Investment Focus: M&G equity calls that paid off in 2023

M&G Investments

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As the year draws to a close, it is worthwhile looking back at the performance of some of our larger equity holdings across our funds to understand which choices worked well, and under what circumstances. Market conditions were favourable for active stock picking in 2023 given the wide dispersion of valuations across the JSE, and even within sectors, while the FTSE/JSE All Share Index (ALSI) produced a return of only 4.7% for the 12 months to the end of November.

As fundamental, valuation-based investors, our portfolio choices are driven by the absolute and relative valuations of each asset, while also considering their risks and quality, to create strong diversification and an appropriate risk-return balance to meet the portfolio's investment objectives. Given the high inflation, slow growth and rising interest rates that prevailed in South Africa over the year, we placed more emphasis than usual on choosing high-quality companies with at least moderately attractive valuations that had proven track records in navigating the difficult operating conditions. Apart from attractive valuations, company characteristics we prioritised in many cases included: 1) a strong balance sheet, so that higher interest rates did not force the company to postpone or cancel its spending/expansion plans; 2) a solid and experienced management team; 3) some degree of pricing power to allow the company to maintain its margins; and 4) an income stream diversified across global markets or products. Following are six stocks that made meaningful contributions to M&G Investments unit trust funds' performance over the past 12 months.

Naspers and Prosus

One of our most impactful holdings over the past 12 months proved to be our overweight exposure to Naspers/Prosus, which was a major contributor to several of our unit trust funds' returns, including our three equity funds and the M&G Balanced and Inflation Plus Funds. Although the shares came under pressure at times amid the disappointing post-Covid recovery in China (since their value is largely derived from their underlying holdings in Tencent, the Chinese online services and gaming company), they gained ground largely on the back of the company's announcement of a greatly simplified shareholding structure and open-ended share buy-back programme in June. The simplification involved the unwinding of the Naspers-Prosus cross-holding structure, such that although Naspers remains the holding company of Prosus, Prosus no longer holds Naspers shares. Management also unveiled plans to improve management incentives and goals, and deliver profitability in the non-Tencent holdings. Another important development following this was the September resignation of the company's CEO Bob van Dijk and other management changes, with the front-runner for new CEO being the current CIO Ervin Tu.

These developments, addressing long-held concerns often voiced by investors including ourselves, were well-received by the market, encouraging renewed optimism around the company's future capital discipline and the streamlined corporate structure. Naspers/Prosus shares re-rated, with Naspers' shares having gained approximately 17% so far in 2023, outperforming Tencent's 8% rise and narrowing the discount at which Naspers/Prosus trade to Tencent. This added value to shareholders and to M&G's portfolios.

Textainer

Global shipping container lessor Textainer is another share that added considerable value to M&G's portfolios in 2023. The company has been a preferred holding for several years, having benefited significantly from the recovery in global trade following the Covid pandemic. It possessed a sufficiently strong balance sheet to be able to buy shipping containers at depressed levels during Covid, and then leased them out at very attractive levels during the recovery, amid an extended shortage of containers as the world geared up simultaneously. In October this year the group announced a buyout offer by US private equity group Stonepeak at a 46% premium to its share price, sparking equivalent share price gains in Textainer and adding excellent value to our client portfolios.

Standard Bank and Investec

M&G portfolios with equity exposure have been overweight SA banks for some time, recognising that they are among the only businesses to benefit from rising interest rates as they receive more income from debtors and government bond holdings. There is a risk that debtors may default as interest rates rise, but at M&G we recognised that SA banks had been conservative in their lending practices in the run-up to, and during, the Covid pandemic, and had over-provided for bad debt in the economic downturn resulting from Covid, as well as in the conversion to a new accounting standard (IFRS 9). They had also had to comply with stricter lending regulations post the introduction of the National Credit Act in the late 2000s, giving them very healthy balance sheets at the beginning of 2023. Yet their valuations reflected the prevailing high uncertainty around inflation, interest rates and growth in SA and globally. Sentiment deteriorated further during the second quarter of the year after the emergence of the US regional banking crisis and rescue of Swiss banking giant Credit Suisse. Yet the banks consistently reported stronger-than-expected earnings and profits, successfully weathering the poor local conditions and helping lift their share prices. Among our bank holdings, Standard Bank and Investec added the most value to our portfolios over the period.

Richemon

Richemont, the global luxury goods group, has been another large contributor to our portfolios' performance in 2023 due to our active overweight in the stock. Despite its cyclicality, Richemont is a high-quality company with a regionally diversified business and a strong balance sheet reflecting a net cash position. The group also has strong free cash flows and a very strong balance sheet, being in a large net cash position. Richemont's jewellery businesses experienced surprisingly strong sales growth throughout 2023 across all its brands like Cartier, Van Cleef & Arpels and Piaget, reporting record operating profit for its 2023 financial year ending 30 March. And this despite headwinds that were supposed to materialise because of economic slowdowns in China and the West. The company's' geographical diversification helped meaningfully as the robustness of the US economy (and Europe to a lesser extent) compensated for the slower than expected Chinese economic recovery post their COVID lock-down.