# Portfolio Manager Quarterly Comment

## ECONOMIC REVIEW

### Global Backdrop

**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 a 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 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.

## Domestic Backdrop

**The first quarter of 2024 has brought limited respite to the South African economy.** Perhaps the only potential ‘green shoot’ underway in the domestic landscape is the lower levels of loadshedding that have clearly improved from the levels seen this time last year. Beyond this, the short-term trajectory for ‘SA Inc’ remains extremely challenged, as the economy struggles to digest and navigate a highly restrictive interest rate level that is not expected to fall much this year, given the global pressures of more benign cuts in resilient economic regions like the US. This backdrop, in conjunction with the weak rand, rising risks of another round of food inflation due to poor crop production weather conditions and generally higher than expected and sticky domestic inflationary pressures across the board, has left the South African Reserve Bank (SARB) with little room to manoeuvre.

This dynamic is squeezing the South African economy, which is desperate for growth stimulus, given the structurally challenged growth outlook that plagues us domestically. With a crucial

national election approaching in May, political parties are preoccupied with election campaigning and thus we remain in a state of limbo until some direction is evident here. International investor interest in the South African investment case remains on hold until this is finalised.

Many questions are circulating around the potential outcome of these upcoming elections. While it is a widely held view that the ruling ANC party is likely to lose considerable ground at the polls, their final level of voter support is very difficult to predict. Should they fall materially below their current dominant level, the need for a coalition partner will become prominent and there are issues with all of the likely suitors; while, ideologically, the ANC and EFF are very far apart, their potential tie-up poses an ominous risk to the SA economy. At the same time, an ANC-DA coalition could be seen as more market friendly, but ultimately there are very plausible questions about the willingness of the polarised ANC and DA to work productively together. Another permutation is a potential ANC-IFP collaboration, but that doesn't hold much promise for overall economic prospects for service delivery and a failing municipal infrastructure in South Africa. Any threats to the sustainability of the reform agenda within South Africa are problematic. The introduction of the left field MK Party, led by ex-president Jacob Zuma, has added additional confusion and volatility to an already highly charged election environment, and some concerns linger around the potential for politically motivated civil unrest and violence, which we hope is a scenario that is ultimately avoided.

The next few months will be pivotal to the outlook for the South African investment case, so we need to get through this time before the outlook potentially improves towards the end of the year, as interest rates start to fall and provide some measure of desperately needed stimulus to the domestic economy.

# MARKET REVIEW

## Global market performance

The rally seen in global markets in the final quarter of last year continued into the first quarter of 2024. **The MSCI World Index generated a total return of 9% in Q1-2024** (in US dollar terms). January, February and March were all positive in terms of returns generated, as markets continued to pre-empt a softer landing scenario in the US and a commencement of interest rate reductions during the course of this year across developed markets globally.

When analysing the **MSCI World Index regional constituents**, the US market continued its ascent, rallying by a further 10.4% in the first quarter of 2024. This drove the North American region's total return of 10.1% for the past quarter. This was followed by the Pacific region within the MSCI categorisation, which generated a total return of 6.8% year-to-date as of 31 March 2024. This sub-regional performance was buoyed by a strong rally in the Japanese constituent equity market, which was up 11.2% in US dollars for the quarter. Within the Pacific region, Hong Kong and New Zealand both retraced and were down 11.7% and 3.7% respectively year-to-date. The European sub-region was also positive, generating a total return in US dollars of 5.4% in Q1-2024. On balance, the sentiment was positive and broad-

based across the developed market complex, with most markets positive for the first quarter of 2024.

From an **emerging market perspective**, performance was more mixed, lagging developed market returns. **The MSCI Emerging Markets Index generated a total return of 2.4% in Q1-2024** in US dollar terms. This was broken down into the following regional constituent performances: Asia: +3.4%; EMEA (Eastern Europe, Middle East, Africa): +1.1% and Latin America: -3.9%. As a sub-region within the MSCI Emerging Markets Index, the **South African market experienced a dismal quarter, generating a negative total return in US dollars of 6.7%,** reflecting the ongoing negative sentiment towards South Africa as an equity investment choice for global investors.

## Domestic market performance

**The first quarter of 2024 was disappointing for South African investors.** The FTSE/JSE Shareholder Weighted All Share Index (SWIX) generated a negative total return (with dividends reinvested) of 2.2% for the quarter. The FTSE/JSE Capped SWIX Index generated a negative total return of 2.3% over the same period.

With respect to the **sectoral breakdown of this performance**, the strongest performance came from the Industrial Index, which added 0.6% in Q1-2024. In contrast, both resources and financials were negative. The Resources Index fell by 1.6% for the quarter but experienced a sharp rally in March of 12.8%, after two months of declining returns in January and February this year. The Financial Index suffered a difficult first quarter, generating a total negative return of 6.1% for the three months ended 31 March 2024. Listed property shares continued to perform well this past quarter and we saw the FTSE/JSE SA Listed Property Index (SAPY) generating a positive total return of 3.8% for Q1-2024.

The best performing JSE-classified **economic sub-sectors** this past quarter were Industrial and Materials (+21.1%), Electronic and Electrical (+14.8%), Personal Goods (+12.5%), Finance and Credit Services (+9.5%) and then Tobacco (+9.2%). The weakest sub-sectors included the Alternative Energy sub-sector (-53.7%), Oil, Gas and Coal (-18.6%), Chemicals (-18.6%), Telecommunication Service Providers (-11%) and Investment Banking and Brokerage (-10.5%).

The top three best performing shares year-to-date as of 31 March 2024 were MultiChoice (+40.2%), Harmony (+32%) and AngloGold Ashanti (+20.6%). The three worst performing shares for the first quarter of 2024 were Montauk Renewables (-53.7%), Spar (-25%) and Remgro (-24.8%).

## PORTFOLIO REVIEW

The SIM Top Choice Equity Unit Trust fund has had a good start to 2024 generating a positive return of 0.5% (net of fees), outperforming its benchmark, the FTSE/JSE Shareholder

Weighted All Share Index (SWIX), which generated a negative return of 2.2% for Q1-2024. For the rolling 12-month period ending 31 March 2024, the SIM Top Choice Equity Unit Trust returned a negative 2% (net of fees), which is below its benchmark's positive return of 2.7% over the same period. While the performance relative to benchmark over one year is disappointing, investors need to be mindful of investing for the long term. Over three years, the SIM Top Choice Equity Fund is behind its benchmark, generating a positive annualised return of 3.8% per annum (net of fees) for the three years ending 31 March 2024, versus the SWIX index return of 5.3% over the same period. **Importantly, over five years, the SIM Top Choice Equity Fund has generated a return that is comfortably outperforming its benchmark: up 8.8% per annum (net of fees), versus the SWIX's return of 7% per annum for the five years ending 31 March 2024.**

**For the past quarter (Q1-2024)**, the top three **contributors** to performance were the following positions held:

- Our overweight exposure to AngloGold Ashanti
- Our underweight exposure to MTN Group
- Our underweight exposure to Standard Bank

We entered the year carrying an overweight position in AngloGold and we also added to this position as we believed there were reasons to be positive on the direction of the gold price. There are a few factors that are supportive of the gold price, and they include the inverse correlation between real rates and gold prices and as expectations are for the US to begin to cut rates, this should be supportive of the gold price as this reduces the carrying cost of gold. Central banks are likely to be cutting rates aggressively if their economy is in recession, which may still play out if we don't achieve the soft landing in the US currently expected by markets. In this scenario, we could also see US dollar weakness, and this will be supportive of the gold price and broader commodity prices. Geopolitical tensions are elevated and likely to remain so and this does drive demand for gold as a 'safe-haven' asset. This is mainly because holding gold provides some diversification benefits in a portfolio as it tends to not have strong correlations to other assets. We have also continued to see many central banks continuing to buy gold and this perhaps reflects their concerns around geopolitics but also elevated government debt levels across the globe. As a concentrated fund we took our gold exposure through AngloGold as we saw it offering the most upside to our valuation.

MTN contributed positively to performance in the first quarter of 2024 as we decided to exit our position early in the quarter after the share had staged a recovery through to the end of 2023, but we remained cautious given the weakness we were seeing in the Nigerian naira. The devaluation of the naira results in a rebasing of earnings for MTN, which will likely recover when pricing can be increased, but this is dependent on regulatory approval, or volumes significantly increasing in Nigeria, to recover margins which are eroded by inflation. This margin recovery process is likely to take time with risks to the downside and we are only likely to see the full impact of the naira devaluation reflect in the first-half results for 2024. In line with our philosophy and process we continually revisit the investment case especially as we continue to see volatility in the MTN share price. MTN's investment case continues to be supported by its opportunity for growth in fintech, continued growth in data demand across its operations, and corporate actions, which are resulting in MTN exiting some countries. MTN, however, faces uncertainty given tough macroeconomic conditions across many of the

countries in which it operates, in particular Nigeria, its largest operation, and for this reason we have remained on the sidelines for now.

We entered the year with market expectations of rate cuts starting as early as March for the Fed and this drove expectations of rate cuts for our own market. These more positive expectations around the rate cutting cycle drove interest rate-sensitive stocks higher towards the end of last year, however, as these expectations have moderated the rate-sensitive stocks have underperformed. The SA banks – which were expected to benefit the most from a rate cutting cycle in terms of better loan growth, improving credit losses and having hedging around their interest rate positions, so that the negative impacts of the endowment effect are managed as rates come off – have all had a difficult start to the year in terms of share price performance. Standard Bank was one of those and although it reported FY23 results in the quarter that reflect a strong earnings performance, the dividend growth was below that of earnings and possibly disappointed expectations. The results also set a very high base for earnings growth and there could be some concern around the sustainability of earnings given the very strong trading profits and the results of its Rest of Africa operations, which were up significantly. We have chosen to take our banking exposure through FirstRand, which offers similar upside but is a quality big four bank, Capitec, which has outperformed the big four in the first quarter as it offers a different growth profile, and Absa, which we see offering the most upside.

**For the past quarter (Q1-2024)**, the top three **detractors** from performance were the following positions held:

- Our overweight exposure to Northam Platinum
- Our underweight exposure to Gold Fields
- Our overweight exposure to Absa

Absa continued to underperform in the first quarter, following on from the sharp correction we saw due to the trading statement release in early December, which disappointed relative to expectations. The FY23 results, released in the quarter, further disappointed the market with issues ranging from hedging losses, naira devaluation, BEE deal impact, further Ghana losses and hyperinflation accounting. Unfortunately, some of these issues carry forward into the results expectations for H1-FY24 and this also is negatively weighing on sentiment. Absa was also exposed to the same dynamics as mentioned above in our commentary around Standard Bank if we reflect on the pressure seen by interest rate-sensitive stocks in the first quarter. We continue to expect Absa's ROE beyond 2024 to continue to expand as earnings growth crystalises through regained market share in SA and a growing African franchise. Absa is trading on very attractive valuation multiples, underpinned by a high dividend yield. In the financial sector, it is still one of the larger-cap banks where we still see significant valuation upside currently and therefore remain overweight.

We are not carrying our gold exposure through Gold Fields given the elevated execution risk at its Salares Norte project and risks for further deterioration in its operational results across core assets in the portfolio. The FY23 results released in the quarter also disappointed on cost guidance relative to peers and this remains a concern going forward. However, as the gold price tracked higher during the quarter, which drove the positive share price performance, our underweight position dragged on performance, but this should be seen in the context of the sizeable overweight position we have carried in AngloGold.

We commenced the year with a slight overweight exposure to platinum group metal (PGM) shares in the fund, however, we pared back this exposure due to concerns around the challenges facing the industry, such as falling PGM commodity prices as well as concerns that the sector was being slow to take capacity out. We continue to assess the risks around the longer-term potential structural demand for PGMs, considering the rise in the production of electric vehicles across the globe, although this does seem to be moderating, and we will repeatedly revisit the investment case for PGMs and challenge our own narratives throughout the course of the year ahead, focusing on the integrity of our fundamental research process, which always leads our decision-making. Our exposure to the sector is concentrated in Northam Platinum due to their long-term prospects and the fact that it has well-positioned mining resources that can withstand the current malaise in PGM prices (cost curve positioning, scale of operations, etc.). Despite the fall in the share price in the first half of the quarter, our adherence to a medium to long-term focus that seeks to filter out short-term noise assisted us to have the conviction to maintain our position in the share, which began to recover in March, and this has continued into the second quarter.

## Outlook – Risks and Opportunities

The start of 2024 continues with as much uncertainty as we experienced in 2023. That said, growth expectations continued to improve through the course of 2023, particularly for the US, as it now looks likely to experience a soft landing, underpinned by pervasive low unemployment and robust consumption demand. In our view, this disguises various imbalances that endure. The US has been pulling away from Europe from an economic growth perspective, as energy and war challenges broaden in that region. Europe was already challenged economically prior to the arrival of these new challenges, and with these enduring for much longer than expected, there appears to be some permanency to the dislocation. This is made worse by the US's role as the global protector no longer guaranteed, and likely to worsen, should Trump be re-elected as president in the US later in the year. The structural challenges in China have yet to be resolved, although the country has pivoted towards new areas of focus, without the traditional economic stimulation measures – i.e. large-scale government funding towards infrastructure, etc. This is perhaps a recognition that historic stimulation has not always achieved the desired results, and excess capacity already exists in infrastructure, with elevated debt levels also remaining problematic. China looks set to export deflation to the world, as interest rates there look low, and they've been stimulating/cutting rates and allowing the Chinese currency to devalue slightly relative to the dollar.

The challenges in Europe look likely to perpetuate for longer and it is perhaps surprising that the European Central Bank has not yet cut rates in the face of declining inflation and weak economic growth. German manufacturing looks challenged in the long term due to an over-reliance on cheap and easily accessible energy. The US has been gradually removing support for Europe, necessitating defence budgets increasing and diverting income that could be more productively spent elsewhere. War in the Middle East and Ukraine perpetuates, creating issues down the line, which, combined with transport challenges in the Red Sea, are likely to slow economic growth in the region. Markets have taken comfort from declining inflation and low unemployment, combined with expectations for interest rate cuts later this year; and yet there is some uncertainty as to where inflation and interest rates will ultimately settle. It may

be plausible to expect that both variables are expected to be above-trend and remain higher than was predicted a year ago. There is a risk that with elevated government debt levels and increased challenges to economic growth globally, we enter a period of structurally lower real growth for longer. From a stock market perspective there has been some concentration of winners around the AI tech theme, particularly in the US. Expectations are high and valuations are elevated. That makes us inherently cautious when considering the global equity market backdrop.

In South Africa, the structural challenges also perpetuate. The broader global backdrop is challenging our growth, while we still require a resolution to various internal challenges. The looming national election is also likely to bring some caution to our market, as political disruptions are likely. There remains some uncertainty as to whether the ANC can maintain its majority voting support and should they fall below the 50% threshold, what that means for managing the economy going forward. Coalition politics has not been very effective at a provincial level and inevitably there will probably need to be some compromise across various political parties, potentially slowing policy changes and challenging economic growth. Making much-needed policy changes economically has been difficult with a majority ANC leadership but may well become more problematic in a compromised political outcome. There is also little room to move fiscally, as interest rates have remained elevated and debt levels high. Recent movements in the bond market, combined with comments from the SARB, have led to interest rate expectations moving higher, notwithstanding expectations that there will still be some cuts in 2024. Foreign investment remains on the sideline, as liquidity challenges generally within emerging markets look likely to perpetuate in an environment of capital constraints globally and tightening liquidity.

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.