Portfolio Manager Quarterly Comment

Market review

Against a turbulent backdrop of 2023, the first quarter of 2024 can be described as a somewhat more 'settled context' from a macroeconomic perspective. Higher, but importantly, stable, interest rates continued to be absorbed around the globe, while inflation has continued to subside against high base effects year on year. Despite apparent declines in the overall pace of inflationary pressures across the globe, there is a lingering and uncomfortable sense that inflation risks remain poised in the system and that a return to the benign levels of inflation seen in the past 20 years, is potentially unlikely. Factors that underpin this narrative include a robust US economy that continues to defy gravity, elevated geopolitical turmoil across the world, and a fragile global supply chain that can easily be disrupted by any major geopolitical event or the ongoing trade wars simmering behind the scenes that have unravelled a synchronised global growth scenario. Nevertheless, while we've seen some emerging markets commence an interest rate cutting cycle (Brazil, Mexico, Peru, etc.), the dominant theme for the rest of this year will remain the timing of developed market interest rate cuts, which will be crucial to providing much-needed global economic relief.

The US economy has remained on its course of resilience, as employment rates remain stubbornly low, underpinning consumption and defying the elevated interest rates within their economic system. It would seem that a 'soft landing scenario' has so far been engineered by the US Federal Reserve (Fed), but there are heightened risks in the near term, as US corporates are increasingly impacted by high interest rates, banks remain in restrictive territory from a lending perspective and consumers face ongoing staggered mortgage renewals at higher interest rates. We thus remain in quite a delicate phase of anticipating an eventual fallout from the restrictive level of US monetary policy, while at the same time trying to anticipate the timing and extent of interest rate cuts expected later this year. The Fed has been consistent in its guidance of late, that they will still cut this year, but that the overall resilience of the US economy may be pushing out the timing of this, despite pleasing short-term inflation prints recently reported. As we've highlighted before, given the sheer dominance of the US economy globally, their next move always has a profound bearing on the global economic growth trajectory.

The Eurozone remains structurally challenged, but there are tentative signs of cyclical recovery in this economic region of the world and the growth narrative is shifting towards a marginally more positive stance. The European Central Bank (ECB) has indicated that they are likely to commence interest rate reductions by June this year, which was reinforced at the March meeting and in subsequent commentary from the European Governing Council. This will provide relief to the Eurozone economies and against the weak base of 2023, the economic prognosis thus improves towards the second half of 2024. On a more negative note, lingering geopolitical upheaval in Eastern Europe and the Middle East continues to impact the Eurozone at the margin and remains unresolved. The UK economy has also shown early signs of emerging from a recession and GDP growth forecasts for 2024 are muted, but positive, with potential for acceleration into 2025. Real household disposable income growth, facilitated by above-inflation wage growth, has provided much-needed support to this economy. The Bank

of England is positioned potentially as the first developed market central bank expected to cut interest rates and some analysts are calling for this to transpire as early as May this year.

Across the emerging economy landscape, lower interest rates should provide some stimulus and relief. The one challenged region remains China. The Chinese economy had a tough 2023, plagued by the factors now widely known by investors: structural over-investment and considerable property sector challenges, compounded by weak consumption demand and a tepid post-Covid recovery. At present, we are seeing some marginal improvements in the outlook for China, augmented by a deliberate, curated expansionary fiscal policy that will focus on the stimulation of specific industries that are seen as strategic to the long-term prosperity of the Chinese economy, such as the battery electric vehicle production industry and the renewable energy industry, as key examples. While still volatile, some early high friction data around electricity consumption, exports and retail data are looking more positive at this juncture. Any recovery from the global backdrop may also bode well to stimulate demand for further growth in Chinese exports, which remain an important lever within that economy. A significant bright spot in the emerging economy landscape that is worth a mention is the Indian economy, which continues to exceed consensus expectations and could grow by between 7-8% this year. The growth trajectory in India is being driven by an investor-friendly economic environment that is encouraging investment, resulting in a protracted gross fixed-capital investment expansion that is growing at double-digit rates.

On balance, while the evolution of the US economy remains a key call this year and broad-based geopolitical risks remain extremely elevated and pose a potential unwanted wildcard, we continue to see evidence of the global economy slowly turning a corner to a more positive economic growth trajectory. With interest rate cuts expected across the developed market landscape later this year, the necessary building blocks of a tentative recovery will continue to slowly fall into place.

On asset class returns, the MSCI All Country World Index (ACWI) returned 8.3% in US dollar terms, driven mainly by a P/E rerating of 5.8%. The MSCI World Index (i.e. excluding emerging markets) was up 9%, with the MSCI Emerging Markets Index up by 2.4%, with the latter driven by the performance of Taiwan (17.3%), India (6.4%) and South Korea (2.4%). The US Dollar Index strengthened by 3.1%, with developed market bonds falling by 2.1% and developed market net real estate down 1.5%. Locally, the FTSE/JSE Capped Shareholder Weighted All Share Index fell by 2.3%, with listed property returning 3.8%.

Asset Allocation

It was another notable risk-on quarter, in developed market equities, with the MSCI World Index (i.e. excluding emerging markets) returning 9%; locally, the FTSE/JSE Capped Shareholder Weighted All Share Index (Capped SWIX) was down 2.3%. The main detractor from local equities came from financials (-7.1% for the quarter), driven not least by the increase in local bond yields. In fact, the US generic 10-year bond yield rose by 32 basis points (bps) over the quarter, with the SA generic 10-year bond yield increasing by 96 bps.

Markets have had to come to terms with the reality that interest rate cuts may not arrive as early and as large as priced in the last quarter of 2023. This resulted in global bond yields increasing again, which certainly impacted local equities. In addition, US headline CPI year-

on-year (y/y) remained stubbornly above 3%, with the latest print of 3.2%, hitting home the realisation that the fight against inflation is not over. US GDP y/y also remained solid with its latest print of 3.1%, indicating that this economy is not yet slowing down.

No significant changes were made over the quarter apart from slight tactical adjustments. As we indicated last quarter, cash and bond yields remain attractive and we continue to harness these while on offer. On global equity, we still prefer SA over emerging markets over developed markets based, not least, on various valuation metrics. We remain underweight SA listed property given the attractive yields from SA bonds, at lower risk than the former. We continue to prefer SA nominal bonds over SA inflation-linked bonds.

Looking ahead, US headline and core CPI measures still remain sticky and not yet within the Fed's desired 2-3% range. This reduces the likelihood of Fed rate cuts soon and increases the probability that rates remain higher for longer. Moreover, the US labour market is still running hot, and the Fed wishes to see it cool down before potentially pivoting on rates. Globally, rising bond yields have resulted in markets migrating from TINA (there is no alternative) to 'there is now an alternative', viz. bonds. Higher bond yields have increased the opportunity cost of holding equities and reduced the opportunity cost of holding bonds; this is accentuated in SA.

Short-term interest-bearing instruments (STIBs)

The South African Reserve Bank (SARB)'s Monetary Policy Committee (MPC) kept rates unchanged over the quarter, leaving the repo rate at 8.25%. The bank's latest forecasts are that they 'still see headline inflation heading back to 4.5%. However, given extra inflation pressure, headline now reaches the target midpoint only at the end of 2025, later than previously expected. As a result, the policy rate in our baseline forecast also starts normalising later'. In relation to core inflation, 'this rise in core inflation was due to an acceleration in services, led by the medical aid component. Services inflation is now at its highest since 2019. This suggests that South Africa is joining the global trend of services, rather than goods, becoming a major source of inflation'.

Given the risk-off quarter in fixed interest, money market curves rose notably, with the three-year fixed-rate negotiable certificate of deposit (NCD) yield climbing 40 bps over the quarter to 9.18%, while the five-year fixed-rate NCD yield increased by 51 bps from 9.27% to 9.78%. Three-year floating-rate note (FRN) spreads decreased by 7.5 bps, from 97.5 bps to a yield of currently three-month JIBAR + 0.9%, with the yield on five-year FRNs also decreasing by 0.075% over the quarter from 117.5 bps to a yield of three-month JIBAR + 1.1%.

Given these dynamics, cash and bond yields remained attractive after adjusting for SA inflation. Corporate credit spreads remain tight, warranting a conservative stance on this sector based on both current pricing as well as fundamentals.

Equities

For the past quarter (1Q24), the top three contributors to performance were the following positions held, viz. our underweight exposure to Remgro: our overweight exposure to AngloGold Ashanti, and our overweight exposure to British American Tobacco. For the past full year (to 31 March 2024), the top three contributors to performance were the following positions held, viz. our underweight exposure to Sibanye-Stillwater: our overweight exposure to Curro Holdings, and our overweight exposure to Reinet.

In the last quarter the fund has had no exposure to Remgro, which weakened considerably due to a poor set of interim results to end-December. Remgro is predominantly a net asset value (NAV) investment and as a result of several of their major investments experiencing a decline in valuation for the interim period, the NAV of the group reduced by 4.6%. The major declines in valuation in the period were derived from the write-down of the Heineken Beverages and Mediclinic investments, offset slightly by a higher valuation from their OUTsurance investment. Despite these changes, the discount that Remgro traded at to its NAV as at the end of December 2023, declined to 31% from 41%, reflecting the lower NAV and a more realistic valuation for the group's investments. We prefer investing in different components of the Remgro portfolio rather than into Remgro directly and have had no exposure to the group, which contributed to performance in the quarter, as the share was particularly weak, especially post results.

From a gold perspective, our preference has been to be invested in AngloGold Ashanti. The share underperformed other gold shares last year, notwithstanding a solid operational result and improving fundamentals and so some patience has been required with this investment. There have also been some technical aspects to AngloGold's prior underperformance due to index changes, etc. In this past quarter, the share performed well as the gold price moved higher and the group continued to execute well. Our large overweight position in the share added to performance in the quarter.

Another share that has required considerable patience has been British American Tobacco. The share performed poorly in 2023, as growth shares dominated and the new CEO recalibrated earnings expectations for the group. That said, there has been relatively modest earnings downgrades and recent announcements around the group's partial sale in their associate ITC (formerly India Tobacco Company Limited) has freed up some capital to initiate a buyback. The group reported steady results in February 2024, although the market seems to have lost patience with their transformation strategy, as they pivot towards next-generation products. In any event, the share is underpinned by a divided yield that is close to 10% in GBP terms and growing. The share performed better in 1Q24 and as we have a large overweight position, this contributed to performance in the quarter.

For the year to end-March, the platinum counters have been very weak, due to a combination of weak platinum metal pricing, as demand remains subdued, while at the same time, global users of the metal destocked through 2023, as the cost of holding inventory increased and the outlook remained uncertain. We remain constructive on the outlook for the platinum counters, although we do acknowledge that we have had to be patient here. Our exposure was mainly in Anglo American Platinum and Northam Platinum, and we carried a significant underweight position in Sibanye-Stillwater. Sibanye is one of the more marginal platinum producers and faces various funding challenges, should platinum metal pricing remain around current levels.

The share price in the quarter correctly reflected these risks, materially underperforming in recent months. As we have a large underweight position, this contributed to performance over the past year.

Other shares which contributed to performance over the past year include an overweight position in Curro Holdings and Reinet. Curro is performing well due to a more cautious approach to capital allocation, while focusing on improving occupancies in the various schools which have been opened over the past few years. Incremental learners can be added with relatively little new capital, while also improving operating profit margins as revenue typically grows slightly ahead of costs while capacity is filled. The group still has significant existing facilities where capacity can be improved and so we expect this to be a multi-year opportunity. Recent results have been strong, aiding the investment case and assisting the share to perform well in the quarter. Reinet is an investment holding company whose major underlying investment, Pension Insurance Corporation Group (PICG), is benefiting from a buoyant market where pension providers are looking to outsource their requirements to PICG and other competitors. Higher interest rates in the UK have improved the outlook for growth prospects, in which PICG is actively participating. Reinet also benefited in the quarter by a slight narrowing of the discount to its sum-of-the-parts NAV, aiding performance in the quarter.

For 1Q24, the top three detractors from performance were the following positions held, viz. our overweight exposure to Anglo American Platinum, our overweight exposure to Northam Platinum, and our overweight exposure to Impala Platinum. For the past full year (to 31 March 2024), the top three detractors from performance were the following positions held, viz. our overweight exposure to Pick n Pay, our underweight exposure to Gold Fields, and our overweight exposure to Anglo American Platinum.

As referenced above, we remain constructive on the medium-term outlook for the platinum counters, although in the quarter there was continued underperformance from the sector, extending the weakness we experienced in 2023. The fund has held various overweight positions in platinum counters in the quarter and over the past 12 months, which have detracted from performance. As long-term investors we can absorb periods of underperformance, on the expectation that this should deliver good future returns. While these are never guaranteed, the current platinum metal pricing, if it remains at current depressed levels, is likely to result in a shrinking of the industry until demand returns. Pricing has been impacted by destocking and weak demand on the back of a shift to electric vehicles, as well as lacklustre jewellery demand. With various platinum metal supply challenges looming in the future, a moderating in growth expectations in electric vehicles, as well as improving Chinese demand, we expect it is only a matter of time before pricing recovers. Our overweight positions in Anglo American Platinum, Impala Platinum and Northam Platinum all detracted from performance in the quarter, while over 12 months our exposure has been more concentrated in Anglo American Platinum, which detracted from performance.

Over the past 12 months, our overweight position in Pick n Pay has also detracted from performance. The share has faced a confluence of challenges, the most significant of which are poor management of the business. The energy challenges in the economy have also had an outsized impact on the group. Decisive action is necessary to turn the business around and this has resulted in the appointment of a new CEO, who was previously the CEO of the group historically. Plans are being formulated to raise capital through a rights issue and then to separately list the successful low-end format business, Boxer, which is expected to unlock

value for shareholders. After many years of disappointments from the group there is no doubt the new management team faces a considerable task. We are of the view that post the recapitalisation, the group has a better opportunity to make decisive changes and improve, particularly the Pick n Pay corporate business. There is substantial upside to the share price should the new management team even partially improve the business, as a significant component of the value of the group is underpinned by the valuation of Boxer. As long-term investors, we remain constructive that value will be unlocked over the medium term in the Pick n Pay investment case.

Our underweight position in Gold Fields also detracted from performance over the past 12 months. Our preference has been to be overweight AngloGold within the gold sector, but underweight Gold Fields. Gold Fields has performed well notwithstanding some operational disappointments, buoyed by the rising gold price. While AngloGold has performed reasonably, it has underperformed Gold Fields. We would expect some of this relative underperformance to reverse in 2024, as some of the index challenges for AngloGold dissipate and strong operational execution continues, combined with a more attractive valuation.

SIM's equities strategy

Overall, we expect the market to remain susceptible to further shocks. That said, significant value remains in our market and timing the market has always proven difficult. We value our companies through the cycle based on a normalised operating environment. What a 'normalised environment' now is, is being called into question. We face the risk locally (and possibly globally), of lower real returns in the future, and yet there will always be opportunities for patient long-term investors. Value, as a style, has been out of favour and we expect it to be back in vogue in a generally challenged global environment. As always, we will endeavour to look for the best opportunities using our pragmatic value, bottom-up research capabilities, while also considering the many and varied risks out there.

Bonds

The Fed kept interest rates unchanged at their March meeting as economic activity remained resilient and inflation sticky. Chairman Powell emphasised the Fed remains fully committed to bringing inflation down to its 2% target. For 2024, they kept their forecast of the number of cuts at a maximum of three. Accordingly, the market's expectations for cuts are also down to no more than three in 2024 from six to seven cuts at the end of 2023. Powell said that the committee will continue its data-dependent approach and evaluate data and rate hike decisions on a meeting-by-meeting basis.

Locally, the MPC kept the repo rate unchanged at their March meeting with a unanimous vote just like in January. The overall tenor of the meeting was cautious as they continued to assess risks to the inflation outlook as tilted to the upside. They upwardly revised their CPI inflation forecasts and now expect CPI inflation returning to the mid-point about one year later in 4Q25.

4Q23 SA GDP rose by a mere 0.1%, lower than the expected 0.3%, implying that the SA economy narrowly avoided a recession. Six out of 10 industries contributed to this growth, with

the transport sector contributing the most and expanding by 2.9%. Agriculture and trade experienced steep declines of 9.7% and 2.9%, respectively.

The 4Q23 SA unemployment rate increased to 32.1% from 31.9% in 3Q23, as the number of unemployed persons increased by 46K to 7.9 million. At the same time employment fell by 22K to 16.7 million, after rising for eight straight quarters, and the labour force rose by 25K to 24.6 million.

The most important take from the budget is National Treasury (NT)'s decision to draw down a portion of the SARB's Gold and Foreign Exchange Contingency Reserve Account (GFECRA), utilising R150 billion over the next three fiscal years, to help finance the borrowing requirement.

Fitch ratings affirmed SA's sovereign credit rating at BB- with a stable outlook. They noted that the credit rating is constrained by weak economic growth, large inequality, rising public debt and a slow projected path of fiscal consolidation. They forecast GDP growth of 0.9% in 2024 and 1.3% in 2025 amid electricity supply shortages and logistics problems. The International Monetary Fund upgraded its global growth forecast for 2024 slightly by 0.2% to 3.1%, but lowered its SA growth forecast significantly by 0.8% to 1%.

Headline CPI increased to 5.6% y/y in February from 5.1% y/y in December. Core CPI rose from 4.5% y/y to 5% y/y. PPI inflation rose from 4% y/y to 4.5% y/y. The rand weakened from 18.26 in December to 18.88 in March vs the US dollar. The 10-year SA government bond yield weakened from 11.05% in December to 12.02% in March. The trade balance increased slightly from a surplus of R13.9 billion in December to a surplus of R14 billion in February.

For the quarter the All Bond Index was down 1.8%, the inflation-linked bond down 0.4% and the Alexander Forbes Short-Term Fixed-Interest (SteFI) Index up 2%. The major driver of global bond yields has been the 69-bps reduction in the US generic 10-year bond.

International

The Fed's rhetoric has changed to a relatively more hawkish stance than the dovish one embraced by markets in 4Q23. Added to this, the federal funds rate was kept unchanged at 5.25-5.50% and expectations are for it to remain so at the upcoming Fed meeting. The Bank of England also kept its rate unchanged at 5.25%, on the back of improved UK CPI prints. In particular, US inflation is not yet within the Fed's required range, and the market has had to adjust its expectation of rate cuts.

Offshore equities have continued their rally in 1Q24, but it has increased their valuation levels. We continue our cautious stance on this asset class. Offshore US bond yields have increased, maintaining the attractiveness of this asset class. With the federal funds rate stable, US cash also still offers value.

As we mentioned last quarter, 2024 is certainly a busy year vis-à-vis country elections, with most likely the most important of these being that of the US. Trump has now been elected as the Republican electoral candidate, and it keeps the US election later this year squarely in focus. Elections will also be taking place in our country, Germany and India, among others. We watch these developments closely.

On asset class returns, the MSCI ACWI returned 8.3% in US dollar terms, driven mainly by a P/E rerating of 5.8%. The MSCI World Index (i.e. excluding emerging markets) was up 9%, with the MSCI Emerging Markets Index up by 2.4%, with the latter driven by the performance of Taiwan (17.3%), India (6.4%) and South Korea (2.4%). The US Dollar Index strengthened by 3.1%, with developed market bonds falling by 2.1% and developed market net real estate down 1.5%.