Amplify SCI* Wealth Protector Fund

Fund Commentary | June 2024

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"Geopolitical risks across several regions remain elevated and continue to drive global economic uncertainty."

Global overview

Signs of a slowdown in the US economy

The US economy was buoyant throughout the second quarter; however, negative economic surprises are revealing cracks. Historic payroll numbers are being revised down and the unemployment rate has risen to 4.1%. Consumers appear to have spent excess savings, built up over the pandemic period and the savings rate at 3.6% is now below pre-Covid levels. Higher rates on floating debt and tighter lending standards are creating a more challenging environment for borrowers, evident in rising credit card and auto loan delinquencies. Fixed long-term mortgages remain shielded from the impact of tight monetary policy, but higher rates on new mortgages remain a headwind for new property owners. Similarly, many corporations that are rolling over debt will experience much higher rates.

Subdued private capex intentions, a high base of government spending (related to the Inflation Reduction Act) and lower emigration will also likely weigh on GDP growth next year. Although inflation has been sticky, on balance it appears to be declining which should give the US Federal Reserve (Fed) room to start its rate cutting cycle. Hence, bond rates are more likely to drift lower from here. Earnings revisions continue to drift up, although this is due to large capitalisation shares. These two factors could support what is a relatively expensive market in the short term.

The higher likelihood of a Trump presidency increases global geopolitical and economic risk. The worrying long-term trajectory of US debt may well result in Republicans restricting his ability to engage in meaningful stimulus measures that were taken during his prior term.

China's consumer confidence remains low

Chinese equity markets rebounded in the second quarter, boosted by investor sentiment and government initiatives to support the real estate sector. However, a People's Bank of China survey in the first quarter of 2024 showed that the percentage of people expecting home prices to fall further reached a record high (22%). Property rental yields remain low relative to the rest of the world. Although household completions are at reasonable levels, new starts continue to fall, which will weigh on future GDP growth.

China's consumer confidence remains low, albeit stable. Chinese economic growth is supported by exports and manufacturing capex. Exports remain at risk from escalating trade tensions. As economic growth is still in an acceptable range, it seems unlikely that any significant stimulus would be forthcoming at the upcoming Third Plenum.

China's manufacturing activity remains resilient, and emerging market manufacturing Purchasing Managers Index (PMIs) are in expansionary territory. This should provide support for commodities.

Momentum stalling in Europe

The European Central Bank (ECB) met market expectations with a June rate cut; however, core inflation appears to be cooling slower than expected, held up by services inflation. Consumption is low relative to pre-Covid levels and capital expenditure remains depressed. Although this could present an opportunity, the PMI is now only marginally in expansionary territory and looking weaker than in the first quarter. Given Trump's isolationist stance, the equity risk premium in Europe could increase.

Local overview

South Africa's new political dawn

The recent elections were a watershed moment for South Africa and its democracy. The collapse in ANC support left the ruling party in uncharted territory with the task of not only finding a new leadership solution, but also including far larger opposition parties than initially thought.

Following two weeks of uncertainty and volatility as markets grappled with potential leadership outcomes, the formation of the Government of National Unity (GNU) was formally announced. The GNU, comprising

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the ANC, DA, IFP, GOOD, PA, PAC, and the FF Plus party, will hold 70% of the National Assembly seats under the presidency of Cyril Ramaphosa. Markets have welcomed the outcome given the centrist anchor, policy stability, and the potential for greater commitment to economic reform and growth. The FTSE/JSE All Share Index (ALSI) gained over 5% in two days of trading following the public announcement, while the rand strengthened to just below R18 to the US dollar.

Outlook: In summary

Globally, inflationary pressures remain evident, but inflation does appear to be slowly gliding down. European policymakers have signalled divergence from the US with rate cuts at the start of June, but any significant shift in rates is unlikely to materialise until further signs of inflation being well under control are evident. Growth data for the US remains buoyant with reported GDP growth of 1.6% in the first quarter of 2024 (annualised); however, numerous factors are signalling a slowdown for the US economy. Geopolitical risks across several regions remain elevated and continue to drive global economic uncertainty.

While the election fears have settled in South Africa, the new leadership structure and GNU dynamics still need to be bedded down following the recent formation of a new Cabinet. The GNU parties are committed to a workable approach and frankly need each other. While challenges will occur, it remains important to distinguish between market noise driving volatility and fundamental changes that could impact the longer-term outlook. From a macroeconomic perspective, continued improvement to energy security, reform of rail logistics, water and infrastructure remain critical to the longer-term economic growth in SA.

Performance and positioning

Performance

South African equities had a strong quarter (ALSI: 8.2%) as sentiment shifted in the lead-up to and after the national elections. A surprisingly positive election outcome led to rand strength and a re-rating of SA Inc stocks. Although performance has been strong, the index has experienced significant volatility given the election-related uncertainty and news flow. SA bonds and property responded well to election outcomes and in June, the SA bond market (FTSE/JSE All Bond Index (ALBI)) delivered a best monthly performance since May 2020 of 5.2%, bringing the quarterly performance to 7.5% for bond investors. South Africa's currency was also supported by a positive election sentiment, gaining 3.7% in the quarter (3.1% in June) to become the best performing emerging market currency for the month of June and recovering losses from the first quarter of 2024.

Global equity markets continued their first quarter momentum as AI-exposed companies led the performance across all markets. Emerging markets outshone their developed counterparts, largely driven by the AI theme in Taiwan which supported Asian market performance.

The SA bond market benefited from election sentiment and a strong rally in June resulted in fixed-income exposures adding to fund performance over the quarter.

From an equity perspective, the fund benefited over the quarter from a meaningful position in Anglo American and other diversified miners. We sold down exposures in these counters given profit opportunities but remain constructive on copper on a medium-term view. Copper is benefiting from an improved outlook for global manufacturing, and lower supply guidance from major miners also resulted in a continuation of expected deficits.

Exposure to SA banking stocks, specifically Standard Bank, Nedbank and Absa was a major contributor for the quarter. The local banking sector performed well, particularly in June when stocks re-rated following a relatively positive election outcome.

Foreign equity exposures detracted, partly due to rand strength. Increased volatility into the snap French election weighed on much of our European exposure although we are starting to see a recovery into the new quarter.

Positioning

We had been steadily increasing our exposure to SA Inc stocks in the run-up to the elections, slowly removing

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our underweight, so that we entered the election period with a well-balanced portfolio. We increased exposure to banking shares, specifically Standard Bank and Nedbank and added to SA retailers. We focused on companies trading on generous valuations with good dividend yields and strong liquidity.

Against an uncertain backdrop, our focus remains on managing a well-diversified portfolio and we have maintained positions in Bidcorp and some other rand hedge stocks with attractive valuations. While many SA Inc stocks have re-rated and are closer to fair value, we maintain an overweight position in the larger SA banking shares given the strong free cash flow and compelling dividend yields.

From a fixed-income perspective, the fund has benefited from exposure to duration. In our view, the bulk movement in yields due to a reduction in credit spreads is largely done and further upside would be driven by a decline in US real rates.

Global equity markets experienced a good first half in 2024, and while continued economic resilience could sustain market strength, US equity valuations remain elevated. We remain underweight the US equity market in our offshore positions but have increased our exposure to European stock markets, which are trading in fair value territory.

INTELLIGENT IMPACT THAT MATTERS