistically):

(gold price - unit costs / FX) x volume / shares in issue x rating.

Subsequent to 2016 global gold equities actually performed in line with the gold bullion price following the excesses of the early 2000's. Now however, off a relatively elevated price level, when bullion breached an all-time nominal high in 2020 (and again breached US$2,000/oz briefly this year), mining cost inflation is hurting rather than helping the performance of gold equities, via a squeeze in profit margins, at a time when aging assets struggle to deliver productivity gains. A further sign of gold equities being in a late cycle is the escalation of merger and acquisition (M&A) activity, as seen in the current all-share offer by Gold Fields for mid-tier Canadian listed Yamana Gold, as the former looks to rebuild its pipeline of replacement and growth opportunities for the longer term.

Thus, while the gold bullion price is an important factor in driving companies' share prices, a miner's operational and local currency also play a material part, as does market rating.

Graph 1: Global gold equities relative to gold price*



*Van Eck Senior Gold Miners ETF (GDX) as a proxy for global gold equities vs gold price
Source: Bloomberg data

How does gold fit into our framework?

In conclusion, although bullion has a place in a diversified multi-asset portfolio, the case for gold equities in an equity portfolio is much narrower and tactical. One cannot make a specific investment case for gold bullion without understanding all the investment alternatives, which highlights the difficulty in assessing the merits of gold in its own right. The mainstream assets can typically be valued using conventional metrics (cash flow), which fit naturally into our valuation-based investment process.

While we recognise the diversifying property of gold bullion in general, this valuation characteristic (lack of cash flow) tends to preclude it from our investment framework. And, while gold equities can be valued on cash flow (in theory at least), their fundamental driver, being the price of gold bullion, undermines this. Equally, the low returns on capital of building new gold mines further impairs our view of the investability of gold miners, beyond tactical dislocations between share prices and the underlying gold price.

Simon joined M&G Investments in 2012 as Portfolio Manager and Analyst in the Resources sector. With 22 years of industry experience, Simon is responsible for managing institutional Resources mandates, with the Mining & Resource Fund that he manages having won Raging Bull Awards in 2013 and 2014. Simon's qualifications include: B.Sc. Engineering, B.Com Economics, Masters in Business Leadership, and CFA.

Analysis

Yusuf Mowlana
Portfolio Manager

Fortress: Not such a shareholder bastion

Key take-aways

- Fortress has recorded a sharp drop in its property-related income due to 1) the Covid-related downturn; and 2) downward adjustments to its income from implementing more transparent accounting methods. This has prevented it from reaching its shareholder distribution requirements, threatening its REIT status.
- Shareholders and management have disagreed over maintaining its dual-unit share structure and over its legal framework. These challenges have left Fortress A and B shares trading at substantial discounts. We find that its A shares offer compelling value over the medium term given that its income is already improving and we are optimistic that the impasse will be resolved favourably.

Coming out of the Covid-19 crisis, listed property group Fortress REIT has been mired in controversy, largely as a consequence of its poor past accounting practices. It has suffered a string of challenges that could potentially lead to the loss of its status as a Real Estate Investment Trust (REIT). While we think it may yet find a workable solution, there are a number of issues that need to be resolved between the Board, shareholders and the legal system before the company will fully regain investor trust.

Here we unpack the issues facing Fortress and its shareholders and explain why we're relatively optimistic about the outcome for the company as holders of Fortress A shares.

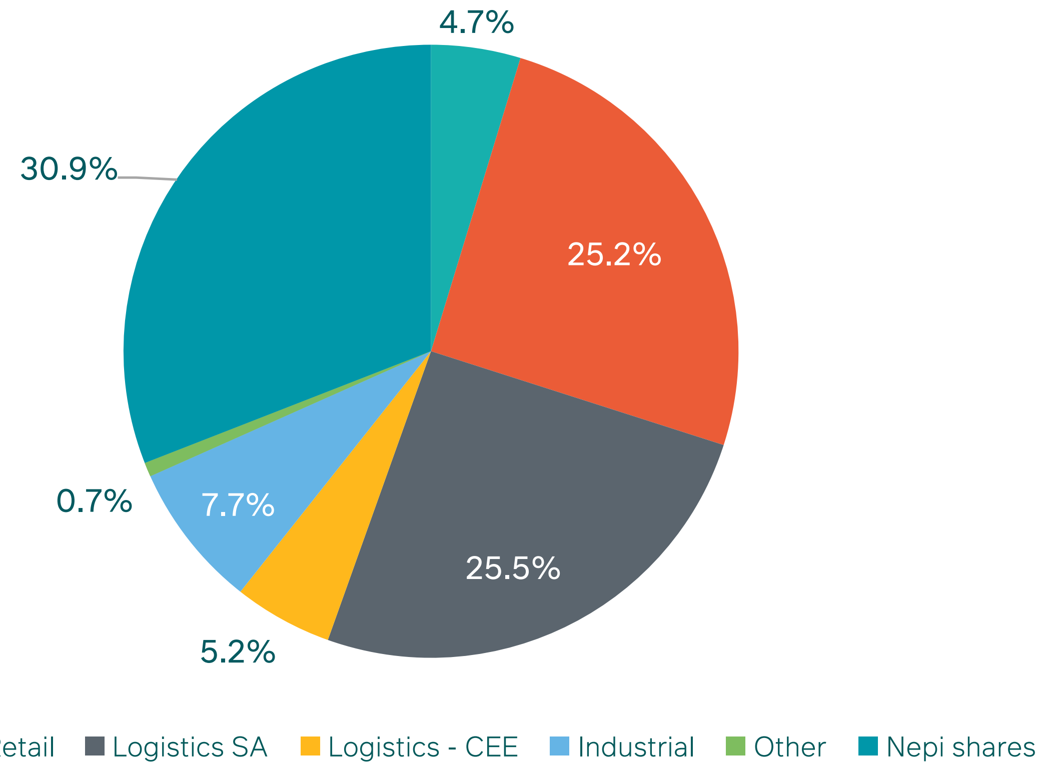
About Fortress

Fortress REIT listed in 2009 as a property loan stock with a dual unit "A" and "B" shareholding structure. These dual unit structures were not uncommon at the time, permitting companies to raise capital from sections of the market with different risk appetites. The A shareholders invested the majority of the capital on listing, R9 per share, and the B holders R1 per share. In return, the A holders received the majority of the company's income, with growth capped at the lower of 5% or inflation, and the B's enjoyed the remainder. In the ensuing period (which turned out to be a boom period for SA listed property), the company was able to pay regular dividends to both its A and B shareholders.

As illustrated in Graph 1, the company's R40.4 billion property portfolio has an attractive mix of assets, with the largest portion invested in NEPI Rockcastle. The retail portfolio is grocery-anchored, while the logistics portfolio is mostly new and fit for purpose. The company retains little residual exposure to the beleaguered office sector.

Graph 1: Fortress property portfolio attractively diversified

Gross asset value split



Source: Company data, gross asset value as at June 2022

Opaque accounting practices

Unfortunately, during the boom period the company -- perhaps due to shareholder pressure or management's incentives for "growth" -- had picked up some bad habits. Chief among these was the recognition of profits that were not backed by cashflows. The examples were numerous, and included: cross-currency interest rate swap[1] income; the non-recognition of interest expenses, which were instead capitalised against land and developments; and also interest recognised on funds advanced to BEE vehicles that were not always settled in cash.

The depths of the Covid pandemic in 2020 turned out to be something of a Damascene moment for Fortress as it closed out its cross-currency swaps positions sadly at a large loss compared to when we had first warned the company of the existential risks posed by these instruments and attempted to improve the quality of its earnings by fully expensing the interest costs incurred on land and developments. This clean-up came as the property sector was hit by lost income from the Covid lockdowns, reducing Fortress's dividends from NEPI Rockcastle as well as income from its own operations.

The net result of the company's adjustments to their accounting policies has seen its distributable income collapse by over 50%, from R3.6 billion for the entire company in 2018 to just R1.7 billion in 2022, despite the company's net property income being flat in that period. An analysis of the decline in income, shown in Table 2, reveals how poor the quality of earnings was prior to 2020. The NEPI dividend, now recognised on a cash as opposed to an accrual basis, should recover in time.

[1]The cross-currency interest rate swap operates as follows: the company enters into an agreement with a bank to swap a notional sum in rand for one in euros, such that the company receives Jibar from the bank and pays Euribor plus a credit spread in return. The difference between Jibar and Euribor creates income, which is in turn paid to shareholders. However, this stream of cash flows is not a "free lunch", as the company would need to provide funding for any adverse movements in the euro/rand exchange rate.

Table 2: Fortress's distributable income plunges by over 50%

	R million	
2018 distributable income	**3 609**	
Cross-currency swaps	-612	Notional income in that the mark-to-market of the currency moves was not accounted for in earnings
Interest from BEE vehicle	-433	The income from the defunct BEE vehicle was not backed by cash
Nepi dividend reduction (est.)	-389	Estimate of the reduction in the Nepi dividend, keeping currencies constant given foreign income hedging
Capitalised interest no longer capitalised to developments	-337	Previously the company appropriately capitalised interest to developments where the fair value was in excess of the cost, but no longer does so
Increased administration expenses	-105	95% increase, or 18.2% per annum
Movement in Net rental income	-61	Net rents are down versus 2018
Reduction in interest on staff scheme loans	-57	Not backed by cash
Other	92	
2022 distributable income	**1 707**	

Source: Company data as at June 2022, M&G Investments research

Shortfall in income creates controversy

With its income levels leaving nothing for its B shareholders and even falling below the entitlement of its A shareholders, more recently the company made an attempt to collapse the dual unit structure. However, this move failed to meet the necessary shareholder support threshold to pass successfully. Behind this failure several factors were at play.

When the company listed in 2009, its Debenture Trust Deed was the governing document of the company. The current scenario, where the income falls below the A share entitlement, was contemplated by the Debenture Trust Deed. The deed awarded all of the income to the A shareholders in the event that the income fell below the entitlement.

Complicating matters was that Fortress converted to a REIT in 2015 after REIT regulations were promulgated in 2013. During the conversion process, a circular which was released to all shareholders promised that "no material rights of the shareholders would be affected as a result of the conversion". At the same time, the clause which awarded all the income to the A holders should the income fall below the entitlement was not carried over to the Memorandum of Incorporation (MOI), which means the MOI is silent on the matter.

The Fortress Board has taken the view that it cannot pay a dividend until such time as the company achieves the minimum income required to meet the A entitlement as defined in the MOI. As such, it currently faces the prospect of losing its REIT status due to not having paid at least 75% of its earnings to shareholders. This is despite having in fact generated sufficient income in the second half of the most recent financial period to pay dividends to both the A and B shareholders, were it not for the adjustments made to the SA REIT Funds from Operations (FFO) measure. Table 3 shows the sizable R183 million net deduction taken in H2 2022 for the NEPI Rockcastle dividend accrual which pushed the company below its R968 million entitlement threshold.

Table 3: Sizeable accounting adjustments impact distributable income

(R millions)

	2021	H1 2021	H2 2021	2022	H1 2022	H2 2022
SA REIT FFO	**1 746**	**837**	**909**	**1 911**	**815**	**1 097**
Company adjustments	-34	-17	-17	-204	16	-220
Interest received on LTIP	2	1	1	4	2	2
SBP - incentive scheme	46	26	20	49	24	25
Dividend accrual	-	-	-	-145	37	-183
Income tax- current	19	0	19	2	-2	4
Staff scheme interest limitation	-17	-9	-8	-20	-8	-13
Capitalised interest	-84	-35	-49	-94	-37	-56
Distributable income	1 713	820	892	1 707	831	877
Entitlement	**1 897**	**954**	**943**	**1 948**	**980**	**968**

Source: Company data as at June 2022

All is not lost

Given the strong recovery in the NEPI dividend, there is a reasonable prospect of Fortress paying a dividend to both classes of shareholders in the medium term. In deciding how best to participate in the potential upside in the company, M&G clients are overweight the A shares, and have an underweight to the B shares based on our assessment of the group's medium-term income-generating potential when compared to the share prices. Ignoring taxes, the A share trades on an 18.3% forward yield based on its entitlement, or a 5.5X PE multiple. This represents compelling value, and we are optimistic that a solution to the current impasse can be found among both A and B shareholders.

Yusuf joined M&G Investments in October 2018. He is currently the Portfolio Manager of the M&G Property and Enhanced SA Property Tracker Funds, as well as the joint-Portfolio Manager of the M&G Equity Fund. He is also responsible for the property allocations within M&G Investments' multi-asset funds as well as equities for Namibian clients. Yusuf joined M&G Investments from Allan Gray where he spent five years as an investment analyst, covering companies across various sectors, with a special focus on listed property. With nine years of industry experience, Yusuf holds a B.BusSc degree from the University of Cape Town and is a qualified Chartered Accountant and CFA Charterholder.

Damon Buss
Equity Analyst

Woolworths: The turnaround is gaining traction

Key take-aways

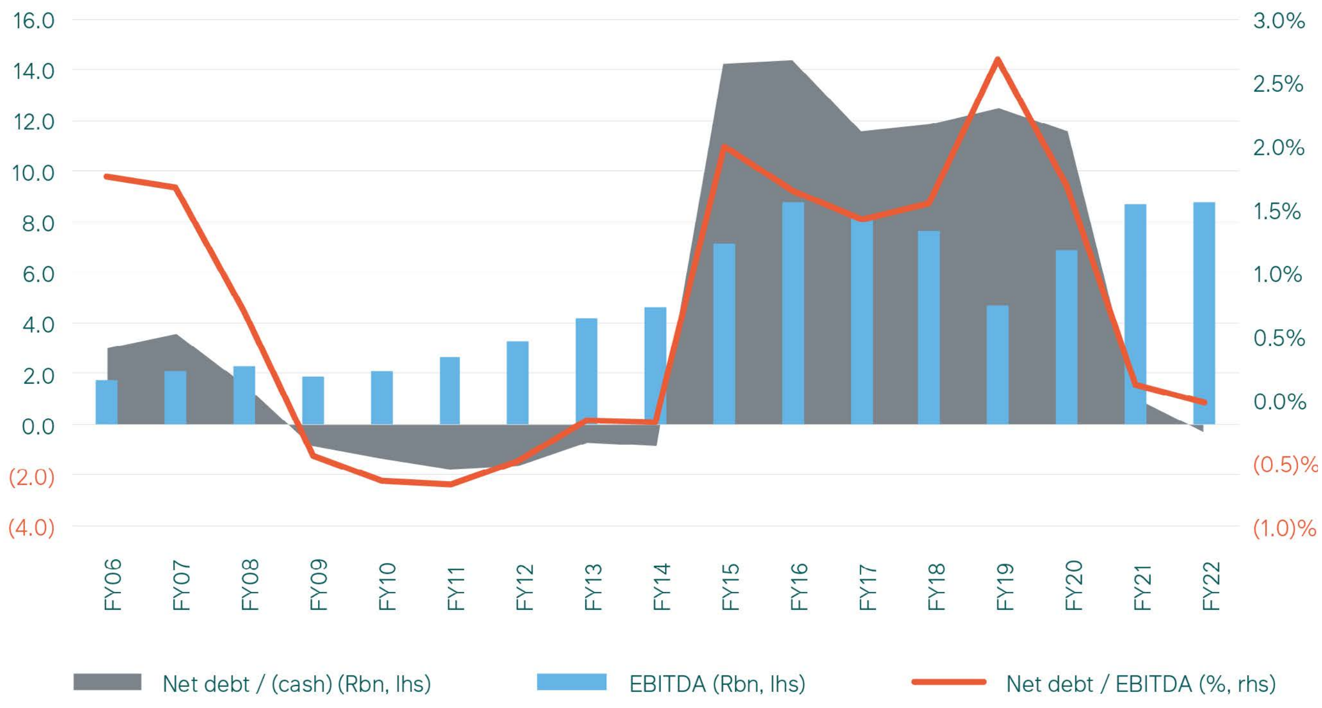
- Although Woolworths' Food division has always performed strongly and is highly regarded, its Fashion, Beauty and Home (FBH) division has struggled in recent years from poor management decisions, poor execution and growing competition in South Africa.
- Its 2014 acquisition of Australia's David Jones department stores turned out to be disastrous for the company, due to the high debt levels it assumed and the group's subsequent poor performance, resulting in large write-offs for Woolworths.
- These issues have weighed on the company's share price, only experiencing a partial recovery from 2020 as the group paid down its debts on the back of the Food division's strong cash flows and implemented fixes to both its FBH division and David Jones. As a shareholder, we are optimistic that its current turnaround will continue, and that share performance will add value to our client portfolios over the medium term.

Woolworths (WHL) is an iconic brand in South Africa, largely due to the success of its Food business in South Africa, which grew rapidly in the 2000s and early 2010s as it rolled out stores and entrenched itself as one of the leading food retail businesses globally.

Its SA Food business is unquestionably the best food retail business in South Africa, with a strong return on capital close to 70%. Its aspirational brand, unmatched product innovation and affluent customer base give it the pricing power to easily pass on input inflation, making it a very defensive consumer business. Food delivers 50% of WHL's profit before tax, providing a solid underpin to group earnings.

In the early 2010s, the highly cash-generative nature of the Food division enabled WHL's balance sheet to be in a net cash position (see Graph1), while still funding dividends and growth (i.e., rolling out new stores and building the supply chain). However, this changed when WHL accelerated its strategy to be "A leading Southern Hemisphere Retailer" with the acquisition of Australia-based David Jones in 2014. This turned out to be a poor investment (we detail why below) and unfortunately also consumed WHL management's attention at a time when the local Fashion, Beauty and Home (FBH) division was struggling in an increasingly competitive market.

Graph 1: Woolworths balance sheet constrained by debt from David Jones investment



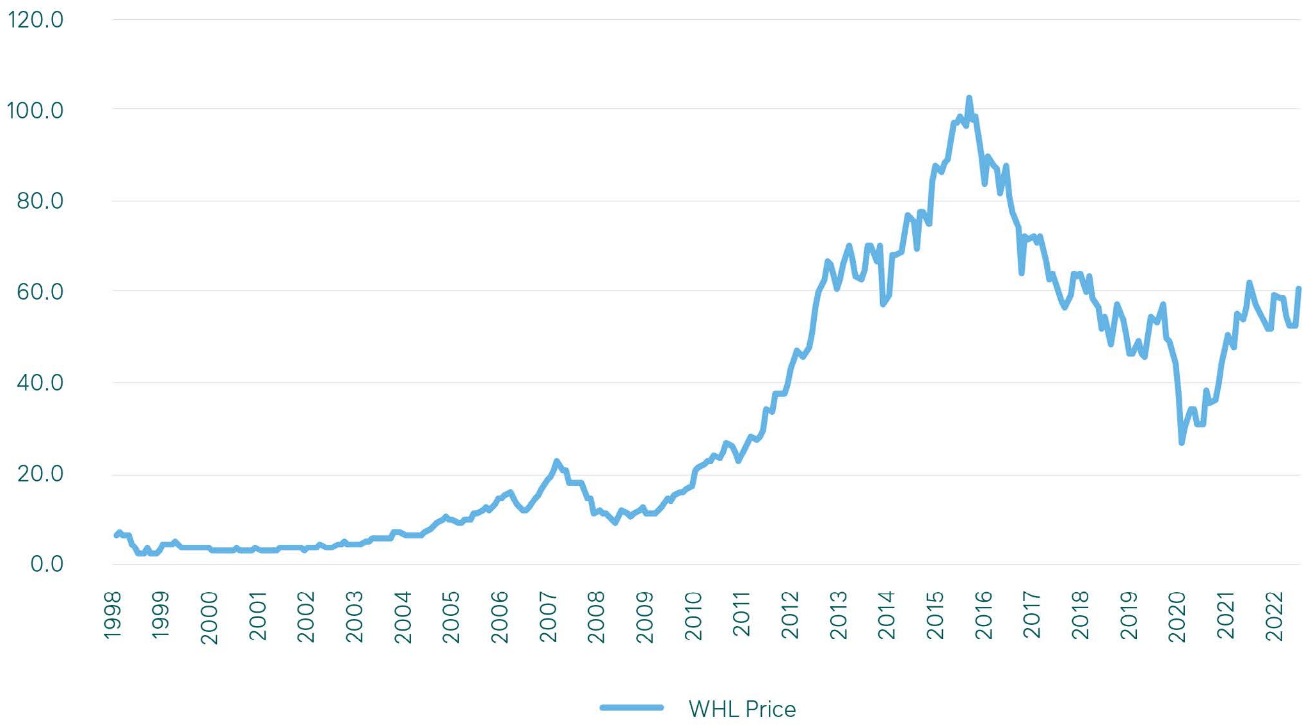
Source: Company data in Rand billions

Woolworths has been on a journey to fix the mistakes of previous management since Roy Bagattini took over as CEO in February 2020, and we think it is making good progress. The upside in the WHL investment case hinges on the company's ability to continue executing the operational fix of the FBH division and to exit David Jones.

What went wrong

The two key drivers of Woolworth's poor share price performance from 2015 onwards (see Graph 2) were the company's FBH business in SA and David Jones in Australia. These businesses underperformed both in absolute terms (FBH profits declined from R2.1bn in FY2015 to R1.8bn in FY2019; DJ profits fell from R1.1bn to R0.3bn in 2FY019) and in relative terms.

Graph 2: Woolworth's share price performance poor since 2015 (R/share)



Source: Refinitiv, Share price (Rand/share)

Fashion, Beauty and Home

FBH was historically known as Clothing & General Merchandise (CGM), as Beauty only became a key focus area post the demise of Edcon, the retailer that dominated South Africa's beauty category. The fashion sub-division of the FBH business has always targeted a slightly more mature, affluent consumer, who wants good-quality, conservative fashion. Historically they did this very well, but started to lose market share when the international apparel retailers expanded in SA from the early 2010s (i.e., Cotton On, Zara and H&M). To grow the business, WHL decided it needed to broaden the appeal of their offering by becoming more fashion-orientated and targeting a younger, less affluent consumer. Christo Claassen was appointed MD of FBH in mid-2014 to drive this strategy. WHL hoped his experience of running Jet (Edcon's value brand) would assist them in successfully executing this strategy, as fashion and value were not their core competencies. Unfortunately, the opposite occurred.

To compete successfully in the mid-tier apparel category, a retailer needs to offer competitive price points and get fashion calls right consistently. New sub-brands (e.g., Edition) with a higher fashion focus were launched, but numerous fashion mistakes were made, which resulted in FBH having bigger and deeper sales to get rid of the stock, something that is very negative for profit margins.

In addition, to maintain gross profit margins at the lower price points, the quality of the product (e.g., material, buttons, zips, etc.) was lowered. This had a drastic impact on the brand's reputation for quality and value, as often within a few washes a garment would lose both its shape and colour. The soles of a pair of shoes I bought for my toddler fell off the second time he wore them.

Post the acquisition of David Jones, WHL also chose to rebrand its core ranges from Woolworths, an iconic South African brand, to David Jones, a brand that the average South African didn't know. Swapping from a strong brand to one that had no brand equity in the local market never made logical sense.

WHL acknowledged they had the wrong person leading FBH and removed Christo Classen in September 2018. Manie Maritz, highly respected in the apparel industry due to building Markhams into one of The Foschini Group's most successful brands, was appointed, but frustratingly his non-compete clause meant he could only start at FBH in mid-2020. For over 18 months, FBH operated under a caretaker MD, and the lack of strategy was evident in the further deterioration of the operations.

The above resulted in FBH's revenue growing by only 1.6% p.a. between FY2014 and FY2021 and profit margin declining from a peak above 19.0% in FY2014 (IFRS 16 adjusted) to 8.0% in FY2021.

David Jones

In 2014, WHL embarked on a strategy to build a leading Southern Hemisphere retailer by acquiring David Jones for R21bn (representing 32% of WHL's market capitalisation at 9 Apr 2014). The David Jones department store model was very similar to the FBH model, and WHL had owned the Country Road Group in Australia for 15 years, hence they thought their knowledge of the market and business model mitigated the risk of doing such a sizeable acquisition.

Department stores have been around since the late 1700s, but gained their prominence in the mid-1900s. Their success emanated from the convenience and consumer experience they offered by housing multiple brands across many categories (apparel, footwear, beauty, home, etc.) in one beautifully designed store. A consumer could get everything they needed in one pleasant shopping environment. However, the establishment of discounters in the late 1900s eroded the value proposition of department stores, while the rise of e-commerce in the 2000s has usurped their convenience aspect. As a result, countless department store businesses have gone bust globally -- for example, Debenhams, a famous UK department store founded in 1778, closed in 2021.

While investors raised concerns about WHL acquiring a business that operated a shopping format that was declining globally, the opportunities to improve David Jones's operating performance were significant.

Initially, good progress was made in improving inventory management; however, the strong force of declining demand for the department store format resulted in revenue not growing after FY2016. Poor execution of the David Jones private label strategy caused gross profit margins to decline from 40% in FY2015 to 35% in FY19. Combined with operational expense growth from implementing new IT systems, launching a loss-making premium food offering and rolling out more stores, this resulted in the operating profit margin declining from 15% in FY2015 to low single-digits in FY2021. These poor operational results necessitated WHL impairing R13bn (62% of the acquisition cost) of the David Jones value.

Ian Moir, the previous CEO of WHL, pushed David Jones into a strategy of premiumising its product offering and store formats, with the aim of creating the best department store in the world. To do so, WHL approved a capex budget of A$200m to renovate their flagship Sydney store and convinced the brands (suppliers) to also invest A$200m into their areas within the store. This created a spectacular store for customers, but shareholders are unlikely to ever see a positive return from this immense investment. To afford this, the Sydney menswear store was consolidated into the Elizabeth Street womenswear store and the menswear building sold for A$360m.

Investors became especially nervous about how David Jones was going to replicate this shopping experience across its 48 stores, not just because of the capital cost but also due to concerns on whether the affluence of its customer base was sufficient for such a premium product offering. Andrew Jennings, an ex-CEO of WHL/Harrods/Saks 5th Avenue (i.e., a premium department store expert), has stated this premium department store model would only work with fewer than 10 stores. With an average remaining lease term of 15 years, David Jones is unable to implement Jennings's advice of exiting the bulk of their stores quickly.

The poor operational performance forced WHL to stop extracting dividends from the Australian operations, as cash was needed to fund the significant capex. Increased debt funding was required, as the internal cash generation was insufficient, and WHL had (rightly) made the call to stop providing funding from the SA operations. The increasing probability of WHL being forced to inject more capital from SA into David Jones weighed heavily on the WHL share price, as seen in Graph 2.

Fixing the underperforming divisions

The positive changes initially started in FY2019, when five new Board members were appointed. The two most significant changes were the appointment of David Kneale, the very highly rated ex-Clicks CEO who brought in substantial retail experience, and the appointment of Hubert Brody as Chairman, who was truly independent. In January 2020, Roy Bagattini was appointed as CEO of WHL, while the architect of the strategy which led to the demise of FBH and David Jones, Ian Moir, was demoted from Group CEO to David Jones CEO. The market questioned Bagattini's appointment, as his previous role as MD of the America's division of Levi Strauss & Co positioned him well to run the pure fashion business (i.e., Country Road Group), but he had limited to no experience in running a food retail business (WHL Food) or department stores (FBH and David Jones).

Turning around a business is a difficult task; doing so during a global pandemic is exponentially harder. Just over two-and-a-half years into the role of CEO, Bagattini is starting to gain the trust of the market as the initiatives he has implemented are bearing fruit.

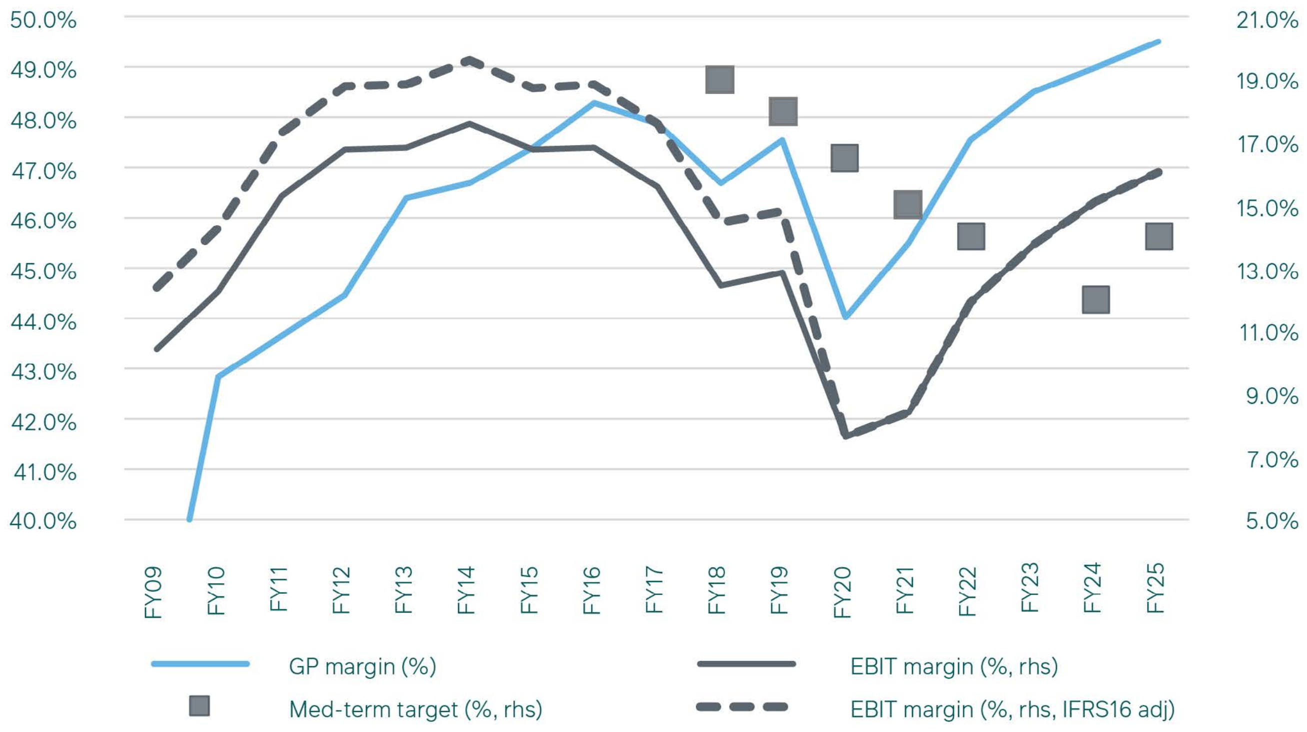
Within FBH, Bagattini and Maritz have made the following changes:

- Rationalised space by 13%, with another 3% to be cut in 2022 – exited loss making space;
- Narrowed the range (discontinued 2 sub-brands) – improving procurement efficiencies;
- Improved customer segmentation, focused on must-win categories, the categories where WHL was historically very strong and improved the product quality (back to the quality a WHL customer expects);
- Enhancing the Beauty and Home offerings – attempting to become the market leader in these categories that were previously dominated by Edgars;
- Increasing local procurement - enables them to react faster during a season to take advantage of the best-performing trends;
- Leveraging customer data better, in an attempt to convert the incredibly strong brand loyalty of the Food division customer into an FBH customer; and
- Optimising the supply chain, which remains the biggest opportunity for FBH, since a frequent customer complaint is FBH not having the customer's size. This implies WHL is getting the fashion call right (the customer wants to buy the product).

While a number of these initiatives are only in the very early stages, they have had a material impact on the operational results of FBH already, with FY2022 sales only 4.8% lower than FY2019 despite the 13% reduction in space. Full-price sales are growing materially faster than total sales, which has reduced the markdown ratio (markdowns as a % of total sales) from 20% in FY2020 to 13% in FY2022 and lifted the gross profit margin in 2H2022 to 49%, the highest level in a decade.

This, combined with good control of operational expenses, has led to the operating margin improving to 11.9% from the Covid low of 7.6%. Importantly, WHL felt comfortable enough to raise the medium-term operating profit margin target from 12% to over 14%. We think WHL is still being too conservative with their operating margin guidance, as management stated there is no reason why their markdown level should not be in line with the global average of 10% (i.e., 3% better than the current 13%). This further 3% improvement should flow through to the bottom line. Graph 3 indicates how conservative the 14% margin target is.

Graph 3: FBH gross and operating profit margins improving from FY2020 (%)



Source: Company data, M&G forecasts

Bagattini's core focus with respect to David Jones was separating the legal entities of the two Australian businesses. Country Road Group (CRG) had cross-guaranteed the other company's debt, which constrained WHL from closing David Jones, as the debt would need to be serviced by CRG. To reduce the debt to a level at which the banks were comfortable renegotiating the terms (i.e., removing the cross-guarantee) required selling two of David Jones retail properties for a combined A$631m (Bourke Street in July 2020 for A$121m and Elizabeth Street in March 2021 for A$510m). These sales enabled all the Australian debt to be repaid and put both David Jones and CRG in net cash positions. Importantly, WHL is now in a position to sell David Jones without having any impact on CRG, and CRG can focus on growing their own business.

The operational fixes within David Jones have included the launch of a loyalty card to improve value offered to customers, reducing space by 10%, with another 8% reduction planned by 2024, improving the private label offering to increase differentiation, launching online (now 20% of sales) and discontinuing the loss-making food strategy. These actions resulted in the operating margin improving to 4% in FY2022 from a loss in FY2020, but this remains well below the mid-teen margins of FY2015/2016 (on an IFRS16 adjusted basis). As a result of the reduced capex and operational fixes, cash flow generation has improved to a point where WHL has been able to extract dividends of A$90m in FY2022 and a further A$50m in FY2023, which have been used to pay down debt at the WHL Group level and return the Group net debt to pre-David Jones acquisition levels of 1.6X net debt to EBITDA.

Although the sustainability of the David Jones operational improvement remains questionable, we are increasingly confident that WHL will be able to sell the business for a reasonable sum. Firstly, it still owns one store (310 Bourke Street, Melbourne) which, based on the sale of 299 Bourke Street in July 2020, should be worth approximately A$218m. The company also has at least A$40m excess cash, after accounting for the A$50m special dividend (noted above) and 1H2023 working capital needs, and the business is generating cash. In addition, Myer, David Jones's closest competitor in Australia, has a market cap of A$460m.

David Jones deserves to trade at a discount to Myer, given its relative operational underperformance, but we don't think this discount should exceed 30%, implying a potential David Jones's market cap of A$320m. Therefore, at worst WHL could extract A$260m (or R3 per WHL share) by selling the Bourke Street property and repatriating the excess cash, with another A$320m (R7 per WHL share) potentially achievable if they find a buyer for David Jones.

Outlook

In our view, the challenges of David Jones are largely behind WHL, and the group balance sheet is now in a far healthier position, enabling WHL to focus on continuing the operational fix of the FBH division and to refocus on investing in growing its higher-quality Food and Country Road divisions. Although the consumer is likely to come under increasing pressure over the next year, we are confident that WHL has sufficient self-help levers-- and is using them -- to outperform the other retailers in difficult economic conditions, with upside optionality if they do exit David Jones.

At the same time, we were able to buy WHL shares for our client portfolios at a cheap valuation compared to both their history and our estimate of fair value. For these reasons, we expect our WHL holdings to add value to our clients' portfolios over the medium term. □

With 15 years' investment management experience, Damon joined M&G Investments in January 2020 as an Equity Analyst where he is primarily responsible for research on Retail sector companies. Prior to joining M&G Investments, Damon spent five years at Electus Fund Managers, during which time he conducted analysis on Consumer and Diversified Industrial companies. He also worked as an Industrials Analyst at Stanlib Asset Management, where he covered multiple sectors, including Small/Midcap Industrials. Damon holds a Bachelor of Economics (Honours) degree from Rhodes University.

Analysis

Stefan Isaacs
Deputy CIO: Public Fixed Income at M&G Investments (UK)

High yield: Reasons to be positive

Key take-aways

- Although global macro conditions are risky for US high yield (HY) corporate bond investors as interest rates continue to rise, there are positive factors for investors to consider.
- Market supply and demand conditions are supportive of yields, with demand exceeding supply. Also, the absolute level of all-in yields has already moved much higher, leaving a substantial cushion for further weakness, and yields are also at their highest in many years relative to the S&P 500 earnings yield.
- Other supporting factors include the improvement in the average credit quality of US HY corporate issuers in recent years and the healthy underlying company fundamentals (such as leverage, etc) versus history. While these may start to deteriorate and risk premia may rise further over the shorter term should macro conditions worsen, there are some reasons for investors to be positive.

Read more

Aadil Omar
Head of Equity Research

The Long Game

Key take-aways

- Being successful in investing over time is about ensuring a win on those points that really matter and stepping up when the odds of losing are small compared to the odds of winning. It also requires mental fortitude when the market is panicked.
- Investing is also about risk control: not risking too much on a single trade, or betting on a single outcome, such that an error could permanently nullify you from the game. This requires a superior risk framework gleaned from history, analysis and M&G Investments has long prioritised the key components of risk consciousness, anchored valuations, and a team-based approach.

I have always enjoyed games, and anecdotally observe that many of my colleagues share the same fondness. The sentiment is widespread in the investment management community; Warren Buffett and Charlie Munger are keen Bridge players, while several hedge fund managers have made an appearance at the World Series of Poker. Perhaps that's a peculiarity of competitive personalities, but given their popularity, I think most people enjoy playing games of some variety, even if for no other reason than a bit of fun.

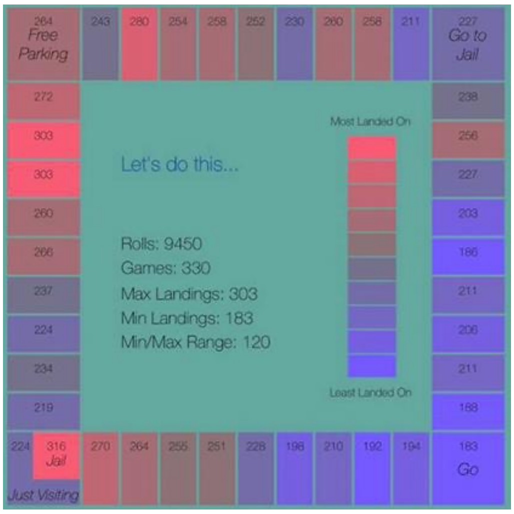
Games provide a controlled environment convenient for experimenting: with strategy, tactics and simulating different plays. More technically, competitive games are interactions humans have with other humans that involve a strategic element; meaning my decisions are contingent on your decisions and your decisions are contingent on my decisions. Consciously or not, we are all playing games all the time.

There are many iterations of games: opponent games, multi-player games, finite games, infinite games, etc… but for purposes of this article let us draw a distinction between games where there is a single play against a clear opponent (a tennis match) versus the long game of navigating a bunch of smaller games that make it up. If a single tennis match is an example of the single-play game, then managing a successful tennis career as a professional sportsman would be the long game. Quick-witted readers might rightfully point out that the long game is simply the sum of individual single-play games over time. And yes, that is technically accurate, but the way one would "play" to win a given match could be different (sometimes vastly so) to the way one would play if you were optimising for the best overall outcome over the span of a career. To illustrate the point, a professional tennis player with a wonky knee would make a very different decision if a shot could compromise his game for the season vis-à-vis a casual player who enjoys the Sunday match with the gang.

Statistics offers an edge in both short and long games

The popular board game Monopoly is a nice playground to observe outcomes across various strategies. As a kid, I remember being attracted to the high-profile properties of Jan Smuts Ave and

Eloff Street, owing to the high rents commanded by the navy boulevards. I'm sure many readers would welcome the nostalgia of recalling the moment when an opponent finally landed on your fully developed navy neighbourhood. But I also remember opponents often getting lucky around these expensive streets and not landing on them as much as I would have liked. The expensive properties would often bankrupt an opponent or two, but somehow it was not sufficient to beat all opponents. This was no coincidence.



Source: www.vice.com

The figure depicts the Monopoly board (left) alongside a heat-map (right) reflecting the frequency with which counters land on individual properties in a typical game. The more a property is landed on, the closer to red it is coloured on the heat-map. What is striking observing the heat-map is how clearly divided the board is (along the diagonal running bottom left to top right – from the "Jail" to the "Go to Jail" squares) between properties that are frequently landed on and those that aren't. As was hinted at, the expensive neighbourhoods (and the cheapest) are the least landed on properties on the board. The most landed on properties are the orange and red neighbourhoods because of where these streets are located relative to the "Jail" square.[1]

The single square most landed-upon in the game is Jail because there are so many ways to get there.[2] Jail then puts you one roll away from the orange streets and two rolls away from the red streets. Despite having an element of luck (by rolling the die), the trajectory around the board is simple statistics. Winning the game is more closely tied to securing the right real estate – orange and red streets – or if you can't do that, to prevent opponents from securing them. If you were to take up Monopoly competitively, you would not want to own the navy boulevards over the orange avenues. Statistics is enough to see you through to the top spot in most games.

But a successful long game requires more than statistics - Strategy is crucial

Robert James (Bobby) Fischer, the Eleventh World Chess Championship winner, had a remarkable career. Widely considered a chess prodigy, he was largely self-taught on his way to becoming a grand master and ultimately securing the championship. Fischer learned the game of chess at the age of six and played what some people dub the "game of the century" at the age of 13. He was a top-eight player by the age of 15.

[1]The most landed on property on the original South African board is Hoffman Square. A player is 1.6x more likely to land on Hoffman Square that they would be to land on Eloff Street over the course of a typical game.
[2]Two cards that send you there; roll doubles three times; and a Go to Jail square

Bobby Fischer is well known for a great number of accolades and personal peculiarities, but he is not as well known for the strategic intent with which he approached his chess career. Robert James Fischer played one of the greatest bait-and-switch long games in the history of the chess championships. How? He always played the same sort of game: regularly opening with the same move (pawn to king 4). He ran the same playbook for the 16 years he was on the public chess scene, until he played the most important match of his career: the 1972 World Chess Championship against then-defending champion, Boris Spassky of the Soviet Union.

After conceding the first two games of the match (actually forfeiting the second game by not arriving to play on the day), Fischer does something completely novel in the third game, surprising Spassky, who then reacts poorly. Fischer plays a move totally out of character and without precedent for the first time in his 16-year career, completely flipping his playbook on its head. All the study of Fischer's previous games in preparation for the match now largely moot, Spassky puts up a weak defence, ultimately conceding the Championship to Bobby Fischer.

Fischer's crushing defeat of Spassky might have played out over 21 games in 1972, but the strategy was 16 years in making and meticulously executed. Imagine the preparation that went into the study of his new strategy, and not revealing that in play until the fateful moment of the championship – that's the long game if ever there was one.

Investing is the long game

> "The less prudence with which others conduct their affairs, the greater the prudence with which we should conduct our own affairs."
>
> — Warren Buffet

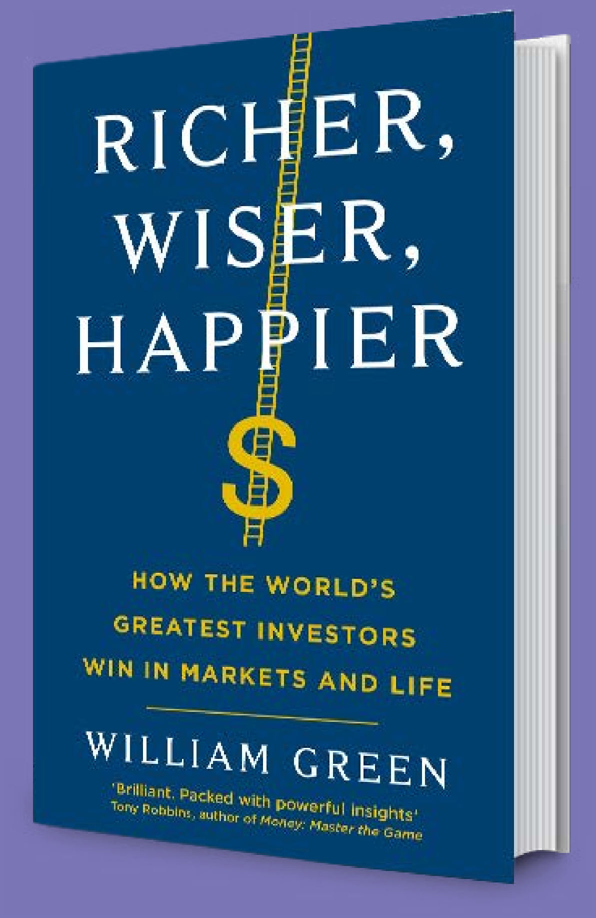
Optimising for the long game is about ensuring a win on those points that really matter. It is also about not letting an error permanently nullify you from the game – think a professional sportsman who risks a debilitating injury to make the point.

Investing is a long game, not risking too much on any individual trade such that if you are wrong, you're out of the game. It is also about capitalising on the moments that really matter and stepping up when opportunities are hugely asymmetrical and the odds in your favour. Having liquidity and the mental fortitude when the market is panicked can be a source of tremendous advantage. For this you will require a superior risk framework that is effective before the event that yields opportunity.

M&G Investments has long prioritised the key components of risk consciousness, anchored valuations, and a team-based approach. Over 25 years, these foundations have consistently helped us serve our clients well in the long game.

Aadil joined M&G Investments in July 2013 as an Equity Analyst. In August 2018 he joined a global equity hedge fund in London, before returning to M&G Investments in January 2020 as Head of Equity Research. With 15 years' investment experience, Aadil's qualifications include a BCom degree (Hons, cum laude) from the University of Pretoria and a Masters in Finance degree from INSEAD. He is also a CFA charterholder.

Book Review



Lynn Bolin
Head of Communications and Media

Lessons on being a super-investor

I must admit that the title of this book *"Richer, Wiser, Happier:* *How the World's Greatest Investors win in Markets and Life"* was somewhat off-putting for me – it seemed to be yet another superficial "how to get rich quick" tome, popular since the 1980's investing boom. But this is not at all the case. For students of investing or professional investors, it may not offer ground-breaking insights into investment techniques, but author William Green does give readers much food for thought about the various ways today's most successful investors approach the markets and, to a large extent, their lives. In this sense, the book can be a valuable tool for understanding the mindsets, life philosophies and personal attributes of individuals who have stood out from the crowd over many years, having conquered financial markets where the future is unknowable and the present consistently defies logic, driving many an investor to ruin and despair.

Green is a veteran financial journalist with 25 years of experience interviewing and getting to know some of the world's best investors, and he shares with us the benefit of his access and personal relationships by gathering a collection of investment – and life – lessons he has garnered directly from over 40 admired investors, some very well-known and some much less in the spotlight.

The best-known among these include Warren Buffett, Charlie Munger, Howard Marks and Sir John Templeton (he was invited to Templeton's private Caribbean island). While much has been written about these high-fliers, the chapters on Munger and Templeton in particular stand out for their first-hand accounts. Other wisdom comes from the likes of Bill Miller (of Legg Mason and Miller Value Partners) and Joel Greenblatt (Gotham Capital). And lesser-known, but equally enlightening, interviewees include Mohnish Pabrai (a copier of Buffett who, together with another investor paid US$650,100 for lunch with the Sage of Omaha), Nick Sleep and Qais Zakaria of the Nomad Partnership, Jean-Marie Eveillard (Société Générale) and Jeff Vinik (Fidelity's Magellan Fund and Vinik Asset Management).

Here are some highlights of lessons that stood out for me:

Around risk:

- Don't attempt to predict the future, rather respect uncertainty. There is so much randomness that it is best to prepare for several different future scenarios and not take big bets on any one outcome that could result in ruin.
- Never use debt or leverage.
- Recognise your own limits and remain humble. Avoid investing in things you don't understand, and equip yourself to avoid the standard "idiocies" to which humans fall prey.
- Be a realist, be skeptical and question what the crowd does. Always be aware of your risk exposure and require a margin of safety in the price you pay.

Around return:

- Don't buy more of the companies that you can make the most money on; buy more of companies that you can't lose money on.
- It's a long-term game about resilience: Instead of obsessing over short-term gains, focus on becoming shock-resistant and staying in the game. It's about longevity.
- Resounding victories tend to be the result of small, incremental advances and improvements sustained over long stretches of time.
- Quality in everything (life, stock selection, investment management business).
- Success in investing (and life) requires very, very hard work and dedicated focus.

If some of these lessons sound familiar to our M&G Investments clients, that is because many are foundational to our own valuation-driven investment approach. We employ them daily and remind ourselves of them regularly, checking to ensure we have not strayed, as humans tend to do, into poor behaviours. To read this book is to better understand how we think about managing your money.

Equally, extrapolating these into broader life applications can be edifying for anyone, especially as we're all prone to biases and the failings of human psychology. What may not be as desirable, however, would be to adopt some of their more extreme personality traits, which can include being "extremely unemotional" and difficult to connect with socially, as well as "obsessive".

Apart from its highly accessible style, a final feature I appreciated about Green's writing is that, after sharing detailed insights drawn out over many hours of interviews, he helpfully synthesises these into more fundamental takeaways. He additionally uses boldface so that they easily stand out from the page for the reader, should he or she be short of time. Not that I would recommend taking this short cut... □

Lynn joined M&G Investments in June 2013 and has almost 30 years' experience writing about global economics and financial markets. She is responsible for overseeing M&G Investments' client magazine, media articles, client communications and digital content. She was previously Head of Communications at Old Mutual Investment Group for seven years, and a senior financial journalist at both I-Net Bridge in Cape Town and Thomson-Reuters in Hong Kong. She has also worked in France and in Washington DC at US State Department for four years. Lynn's qualifications include a Masters in Public Affairs (Economics) from Princeton University's Woodrow Wilson School, a graduate year at the Ecole National d'Administration in Paris and a BA in Economics (Honours, Magna cum laude) from Kalamazoo College, Michigan.

Contact us

Client Services
0860 105 775

Email
info@mandg.co.za

mandg.co.za