Chris Sickle
Chief Executive Officer

Letter from the CEO

Reflecting on the unexpectedly turbulent year that was 2022, our investment team was put to the test on numerous occasions, and I have been proud to see them stick to our long-held investment process and prove their mettle. Although absolute fund returns for clients have unfortunately been lower than average on a historic basis due to the difficult economic and financial conditions, our relative SA fund performance for the year to date (to 20 December 2022) shows how successful our equity, fixed income and property investment teams have been: all of our rand unit trusts (excluding global funds) outperformed the average fund return in their ASISA categories. This encompasses income funds, multi-asset funds, property funds and equity funds. Several were ranked among the top 25% in their categories over longer-term periods as well, including the M&G Equity Fund, M&G Dividend Maximiser Fund and M&G Balanced Fund.

SA fund outperformance in 2022

Our stock-picking skills came to the fore once again. As a good example of our SA equity selection, the M&G SA Equity Fund recorded excellent alpha (above-market performance) versus the FTSE/JSE Capped SWIX Index for the year to 20 December with an 8.2% return versus 4.7%. The fund's benchmark, the average of the ASISA SA Equity General category, returned 3.5% over the same period.

Equally, we were correct in our multi-asset funds' asset allocation choices with our preference for local stocks and bonds over their offshore counterparts – this proved to be a key decision as these local assets strongly outperformed global equity and bond indices over the period. In fact, rand asset outperformance was a clear theme for most of 2022, with offshore assets providing little downside protection. Given the MSCI ACWI's net US dollar return of around -18.7% and the S&P 500's -18.5% net return year to date, even US dollar appreciation of around 8.5% against the rand couldn't lift US dollar returns into positive territory for rand investors.

This offshore weakness created the perfect "trap" for investment managers who immediately decided to increase the global asset weightings in their portfolios in response to February's lifting of the Regulation 28 offshore asset limit for retirement funds from 30% to 45%. We instead refreshed our modelling of strategic offshore allocations, running numerous scenarios to ensure robustness. We concluded that, under the most plausible outcomes, around a 30% long-term (strategic) foreign currency allocation remains appropriate. Equally, we opted to keep our portfolios underweight global assets in the short term (tactically) due to the much more attractive valuations of SA assets at the time. However, we did begin adding more offshore asset exposure in the second half of 2022 due to their underperformance versus South Africa, so that we are now more neutrally positioned at the end of the year.

Political risk abates

In a surprise-filled year, the last (significant) event we encountered was December's market sell-off, prompted by reports that President Cyril Ramaphosa was considering resigning in response to findings by a Parliamentary panel that there was prima-facie evidence of him having committed impeachable offenses related to the Phala Phala robbery. Once again, we didn't start selling SA assets, but instead monitored developments closely and watched for any changes in longer-term financial fundamentals – which never materialised. The situation was resolved at the party's elective conference in mid-December, as the vast majority of the ANC rallied behind Ramaphosa and the President emerged even stronger than before. SA bond yields, which had jumped as a result of the elevated political uncertainty, gradually returned to near their previous levels and the rand strengthened, showing why we always focus on longer-term fundamentals during these short-term episodes.

2021 Stewardship Report

I'm pleased to report that in December we launched our 2021 Stewardship Report, as we continue to report on our approach, priorities, activities and accomplishments regarding the responsible stewardship of our clients' capital for the past year. I urge you to read it online, as we relate some interesting examples of our company engagements, voting dilemmas and key themes. With a global footprint, we are able to take full advantage of our global M&G colleagues' expertise and advanced information systems to improve our own data collection and deepen our understanding of the global environment in which our investee companies operate.

We have been even more active in 2021 than in previous years, in face of the serious ongoing socio-economic challenges exacerbated by the Coronavirus pandemic, such as poverty, unemployment and inequality, as well as the urgency of combatting environmental challenges. Environmental, Social and Governance (ESG) factors and other sustainability considerations have been playing an even more impactful role in our investment process and active portfolio management.

Going into 2023

As is often the case, going into the new year we are faced with mixed conditions. It is easy for SA investors to be bearish given the news headlines, but there are positive factors to be aware of. On the bearish side globally we have elevated uncertainty, as we wait to see where inflation and interest rates eventually peak, and growth troughs. Stagflation and/or recession are possibilities in certain economies like Europe and the US (to a lesser extent), and even China is facing exceptionally slow growth prospects amid a resurging wave of the Covid virus. Additionally, Russia's tragic war against Ukraine drags on with no resolution in sight, with its destruction and dislocations of people and trade, not to mention Europe's energy crisis.

On the positive side globally, there are signs we are getting closer to the end of the rate-hiking cycle: US inflation peaked some time ago, the US Federal Reserve reduced its December interest rate hike, and the market expects a pause sometime in the first quarter of 2023, bringing greater clarity to the outlook. Equally, businesses are dealing more adeptly with supply chain disruptions and energy prices have fallen from their peak levels. Investors appear more confident around company earnings going forward, leading to the equity rallies we experienced in October and November. Equally, there are pockets of attractive equity valuations, but investors need to be selective.

In South Africa, we are also confronting high inflation and interest rates and low growth prospects going into 2023. Continuing power outages are also weighing heavily on businesses and consumers. On the positive side, inflation is falling and further interest rate increases are expected to moderate, broadly following the lead of the US. Equally, political risk has abated. For investors, we believe SA equity and nominal bond valuations are attractive when considering the risks involved, reflecting overly pessimistic views on risk, so we would expect these assets to deliver above-average returns over the medium-term from current levels.

Investors should continue to be discerning when it comes to SA equities, however, and choose those companies with strong balance sheets, management teams already proven to produce reliable results in uncertain, low-growth conditions, and companies able to pass on price increases to consumers and suppliers amid inflation that could remain higher for longer. These defensive characteristics should improve the performance of investor portfolios. Our portfolios are positioned along similar lines, and we are confident that, as we did in 2022, we should be able to produce alpha for our clients in 2023. Remember to stay the course, look to the longer term, and keep investing according to your financial plan to be successful in the new year.

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).