Amplify SCI* Flexible Equity Fund

Fund Commentary | December 2023

Omri Thomas
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Overview

Investors continued to flee the Chinese market

The last quarter of the year marked a sharp reversal in expectations regarding the path of inflation and interest rates. At the end of the third quarter market participants expected overnight rates in the US to move higher in the short term, and to average 4.4% per annum for the following five-year period. By year-end, with inflation falling and the eagerly awaited US Federal Reserve 'pivot' finally materialising, these expectations had shifted materially lower. Rates were now forecast to fall in the short term and to only average 3.5% per annum over the following five years – a massive decrease of nearly a full percentage point per annum.

This sharp reversal in rate expectations fuelled a strong rally in equity and bond markets in the final quarter of the year. Whether or not inflation is now truly under control remains to be seen and we are left wondering if the sharp fall in rates may in fact be a signal that economic growth may be set to slow.

For the 2023 year, the MSCI All Country World TR Index moved 22.1% higher, strongly outperforming the MSCI Emerging Markets TR Index, which returned 9.9% in US dollar terms. Within Emerging Markets, the standout negative performance came from China (MSCI China TR Index down 11.1% in US dollar terms), as investors continued to flee the market in the face of an economy that is struggling to recover post Covid; and the fear that further regulatory interventions by the government will impede company profitability.

Local equity markets were again a relative disappointment, with continued load shedding and low growth thus far limiting the ability of the market to rerate from depressed valuation levels. The FTSE/JSE Capped SWIX TR Index delivered a lacklustre 7.2% in rand terms (flat in US dollar terms) for the year.

Global bonds recovered sharply towards year-end and returned 4.9% in US dollar terms for the year. Local bonds produced a credible 9.7% in rand terms (+2.3% in US dollar terms) for the year, despite much intra-year volatility and a sharp steepening of the curve as investors started to question the ability of the government to service and repay its longer-dated debt.

Performance

Returns

Performance to 30 September 2022	Amplify Flexible Equity	ASISA category average	FTSE/JSE All Share
3 months	2,7%	+5,9%	+6,9%
12 months	+4,6%	+11,7%	+9,3%
3 years	+16,6%	+10,9%	+13,5%

The Amplify Flexible Equity Fund produced a positive net return of 2.7% over the last quarter, which was below peers (peer group up 5.9%). The Fund's conservative positioning throughout the year dragged on performance as an especially strong fourth quarter was experienced in global markets. Over the longer term, the fund continues to compare favourably to the benchmark and market returns.

Top 5 winners and losers for Q4 2023

Top contributors	Average weight	Performance contribution	Top detractors	Average weight	Performance contribution
R2040	13,4%	1,1%	Sasol	1,8%	-0,7%
R2037	5,6%	0,6%	Auto-home	2,9%	-0,3%
R2044	5,2%	0,5%	African Rainbow Capital	1,0%	-0,2%
FirstRand	2,6%	0,4%	Absa	3,0%	-0,2%
Abax Global Equity	3,4%	0,3%	Sasol convertible debenture	1,6%	-0,2%
Total		3,9%			-1,6%

The three top contributors to returns over the last quarter were South African Government Bonds as we saw a contraction in bond yields driven by a rally in global bonds. The FirstRand contribution was slightly offset with our exposure to Absa. The Abax Global Equity Fund also aided performance on the back of strong global markets in the last quarter.

Sasol was the major detractor over the last quarter as the global crude oil price declined by 12% over the quarter. The chemical market fundamentals also deteriorated, adding further pressure to the Sasol share price. At the current P/E ratio of 3.5 times, a lot of negative news seem adequately discounted and we retain our position in Sasol.

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Future outlook and positioning

Preference for quality SA counters

We still believe local bonds are attractively valued (at the time of writing the SA 10-year bond yield was close to 11.5%) with inflation expectations anchored around 5.5% and global rates having peaked. This implies a prospective real return pretty much in line with the long-run equity risk premium, with arguably less risk.

As mentioned before, global fixed income has become an investable asset class for the first time in many years. Although less exciting than three months ago (post the strong fourth-quarter rally), US Treasuries yielding close to 4% (versus 1.5% at the beginning of 2022) still offer some value and strong diversification benefits.

We have been selectively adding to our local equity exposure during weakness experienced by certain stocks (Absa, Anglo American, British American Tobacco, Prosus and Naspers), while at the same time trimming some stocks that had performed well (most notably FirstRand and Capitec). The South African equity market continues to be attractively priced, both on a relative and absolute basis. Unfortunately, we've seen little buying interest from foreign or domestic investors. We retain our preference for quality counters that can tough it out despite the headwinds.

We view US equities to be on the expensive side, especially on a relative basis, while we see interesting opportunities within the Chinese equity market at extremely compelling valuations. We have incrementally been increasing our weighting to these ideas over the course of the year. As we are cognisant of the manifold risks of investing in China, we will try and manage this at a portfolio level by both limiting our total maximum exposure to this market, and by also diversifying across a number of holdings with varied business models operating in different industries.

We maintain a defensive positioning, but have selectively increased our equity exposure, as we see value in the local market. Given the high allocation to bonds and a current preference for yielding local equities, the fund is offering an attractive running yield of 7.7%. Given inflation expectations of 5.5%, this offers an attractive real return, which we would look to enhance through security selection and tactical asset allocation

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