Quarterly Commentary

M&G Investments

M&G Global Equity Fund

Global Equity USD-denominated

Q1 2024

Market overview

The first quarter of 2024 (Q1) brought a continuation of the relatively bullish investor sentiment towards global equities seen in the last months of 2023, as prospects for growth in the US were buoyed by positive company earnings reports and supportive economic data that increased the likelihood of a "soft landing" for the economy. On the other hand, global bonds were weaker as inflation proved somewhat higher than expected (the price of Brent crude oil rose roughly 14%) and major central banks kept interest rates on hold, prompting pundits to move out their rate cut expectations to the second half of the year. Still, they and the US Federal Reserve are roughly aligned in their forecasts of a 25bp interest rate cut in each of Q2, Q3 and Q4, starting at the Fed's 11-12 June FOMC meeting.

Global equity (as measured by the MSCI ACWI) delivered a total return of 8.2% in Q1 compared to 11.0% in Q4, while developed market equities produced 8.9% and emerging market equities returned only 2.4% (MSCI Emerging Markets Index – all in US$). Global bonds posted -2.1% (Bloomberg Global Aggregate Bond Index, in US$).

United States

In the US, stubborn inflation (and the Fed's unwavering fight against it) was one of the few negative factors denting investor sentiment. At 3.2% y/y, February CPI was marginally higher than its January levels, with rising energy prices making themselves felt. At the same time, the Core PCE Price Index, the Fed's preferred inflation measure, came in at 2.8% y/y, as expected. Also in line with expectations, the Federal Reserve kept benchmark interest rates on hold at its March FOMC meeting, and is forecast to do the same in May. For the quarter, the Dow Jones produced 6.1%, the Nasdaq 9.3%, and the S&P 500 10.6% (all in US$). The S&P's 12-month forward P/E ratio rose to a heady 21X at quarter end from 19.5X at the start of the quarter, with price gains outpacing those of earnings. Although the breadth of the gains improved from 2023's narrow focus, a look at the Equal-Weighted S&P Index shows that it was still large-cap shares driving the outperformance of the market during the quarter.

United Kingdom

In the UK, the Bank of England (BoE) kept its main interest rate unchanged at 5.25% at its February meeting, saying its next move would remain data-dependent. Similar to the US, the market is pricing in the start of rate cuts from June 2024. February CPI fell sharply to 3.4% y/y from 4.0% in January, helping reinforce the prospect of rate cuts. With Q4 2023 GDP growth reported at -0.3% after -0.1% in Q3, the economy entered a technical recession, and only slight improvement is expected in 2024: the BoE forecasts flat (0%) GDP growth for 2024 as a whole. In Q1 2024, the FTSE 100 returned 3.0% in US$.

Euro area

In the Euro area, optimistic corporate news sent European shares to record highs in mid-March, with upbeat earnings updates and some M&A news boosting investor confidence. Euro area CPI fell to 2.6% y/y in February, but was still uncomfortably above the ECB's target of 2.0%. As expected, the ECB left rates unchanged, even as a softer outlook for inflation and economic growth bolstered expectations for cuts starting in June. Q4 2023 GDP growth in the region was reported at a mere 0.1% (q/q annualised). In European equity markets, France's CAC 40 returned 6.6% in Q1, while Germany's DAX delivered 7.9% (both in US$).

Japan

It proved to be a momentous quarter for Japan -- the BOJ announced its first rate hike in 17 years, setting a new short-term rate target of 0-0.1% and ending eight years of negative interest rates. This came amid a rise in March CPI to 2.4% y/y, even as the latest GDP data showed the economy grew by only 0.4% (q/q annualised) in Q4 2023, and personal consumption marked its third consecutive quarterly decline. The mixed data added to uncertainty around how soon the BOJ could raise rates again, but the equity market reacted positively as the Nikkei was among the world's top-performing markets with a 13.2% return in Q1, after delivering a remarkable 22.6% in 2023.

China

China experienced a mixed quarter of sharp equity selling followed by some recovery, as the Chinese authorities enacted measures to stabilise the capital market and bolster economic growth. The PBOC cut the bank reserve requirement ratio by 50bps, followed by a historic 25bp cut in the 5-year Loan Rate. These moves significantly boosted market sentiment. GDP growth for Q4 2023 came in at 5.2% y/y, surpassing the government's 5% target level, and the new 2024 target was set at 5.0%, as expected. This is expected to be even more difficult to achieve, due to prevailing headwinds such as weak consumer demand, industry oversupply and lower consumer and business confidence. Analysts foresee further policy support in the months ahead to further support market confidence and sustainable growth. Chinese markets were still fairly weak in Q1, with Hong Kong's Hang Seng returning -2.7% and the MSCI China delivering -2.2%, both in US$.

Emerging markets

With the exception of India, which returned 6.1% (in US$) for the quarter, larger emerging equity markets performed poorly. Brazil's Bovespa was among the weakest with a return of -7.4%, while the MSCI Turkey fell -5.6%, the MSCI South Africa delivered -6.7% and South Korea's KOSPI produced -0.3% (all in US$).

Annualised performance

	B Class	Benchmark
1 year	20.5%	23.2%
2 years	6.4%	6.8%
3 years	5.8%	7.0%
5 years	10.2%	10.9%
Since inception	8.2%	9.6%

Risk profile

Risk of not earning meaningful inflation-beating returns over the long-term

HIGHER — LOWER

LOWER — HIGHER

Variability of returns over the short-term

Fund facts

Investment manager
M&G Investment Management Limited (UK)

Fund managers
Gautam Samarth

Morningstar category
Global Flex-Cap Blend Equity

Benchmark
MSCI All Country World Index TR Net

Inception date
9 June 2017

Fund size
USD 413.0 million

Sources: M&G Investments, Morningstar & Deutsche Securities

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Performance

For Q1 2024, the fund returned 5.5% (net of fees, in US$) compared its benchmark, the MSCI All Country World Net USD Index, which returned 8.2%. For the 12 months ending 31 March 2024, the fund delivered 20.5% (net of fees, in US$), compared to the benchmark's 23.2%.

A key attribute of portfolio construction within the fund's machine learning model is that active country, currency and industry exposures are constrained to ensure that style and individual stock risk are the main drivers of active returns. The portion of the fund managed using its proprietary machine learning model is approximately 90%, with the balance of approximately 10% remaining in strategic ETFs. The ETF allocation is primarily used for liquidity purposes.

The portfolio outperformed on 30 out of 64 trading days during the quarter, offering an unfavourable hit rate of around 47%. This was accompanied by a modestly negative skew, (i.e. the contribution from outperforming days did not fully offset the lag from underperforming days), resulting in the fund underperforming over the quarter.

The portfolio's style exposure proved to be a significant headwind over the course of the quarter, accounting for almost all the underperformance. Within style, exposure to smaller cap and higher volatility companies proved to be the most significant drag on relative returns. Stock selection had a modest negative impact over the quarter.

Outlook

At the end of 2023, the consensus outlook for 2024 was broadly one of slowing global growth supporting further disinflation. Versus this, the strength of US growth and US earnings have positively surprised the market and supported strong equity returns. In turn, this has fostered further risk-seeking behaviour in equities and corporate credit and somewhat skittish risk aversion in government bonds.

Central banks seem broadly comfortable with the path of inflation, but don't want to cut while growth remains strong and inflation above their target levels. Bond markets now appear to have priced in a significant portion of this and offer attractive real yields and potential diversification if growth falters. Equity valuations look demanding in places (most notably the US), but not detached from earnings.

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