PRUDENTIAL DIVIDEND MAXIMISER FUND
30 JUNE 2021

PRUDENTIAL INVESTMENT MANAGERS

QUARTERLY COMMENTARY

EQUITY

MARKET OVERVIEW

During the second quarter (Q2) of 2021, more progress in vaccine rollouts worldwide, as well as positive corporate earnings reports and economic news, continued to lift equity returns, particularly in developed markets, even as concerns emerged over high valuations. Bonds – both government and corporate credit – also recorded solid performances, retracing some of their Q1 losses and buoyed by reassurances from central banks that easy monetary policies would not be halted any time soon. It was no coincidence that cheaper, out-of-favour equities like Listed Property were among the strongest performers, while more expensive sectors like Resources underperformed.

Meanwhile, the approval of even more US government spending helped support the global growth outlook, as did improving conditions in the UK and Europe. However, emerging market equities lagged those of developed markets, and South African equities broadly underperformed their EM peers due largely to the market's high Resources exposure, after outperforming in Q1.

In the US, the economy gathered speed as Q1 GDP growth was recorded at a final 6.4% (q/q annualised) and Q1 consumer spending jumped 11.1% y/y, amid a ramp-up in factory production and signs of labour shortages in some areas. Bullish sentiment was further stoked by the bipartisan approval of a five-year, US$1.2trn infrastructure spending plan. At its June policy meeting, the US Federal Reserve (Fed) left interest rates unchanged, easing investor concerns over rising inflation, while also signalling two 0.25% interest rate hikes by the end of 2023. Longer-dated US Treasuries rallied on the accommodative stance, helping flatten the UST yield curve after its steepening trend in previous quarters. This was despite headline consumer inflation of 5.0% y/y in May, its highest rate in nearly 13 years, which policymakers consider to be temporary.

Spurred by the improving growth outlook, US equity markets continued to rally for the quarter (although June gains were more subdued), with the S&P 500 delivering an 8.5% return, the Dow Jones Industrial 30 5.1%, and the technology-heavy Nasdaq 100 11.4% (all in US$).

In the UK, the rapid spread of the Covid-19 Delta variant, in the face of the country's successful implementation of its vaccination programme, proved to be a setback for the economy's anticipated full reopening in June, dampening market sentiment to some extent. The latest GDP figures proved equally bleak as the economy shrank by 6.1% y/y in Q1 2021. Despite this, the Bank of England upgraded its growth forecast for the year to 7.25% from 5% in February, and left its key interest rate unchanged as expected, while warning against any "premature tightening" until it reached its GDP growth and inflation goals.

In the EU, Q1 GDP contracted by 1.7% y/y, disappointing most analysts on the back of slower-than-expected vaccine programme rollouts and the emergence of more contagious virus variants which forced extended lockdown measures. On the other hand, later in the quarter, consumer and business sentiment recorded strong rebounds, albeit not yet reaching pre-Covid levels.

Meanwhile, the European Central Bank (ECB) left interest rates on hold at its June policy meeting, with President Christine Lagarde injecting some bullish sentiment by emphasizing that growth in the region should pick up amid stronger global growth and consumer spending, and that the central bank would continue its bond purchases and other supportive monetary measures. Unlike the US Fed, she refrained from signalling when the ECB might start to ease its accommodative policy. Consumer inflation in the EU rose to 2.3% y/y in May, due largely to a low annual base effect.

For the quarter, French equities far outperformed their regional counterparts as the CAC 40 delivered 10.1%, the UK's FTSE 100 5.8%, and the German DAX 4.4% (all in US$).

Japan's economic contraction for Q1 2021 was revised to -3.9% y/y from a previously estimated -5.1% y/y, above market expectations of -4.8% y/y. However, further restrictions to economic activity due to the worsening spread of the Coronavirus, particularly in the Tokyo region, have led many to expect Q2 growth to be weaker, and again in negative territory. The Bank of Japan left its key short-term interest rate unchanged at -0.1% in June, and also extended the deadline for its pandemic-relief programme from September 2021 to March 2022. In a further move to boost growth, policymakers unveiled a new scheme to provide funds to financial institutions that invest or extend loans related to climate change issues. Japan's CPI hovered around 0%, higher than previous deflation due to the rise in global oil prices, although inflation expectations were unchanged.

In China, GDP growth slowed to 0.6% q/q in Q1 2021 from 3.2% the previous quarter. The People's Bank of China again left its lending rates on hold in June, while noting in its Q1 monetary report that it was more worried about an uneven economic recovery, weak consumer spending and lack of private business investment than rising prices. The government continued its crackdown on the large local IT and fintech companies, introducing more regulations regarding financing and microlending in a bid to curb "monopolistic" practices online.

For the second quarter of 2021, Japan's Nikkei 225 returned -1.6%, the MSCI China produced 2.3% and Hong Kong's Hang Seng delivered 2.9% (all in US$).

Among other large emerging equity markets, in US$ terms Brazil's Bovespa was by far the best performer with a 22.3% return, rebounding from a disastrous Q1, while the MSCI Russia delivered 14.4%. The MSCI India posted a respectable 7.0% and South Korea's KOSPI 6.3%, but the MSCI South Africa and MSCI Turkey both ended in the red with -1.3% and -0.2%, respectively, all in US$.

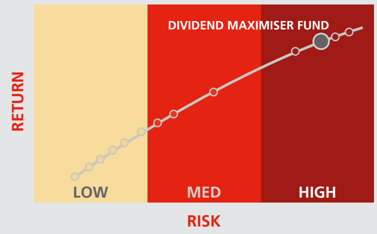
After gaining over 22% in the first quarter of 2021, the spot price of Brent crude oil rose another 18.2% in Q2, for an increase of 45% so far in 2021, fuelling inflation around the globe. As for commodity prices, most were higher over the quarter with the exception of platinum, which lost 7.4%. The gold price gained 4.5% for the quarter, and palladium was up 3.5%, giving it a 40% gain over the past 12 months. Industrial metals were also stronger: nickel rose 14.6%, aluminium 11% and copper 6%.

Turning to South Africa, economic growth surprised to the upside as Q1 2021 GDP growth measured 4.6% q/q annualised, notably higher than the 2.5% market forecast. Despite the gradual recovery, Stats SA noted that the economy's absolute size was equivalent to that last seen in Q1 2016, five years earlier. Covid-19 vaccine supplies continued to make their way into the country and the government's vaccination

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK	T CLASS	B CLASS	F CLASS
1 year	30.1%	25.0%	30.3%	30.5%	30.6%
3 years	7.2%	5.5%	7.5%	7.5%	7.8%
5 years	7.5%	4.6%	7.9%	7.9%	8.2%
7 years	6.5%	4.2%	n/a	6.9%	n/a
10 years	10.5%	8.1%	n/a	10.9%	n/a
Since inception	16.0%	13.0%	6.6%	10.6%	8.2%

Inception date B Class: 2 January 2007, T Class: 2 January 2015, F Class: 1 June 2016

RISK/RETURN PROFILE:



FUND MANAGERS:
Ross Biggs and Kaitlin Byrne

ASISA CATEGORY:
South African - Equity - General

BENCHMARK:
ASISA South African – Equity - General Category Mean

INCEPTION DATE:
2 August 1999

FUND SIZE:
R3 765 825 267

AWARDS:
Raging Bull: 2006, 2008
Morningstar/Standard & Poor's: 2007, 2009

Sources: Prudential, Morningstar & Deutsche Securities

programme made headway, but this progress was overshadowed in June as the third wave of Covid infections gathered pace, driven by the more transmissible Delta variant. This prompted President Cyril Ramaphosa to reintroduce Level 2, and subsequently Level 4, lockdown measures, again curtailing vital economic and social activity.

Meanwhile, the South African Reserve Bank kept its benchmark interest rate unchanged at a record low of 3.5% at its 20 May MPC meeting, warning that slow progress on vaccinations, limited energy supply and policy uncertainty continue to pose downside risks to the economic outlook. This was despite the jump in consumer inflation to 4.4% y/y in April and 5.2% y/y in May, attributed largely to the previous low base. The central bank raised its growth forecasts for 2021 from 3.8% to 4.2%, but lowered its projections for 2022 and 2023 to 2.3% and 2.4% respectively. It is also projecting two 25bps interest rate hikes in 2021.

During the quarter global credit rating agencies S&P and Fitch reaffirmed South Africa's long-term sovereign credit rating at BB-, citing an upturn in near-term economic performance and improved public finances as contributing factors. Moody's, however, postponed its review on South Africa's credit rating, which currently sits at Ba2 with a negative outlook.

The FTSE/JSE ALSI was roughly flat for the second quarter, returning 0.05%, while the FTSE/JSE Capped SWIX All Share Index, which we use as the equity benchmark for most of our client mandates, returned 0.6%.The standout sector was Listed Property (the All Property Index) with an 11.1% total return. Financials delivered 7.5% and Industrials eked out 0.8%, but the Resources Index returned -5.0%. This performance reflected the value still seen in "SA Inc" counters, which have lagged during the recovery, and the growing view that Resources shares may be reaching the end of their bull run.

Finally, the rand appreciated against the major global currencies over the quarter, rising strongly from its oversold position in April and May before retracing some gains in June. It gained 3.3% against the US dollar, 3.1% versus the pound sterling and 2.4% against the euro over the three months.

PERFORMANCE

The fund delivered a return of 2.2% (net of fees) for the second quarter of 2021, outperforming its benchmark (the average of the general equity funds) by 1.7%. For the year ended 30 June 2021, the fund returned 30.1% (net of fees), outperforming its benchmark by 5.1%

The fund's dual focus of buying undervalued companies with strong cash flows and dividends remains core.

The fund's overweight position to Textainer Group Holdings was once again the largest stock contributor to outperformance over the last quarter. Textainer is one of the worlds' largest container leasing companies and leases containers to shipping companies. Going into the pandemic, the business was in a strong position to take advantage of some opportunities that arose. We have been exceptionally impressed with how the company's management has allocated capital. The company has been able to buy back a substantial number of shares at extremely attractive prices and we think this smart allocation of cash should further accelerate the improvement of returns from the company. The container leasing market's fortunes have rapidly improved over the last year and Textainer has managed to put a substantial amount of capital to work by buying a large amount of containers and leasing them out over the long term at very attractive rentals. Despite this large investment, we expect Textainer to also be able to resume the payment of dividends this year which is indeed an exciting milestone for the company and investors.

Combined Motor Holdings was among the fund's largest stock contributors to performance. We were able to buy a position in this motor car retail company at good prices over the last year as the market feared the worst for this sector. The company has come through the Covid-19 crisis exceptionally well and has managed to generate a significant amount of cash flow over the last year. We expect exceptionally-low interest rates to be very supportive of car retail in the coming years and expect strong dividend growth from this company over the next three years. The share price appreciated by 45% over the last quarter.

The pace of profit recovery and concerns over further bad debts arising from Covid-19 related constraints are still weighing on the share performance for South African banks, despite many banks resuming the distribution of dividends. We continue to believe that this might be a very good opportunity to buy banks in South Africa at very undemanding valuations, and for this reason, we have one of our larger sector overweights to the banks sector. While the Covid-19 virus shutdown resulted in significant concern over the potential for bad debts in the banking sector, we believe that the associated share price falls provide a substantial risk premium. We continue to be overweight Standard Bank, ABSA and Investec. Capitec, in which the fund does not hold a position, was the largest detractor from relative performance over the last quarter. The recovery in Capitec's share price has been very strong and is now trading above its pre-pandemic levels. While we remain overweight the banks sector, we think there is also good opportunity to generate alpha within this sector by being overweight relatively undervalued banks versus the banks such as Capitec and FirstRand. While we rate FirstRand and Capitec more highly in terms of quality, we cannot ignore that that they are substantially more highly rated than other banks in the sector.

During the quarter, platinum group metals prices fell, in particular rhodium and palladium. As we have commented previously, this sector's fortunes have rapidly improved after many years of earning margins which on average were not high enough to even compensate the mines for ongoing maintenance capex. Today, margins in the sector are at near-record highs and cash generation is very strong. Once-indebted companies have been able to substantially pay down or pay off all the debt that they had accumulated. We are cognisant of the high margins that companies are currently earning, but moved to an underweight position in the platinum sector in the first quarter of the year due to rising valuations of platinum companies. This underweight positioning benefited the fund in the second quarter.

The fund's overweight position in MTN was also a key contributor to the outperformance over the quarter. The market has been very concerned about the risks of doing business in Nigeria, where MTN has a significant business. While we do not disagree that investing in Nigeria requires a higher risk premium, we think that MTN presents excellent value and continues to be one of the larger overweight positions in the fund. MTN is trading on a dividend yield of over 6%, which we think should be able to grow over the next five years. MTN has been steadily reducing debt levels on its balance sheet by realising non-core assets like their tower assets. We think that this process will not only ensure a stable and growing dividend but will also reduce any balance sheet risk.

We continue to think that offshore equity markets look attractive, but over the last year we have seen opportunities to reduce our offshore weighting based on the relative attractiveness of the SA market. The fund is approximately 20% invested offshore, mainly through the Prudential Global Equity Fund and the M&G Global Dividend Fund. The offshore allocation to the Prudential Global Equity Fund was a large contributor to outperformance over the last quarter as global markets outperformed the South African equity market. The rand was a headwind to this outperformance as it appreciated by 3.3% relative to the USD over the quarter.

We acknowledge that while it is very difficult to forecast the future and we do not make any attempt to do this, we do spend a lot of time thinking about the economic cycles that various sectors are in, and where valuations are. In this way, we aim to try make money for our clients through these cycles and continue to try buy companies that have proven dividend and cash flow track records and which can withstand the normal upheavals that occur in markets over time. We aim to continue building risk-cognisant portfolios that seek to add value through stock selection relative to the benchmark.

STRATEGY AND POSITIONING

We remain optimistic regarding the South African equity market returns over the medium term due to the prevailing excessive levels of pessimism reflected in share prices and valuations. Going into the Covid-19 pandemic, the South African market, in our view, was already undervalued and has fallen to levels which we think are exceptionally attractive. The price-to-book value ratio of the JSE remains close to 1.7X as at the end of June 2021. We also note that within the South

Sources: Prudential, Morningstar & Deutsche Securities

African market, many commodity companies continue to experience substantial upgrades in their revenue and earnings, as the prices of platinum group metals, coal and iron ore continue to remain elevated. These strong commodity prices are not only helpful to the companies mining them, but are also broadly helpful to the South African economy. We have therefore reallocated some capital out of the mining sector and into some South African economy-focused companies.

South African assets appear to be undervalued relative to emerging and developed markets. We believe that earnings and dividends in South Africa should show a strong return to growth over the medium term. This growth in dividends is based mainly on a return to more normal profit margins amongst the mining companies and related industries, which we are already witnessing, as well as a resumption of dividends from banks and SA industrial companies.

The focus of the fund continues to be on finding companies that are undervalued and which are paying good dividend yields with the potential to pay growing dividends over the long run. We are confident that we have built a portfolio of attractively priced stocks that in aggregate is cheaper than owning the index, yet still capable of delivering attractive underlying growth independent of the economic cycle in which we find ourselves. ■

Sources: Prudential, Morningstar & Deutsche Securities