Portfolio Manager Quarterly Comment

ECONOMIC REVIEW
Global backdrop

A review of the past year of 2023 very much resembles the volatility and turmoil that characterised the 2022 calendar year for the global investment environment. We commenced this past year with elevated risks on multiple fronts. Most prominent were lingering concerns related to inflation and rising interest rates in many markets, threats of recession in many regions of the world potentially, and lastly, geopolitical upheaval (at the time Russia remained at war with Ukraine). We now enter 2024 with a challenging combination of similar risks, albeit that a consensus has formed that we are now at the peak of the global interest rate cycle and while some lingering upside risks remain a concern for inflationary forces at the margin, overall this general thematic risk is a lot more contained in many regions of the world than it was this time last year. Unfortunately, geopolitical risks have accelerated with the addition of the Israeli-Palestinian conflict, which commenced in October last year and continues to pose an elevated risk to the wider Middle Eastern region.

The US economy has confounded sceptics this past year, delivering strong GDP growth momentum in the face of a sharp increase in the US federal funds rate over the last two years and corroborated by a strong performance by the US equity market in 2023. We entered the year with a historically reliable recession indicator in play for the US economy: two-year interest rates exceeded 10-year interest rates, inverting the US yield curve. This remains the status quo up to today and despite some closure of the gap due to a rise in the longer end of the US yield curve towards the end of last year (as mirrored globally in many markets), this highly regarded signal continues to call for an imminent recession in the US. While this may still play out, the overall narrative around the US economy has softened and an expectation of a softer landing has become more prominent. One of the key reasons for this remains the ongoing resilience in US labour markets, which continues to support US consumption and the dominant services mix within that economy. At the margin we've seen some softening of labour data here and there, but the unemployment rate in the US remains at decade lows. A softer US housing market and much higher interest rates relative to history do not seem to have compromised the US consumer, with many market proponents citing residual effects of historic economic stimulation that bolstered savings and the ability for US consumers to continue to spend.

This year may also prove to pose a state of flux for US economic policy, as the country faces a crucial presidential election in November 2024. While the US Federal Reserve (Fed) seems to have achieved a stabilisation of inflation, it has signalled that further interest rate hikes are unlikely, and the market has now turned its attention to the prospect of interest rate cuts. The timing of this remains very uncertain, given that the present higher interest rate regime has yet to tilt the US economy into a full-blown recession. Ultimately, it remains to be seen how this dynamic plays out this year and the risk of some form of recession in this very important economy globally continues to be a feature of our scenario analysis, albeit that it may transpire

as a more shallow, shorter-lasting recession. What we do observe is that very high levels of uncertainty and difficulty with forecasting these dynamics have led to the market becoming very short-term orientated and 'news flow-driven', exacerbating market turbulence as important economic data are systematically released.

Across in Europe, more challenging dynamics have plagued this geographic collection of economies. Here, we have seen recessionary forces at play and a far weaker growth trajectory than the resilience that has characterised the US. While the UK has narrowly averted a recession, despite multi-decade high interest rates, the same can't be said for many European countries that have experienced contractions within their economies this past year and remain under considerable stress going into 2024. While the damaging impact of rampant energy prices and supply bottlenecks that plagued European economies going into 2023 have largely subsided, decreased household spending, high interest rates and ongoing geopolitical turmoil in Eastern Europe remain key threats to this broader region. The entire structural positioning of Western European economies continues to shift in the aftermath of a cut-off of Russian energy in the form of both oil and gas, much of which is now being diverted to China and to alternative trading partners that are willing to take Russian commodities. We expect this impact to reverberate across European economies over the next few years, as they reposition their manufacturing and industrial bases in response to this. A spillover from the unrest in the Middle East and its impact on the Mediterranean Sea has the potential to place further pressure on Europe, with many shipping companies already diverting their geographic route to now travel around the South of Africa to facilitate key seaborne trade. At the same time, long-term demographic challenges continue to accelerate slowly and pose great structural risk to many European economies. So while we do not expect deep and protracted recessions to play out in the key European economies in 2024 (the UK, Germany and France being the most important), we see this region as remaining in a state of flux, with the only silver lining likely to come from any prospective declines in interest rates that may be announced by the European Central Bank or the Bank of England during the course of this year.

China and the broader Asian region remain a mixed influence on the overall global economy going into 2024. The most important region remains the Chinese economy, which continues to struggle with a multitude of challenges, many of them structural in nature, resulting in protracted impacts. The most critical remains the broad and lingering impact of the Chinese property market, which has historically been a key growth lever for this economy, as pressure from over-investment and unsustainable levels of debt weigh. The risks here have not abated. At the same time, consumption has remained more subdued than anticipated, plagued by unfavourable demographic shifts and a high youth unemployment rate. High levels of government control and regulation remain a third force that impacts the Chinese economy, albeit that the theme of 'Common Prosperity' by the Chinese authorities is noble in its intent. A case in point was a raft of regulations published late last year to clamp down further on gaming, which led to some panic across the world for large tech companies that have exposure to the supply of this (Tencent, NetEase, etc.). Lastly, the threat of deflation in the wake of weak consumption remains a concern for the Chinese economy, despite multiple attempts to stimulate the economy. Given this structurally challenged backdrop, it can be said that we do not expect the Chinese economy to provide substantial support to global economic growth this coming year.

Domestic backdrop

This past year has been a very challenging year for the South African economy. After a challenging 2022, we entered 2023 with a bout of intense energy loadshedding that extended throughout most of last year, with some respite seen during the winter months, when scheduled maintenance was intentionally reduced across the energy generation fleet. This set a challenging backdrop for economic growth in 2023 and sets the stage for a potentially fragile recovery in 2024 if we can improve this situation in the near term, which is also potentially debatable. This past year was one that was characterised by 'state owned entity-induced' headwinds from both Eskom and Transnet, which posed an additional layer of risk to the domestic economy, hampering productivity, trade and overall growth. The ongoing challenge of decaying infrastructure and state capacity has deteriorated further and remains a crucial risk to the effective functioning of the South African economy going into 2024.

An adverse commodity cycle also weighed on the South African economy this past year, and while pressure was seen across the board in most commodities, it was most notably observed in the platinum mining industry, which suffered sharp commodity price contractions from 2022 commodity price levels. This naturally hampered domestic economic terms of trade and resultant tax collections, further pressuring already fragile fiscal dynamics. In conjunction with the risks highlighted above as well as a very strong US dollar, we saw a substantially weakened rand this past year, closing the year as one of the worst-performing currencies globally in 2023.

The South African economy remains plagued by structural challenges that are well telegraphed and understood by market participants and the loadshedding challenge has only served to weigh more on this narrative. As a result, we go into 2024 remaining circumspect about real economic growth prospects. Despite this, a few points should be raised as important considerations to the present domestic economic outlook. From a cyclical perspective, South Africa, like many other economies, is currently challenged by elevated interest rates versus recent history and this naturally stifles growth and consumption, given the effectiveness of the South African monetary policy transmission mechanism into the economy; we expect interest rates to fall in 2024 and while the timing and extent is unpredictable, this will provide a cyclical underpin to the South African economy this year. Thus, with all the available information that we currently have, we do expect a better trajectory for the South African economy this year versus last year, albeit that this scenario can always potentially be destabilised by the advent of an unanticipated 'black swan' event.

Finally, we are also entering a national election year in 2024, which can prove disruptive, but also deliver much-needed change if new governing structures can emerge. One of the likely permutations is further contraction in support for the ruling party, the ANC, which could usher in a new era of coalition politics that is a feature of many countries around the world but is largely unchartered territory for South Africa at a national level. At a political level, a lot is at stake currently from a domestic perspective, with heightened uncertainty, which needs to be factored into our thinking this year when analysing our investment environment.

MARKET REVIEW

Global market performance

After a weak third quarter, in the last eight weeks of 2023, the investment world moved back towards a 'risk-on' paradigm and across the board we saw an extraordinary rally in global markets, premised on a scenario of substantial interest rate cuts anticipated in 2024. As highlighted above, a prevailing sense of uncertainty and the myopic focus of market participants presently has caused extreme turbulence in global markets, and we see this theme potentially continuing into 2024.

After a tough 2022, **the MSCI World Index ended the year on a high note and was up 24.4% in 2023** (in US dollar terms). The final quarter of 2023 was the grand finale and saw the MSCI World Index generating a total return of 11.5%.

Regionally, the North American region was the strongest, generating a total return of 11.9% for the quarter and up 26.6% for the full year in 2023. Despite the economic woes of Europe highlighted above, their equity markets delivered a robust performance last year, with this region up 20.7% for the full year and up 11.1% in the final quarter of 2023. Within the developed market landscape, the Pacific region was last, but certainly not least, also generating a robust return of 15.6% for the full year and 9.3% in the final quarter (all returns quoted in US dollars). Within the MSCI suite of performance, the only sub-regional developed equity market that lagged in 2023 was Hong Kong, which generated a total negative return for 2023 of 14.8%, but also enjoyed a final quarter rebound of 3.4% in the fourth quarter of 2023. Across the developed market universe not one single sub-regional market generated a negative return in the final quarter of 2023, reiterating the broad-based nature of the rally across global equity markets that was experienced.

On the **emerging market front**, we saw similar dynamics, with all the action concentrated in the final quarter of last year – **the MSCI Emerging Markets (EM) Index was up 7.9% in the fourth quarter and ended the full year up 10.3%** in US dollar terms.

Regionally, this performance was more mixed than the broad-based rally seen in developed markets. Within the MSCI EM regional clustering, the Latin American region (Brazil, Chile, Colombia, Mexico and Peru) was the strongest – up a staggering 17.8% in the final quarter and 33.4% for the full year of 2023. While both the EMEA (Eastern Europe, Middle East and Africa) and Asian regions were also up in the final quarter and for the full year, their relative return profile was not quite as buoyant as the stunning performance of the Latin American region. The EMEA region generated a final quarter return of 8.4% and delivered a full-year return in US dollars of 8.6%, while the Emerging Asian region (China, India, Indonesia, etc.) was up 6.8% in the final quarter and up 8.2% for the full year in 2023. The main laggard in the Asian region was the **Chinese market, which delivered a negative total return of 11% in US dollars for the full year of 2023**. Kuwait, Turkey, the UAE, and China were the only geographic sub-regions globally to post a negative return in the fourth quarter (the Chinese market was down 4.2% over that period).

Within the MSCI EM Index, the South African region enjoyed a sharp rally in the final quarter of 2023 in US dollars, posting a return of 12.7%, a welcome trend after the preceding three negative quarters. For the full year 2023, the South African region underperformed and posted a below-average return in US dollars of 2.3%.

Domestic market performance

The relief rally seen in the final quarter of 2023 redeemed the South African domestic equity market's performance for the full year in rand terms. The FTSE/JSE Shareholder Weighted All Share Index (SWIX) ended the full year up 7.8% (total return with dividends reinvested) in 2023. Following a challenging third quarter, the final quarter saw the SWIX generating a total return of 8%. The FTSE/JSE Capped SWIX Index was up 8.2% in the final quarter and 7.9% for the full year of 2023.

From a high-level sector perspective, financial shares generated the best returns last year, with the Financials Index up 20% for the full year in 2023 and producing a robust return of 12.3% in the final quarter of 2023. This was closely followed by the Industrial Index for the full year, which was up 16.6%, but lagged the stellar performance of the financial universe in the final quarter of 2023, generating a total return of 5.9% in the fourth quarter. The past year was not a good year for resource shares, as the Resources Index lost 11.8% for the full year of 2023, but did enjoy a minor relief rally in the final quarter of 3%. Listed property shares enjoyed a better year in 2023 than the preceding few years – the SAPY Index gained 10.1% in 2023 and enjoyed a very sharp final quarter rally of 16.4%. The rally seen in financial and property shares was primarily in response to a synchronised fall in global bond yields highlighted above that transpired towards the end of last year.

For the full year, from **an economic sub-sector perspective,** the strongest performance came from the Pharmaceutical & Biotech sub-sector, which generated a total return of 50.6% in 2023. This was followed by the Life Insurance sector (+38.6%), Industrial Transportation (+38.5%), Consumer Services (+35.3%) and the Non-Life Insurance sector (+34.9%). On the negative side, the worst-performing economic sub-sector was the Finance and Credit Services sector (-75.9%), comprised solely of the performance of Transaction Capital, followed by Automobiles and Parts (-35.5%), Closed-End Investments (-21.3%), the Chemicals sector (-21%) and the Industrial Metals and Mining sector (-15.7%).

PORTFOLIO REVIEW

For the fourth quarter of 2023, Morningstar data indicate that the **SIM General Equity Unit Trust generated a return of 4.8% (net of fees), underperforming its benchmark, the FTSE/JSE Capped Shareholder Weighted All Share Index (Capped SWIX), which generated a return of 8.2% over the same period.** For the rolling 12-month period ended 31 December 2023, the net total return of the SIM General Equity Unit Trust is 4.3%, below its benchmark's return of 7.9% over the same period. Over three years, the SIM General Equity Fund is slightly behind its fixed benchmark, generating an annualised return of 11.7% per annum (net of fees) for the three years ended 31 December 2023, versus the Capped

SWIX return of 12.7% over the same period. **Most importantly, over five years, the SIM General Equity Fund has generated a return that is comfortably beating its benchmark: 11.1% per annum (net of fees), versus the Capped SWIX return of 9% per annum for the five years ended 31 December 2023.**

The following attribution analysis analyses the **South African equity component of the portfolio** and excludes the international exposure.

For the past quarter (Q4-2023), the top three **contributors** to performance were the following positions held:

- Our overweight exposure to Anglo American Platinum
- Our underweight exposure to Sibanye-Stillwater
- Our overweight exposure to Northam Platinum

For the past full year (2023), the top three **contributors** to performance were the following positions held:

- Our underweight exposure to Sibanye-Stillwater
- Our overweight exposure to Datatec Limited
- Our underweight exposure to Capitec

In the past quarter, the SIM General Equity Fund's exposure to, and deliberate stock selection within the platinum group metal (PGM) shares, captures the essence of our investment philosophy within the SIM equity team. We commenced the year with an overweight exposure to PGM shares in the fund. During the year, we pared back this exposure due to concerns around the challenges facing the industry, such as dramatically falling PGM commodity prices as well as concerns around the longer-term potential structural demand for PGMs, considering the sharp rise in the production of electric vehicles across the globe. We repeatedly revisited the investment case for PGMs and challenged our own narratives throughout the course of the year, focusing on the integrity of our fundamental research process, which always leads our decision-making. In the final quarter, we concentrated our exposure in two key PGM investment cases, namely Anglo American Platinum and Northam Platinum, and tactically increased our exposure to these specific shares, considering the dramatic sell-off across all the PGM shares that we saw in the second half of last year. Both investment cases were scrutinised and selected for their long-term merits and the fact that they have well-positioned mining resources that can withstand the current malaise in PGM share prices (cost curve positioning, scale of operations, etc.). At the same time, the collapse of their respective share prices offered a significant investment opportunity, when the market was clearly avoiding exposure to this area of the market. Our strict adherence to a medium to long-term focus that seeks to filter out short-term noise, assisted us to have the conviction to invest in these shares, which supported the returns of our fund in the final quarter of 2023.

For the full year (as well as the recent quarter), our underweight exposure to Sibanye-Stillwater added value to our fund. As highlighted above, this depicts our stock selection within the mining sector and in the case of Sibanye-Stillwater, we were particularly concerned with the structural commodity mix of the company (a palladium-rich PGM resource), the problematic cost position of their South African gold and platinum mining operations in a low commodity price environment, and finally, management's stated intentions to participate in corporate actions that both absorb significant management time and can result in material misallocations of capital.

Our enduring overweight exposure to Datatec added value again this past year, as the company delivered on its stated objectives and our long-term expectations of the investment case. The company reported robust financial results last year that were ahead of expectations, benefiting from the fact that their niche offering of services remains firmly in demand within the technology landscape. The long-term investment thesis for the share, which involves unlocking our assessment of intrinsic value through deliberate strategic actions, remains intact and it was pleasing to see the market rewarding the investment case for a third year in a row now.

Capitec was another positive contributor to the performance of the SIM General Equity Fund in 2023. In line with our investment philosophy, we had no exposure to Capitec in the first half of last year, as the share price fell sharply. The share came onto our radar after this negative performance, and after repeatedly scrutinising the investment case within the team, we added exposure to the share when we felt comfortable that value was emerging. On a net basis, through the course of the year, we were underweight Capitec, but our decision to add exposure timeously, as the share recovered, added value to the fund. Our analysis showed that the investment case depicts a rapidly evolving, high-growth investment that continues to deliver across multiple growth levers – a strong, transactional retail client franchise, a nascent disruptive business banking offering, and lastly, a lucrative insurance offering that is also at the early stages of its evolution. The ability to monetise a large and extensive client base effectively remains the key underpin to the Capitec investment case. The market gave us an opportunity to obtain exposure to this investment case at very attractive levels last year that adhered to the parameters of our investment philosophy and was not at the previous lofty levels that this share typically trades at.

For the past quarter (Q4-2023), the top three **detractors** from performance were the following positions held:

- Our overweight exposure to Pick n Pay
- Our underweight exposure to Gold Fields
- Our overweight exposure to Sasol

For the past full year (2023), the top three **detractors** from performance were the following positions held:

- Our overweight exposure to Pick n Pay
- Our overweight exposure to KAP Limited

- Our underweight exposure to Gold Fields

Our exposure to the Pick n Pay group impacted our fund's performance negatively over the past quarter and over the past year. This business was unfortunately severely impacted by the intense loadshedding described in the economic analysis above. In conjunction with a confluence of factors, such as the implementation of a new strategy to stem market share losses as well as a CEO leadership change late last year, the group suffered a treacherous year in 2023 and generated financial losses for the first time in their corporate history. As our investment philosophy dictates, we always let the work lead us, as we ground ourselves within our research process and remain focused on the longer-term prospects of each business that we invest in. While we could not forecast or anticipate the extent of financial impairments and management changes that transpired for the group, we expected Pick n Pay to have a challenging year, which was embedded within our investment case assumptions for the company. Given the confluence of negative developments that ultimately played out last year, the longer-term survival of the business clearly came into question by the market, as the share was indiscriminately sold off during the year. While we do concede that the market share losses have been worse than anticipated in the Pick n Pay Corporate division, we still believe that there is substantial value in the rest of the business and that the group's execution in both the Boxer offering as well as their clothing offering was diluted by the market's reaction. We are thus enduring the short-term underperformance from our exposure to this investment, as our analysis indicates that over the medium to long term, there is now substantial value in the investment case, and we believe that this value will be realised for our clients over time.

OUTLOOK

Risks and opportunities

As we enter this next year, several issues remain unresolved and unclear. While we can clearly support the fact that we are at the peak of a challenging global interest rate cycle, it is yet to be ascertained where the environment settles, how inflation evolves around the world and where interest rates ultimately recede back to. We have a clear sense that they will need to be higher than history, which implies a higher cost of capital than the investment world has become accustomed to in recent times. This poses a challenge to equity valuations, and we are incorporating these debates into our views and our process. At the same time, we see the year ahead as being fraught with economic growth challenges in many regions of the world – potentially the US, in Europe and likely in China. This means that a broad-based, typical business recovery is not expected to play out as it has in previous cycles and that there are more nuances in the current environment that we need to consider. We also need to overlay structural longer-term challenges such as climate change, the green agenda, ageing demographics, and geopolitical upheaval, all of which move slowly, but have a material influence on the environment that we are navigating.

In South Africa, we face a continuation of the same structural challenges – economic growth, underperforming state-owned entities, weak institutional state capacity, high unemployment,

and a fractured political environment. These factors are always considered and factored into our risk management process. Despite these structural impediments, a cyclical narrative also requires consideration, and we have highlighted above that any reduction in loadshedding and a lowering of interest rates will support the performance of the South African economy in the near term. In many sectors of our market, South African equities remain materially discounted relative to their global peers and the lack of foreign interest in our market further exacerbates this. This also implies that we have several investment cases that we hold within the fund that offer excellent value but will require patience to unlock over time.

This past year has offered great learnings from the confluence of challenges that transpired during the year. It has reminded us of the importance of remaining committed to our robust investment research process and anchored within our investment philosophy – of the need to constantly scrutinise and re-scrutinise the investments that we hold on behalf of our clients. Last year was characterised by extreme turbulence, material dislocations in the market and a short-term, myopic focus. When confusion prevails and a general consensus is not comfortably known or a business cycle is not playing out in its usual manner, it is difficult to stay one's course and stick to your knitting. Our experience this past year has taught us that these choppy and volatile market conditions can endure and that we will likely need to continue to navigate these dynamics to protect and grow the capital of our clients. If we are prepared to question ourselves over and over and deliver a high quality of research that has some edge and can provide us with the conviction that we need to concentrate capital in ideas, then these turbulent market conditions can offer some exceptional investment opportunities.