Wood for the Trees

April 2024

Global equity markets have been on a tear since October as investors reentered global stock markets ahead of expectations of imminent rate cuts from the major central banks. That narrative changed in April as stronger-than-expected economic data and stickier inflation reignited "the higher for longer" narrative.

Most global markets gave back some of their year-to-date (YTD) gains in April. April was a tough month for stocks across pretty much every geography. 2-year Treasury yields – which reflect the market's view of the future Fed rate policy – rose throughout the month, breaching 5% for the first time since it broke through similar levels last August. As was the case in 2023, this move was an equity rally killer.

The S&P 500 finished down 4.2% in April; its worst pull back since September 2023. Most of Europe followed suit. There were a few bright spots, with the UK and South Africa markets beating the trend and finishing the month up, 1.4% and 2.1%, respectively.

The volatility was primarily caused by strong economic data beating expectations, and once again proving that the US economy remains resilient and on solid footing. April started off with the US ISM Manufacturing PMI moving above 50 for the first time since October 2022. March Retails Sales showed an increase of 1.1% M/M, almost 3 times the 0.4% expectations, and 4% Y/Y. Non-Farm Payroll data for March further supported the strong momentum in the US economy; showing 315k jobs added, resulting in the unemployment rate falling to 3.8%. April's economic data culminated in 1Q GDP numbers showing little signs of a slowdown, with "Final Sales to Private Domestic Purchases" increasing by 3.1% Y/Y; the third consecutive quarter above 3%.

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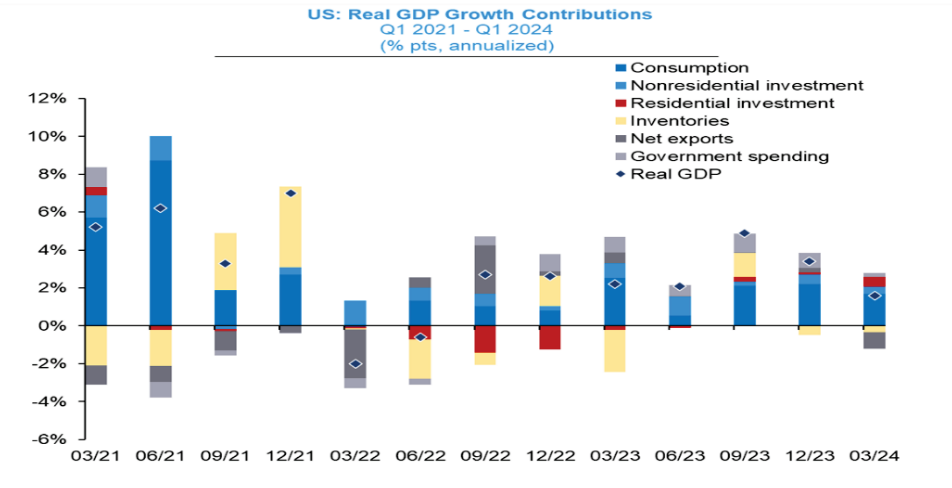
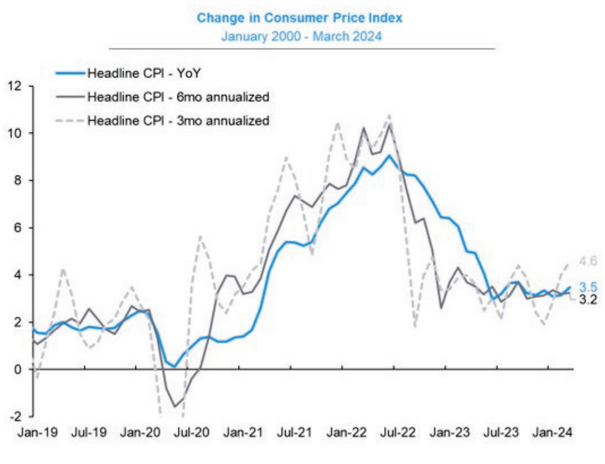
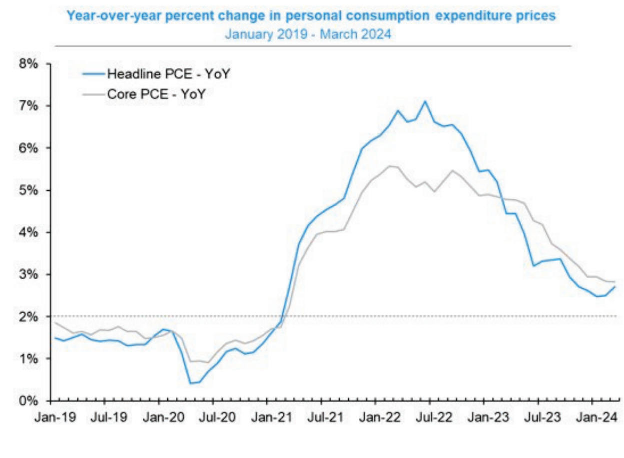


Source: BEA; EY-Parthenon

April's strong economic data was supplemented by the latest inflation figures showing clear evidence that the Fed's job is not over as prices remain sticky. March CPI data showed a slight pick-up in inflation from February, coming in at 3.5% Y/Y versus expectations of 3.4% and February's figure of 3.2%. Core PCE inflation, the Fed's preferred measure, corroborated the sticky nature of prices, also coming in above expectations at 2.8%.

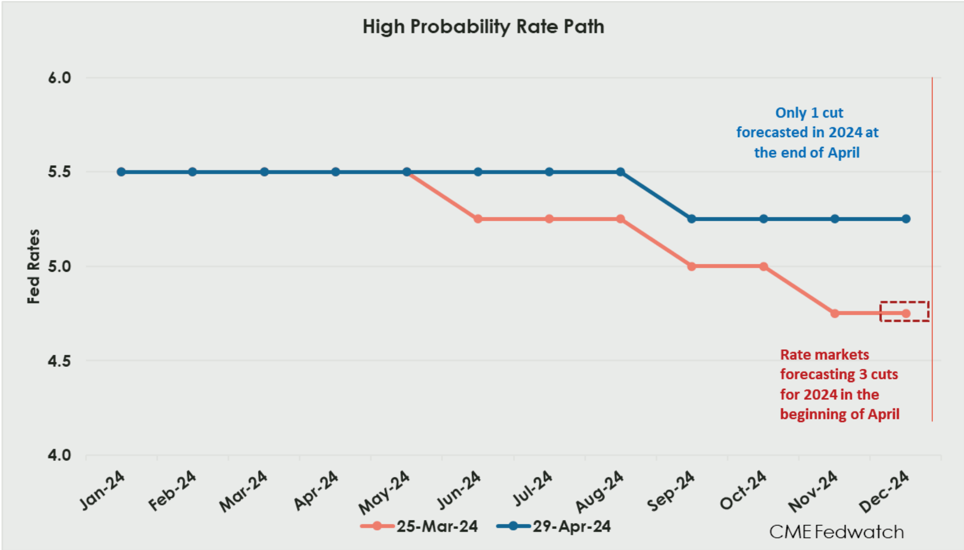


Source: BLS; EY-Parthenon



Source: BEA; EY-Parthenon

Given the stronger-than-expected data on all fronts, rates markets were quick to remove 2 of the 3 expected cuts that were previously priced in prior to April. With some outliers suggesting a rate hike may be back on the cards.



Heading into the Fed meeting on May the 1st, all eyes were on Chairman Powell to try get a sense of what the FOMC were thinking. As expected, they held rates at 5.25-5.5%. Powell noted that "*the path of inflation was proving more persistent than expected*" and "*rates many need to be held at current levels for longer*". Chairman Powell did however, squash concerns that there could be a potential hike in the short term; causing equity markets to respond positively.

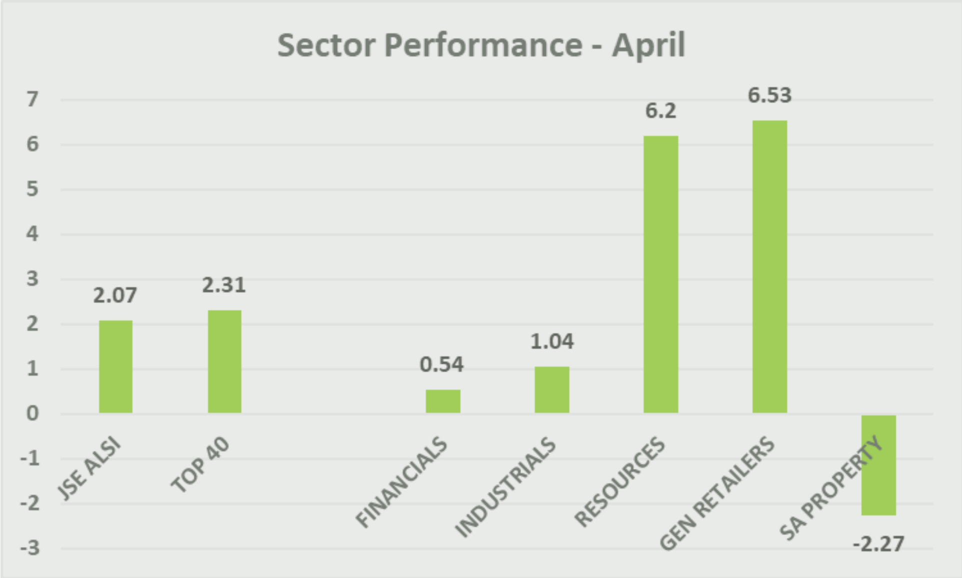
As we stand currently the market is expecting only 1 cut this year, and for that cut to occur in September. As per usual, any move remains data dependent.

Outside of the macro-economic front, we are almost through 1Q24 earnings season in the US. For the most part, earnings have been coming in ahead of expectations. With 80% of S&P 500 companies having reported, 77% have beaten expectations (above the 10-year average). The average beat is about 7.5%. As it sits, the average earnings growth for 1Q24 will be 5%. Representing the highest Y/Y earnings growth since 2Q22. Looking ahead to FY24, earnings growth is expected to be around 11%.

We have started to hear some companies mention the fact that the low-end US consumer is beginning to show some signs of pressure (Pepsi, Nestle, McDonalds, Coke). Liza will go into more details on the earnings front later in the newsletter.

On the local front, sentiment is being driven by election outcome expectations. Sentiment among the "man on the street" seems to be quite negative going by some conversations I've had, driven by concerns the ANC vote will slip under 40% requiring them to partner with the EFF. A situation that many political analysts suggest is unlikely. For the most part, experts forecast the ANC getting between 43-47% of the vote and bringing the IFP in as a minor coalition party. Under this scenario the status quo remains. If this is the case, we believe that the market has the potential to rally given the negative sentiment being priced into valuations currently. Mandy provides a detailed election update.

Despite the increasing media storm around the upcoming elections, the SA equity markets performed very well in April with strength being broad-based. As we approached the end of April, BHP's bid for Anglos gave the JSE an additional boast.



Investors have generally been sitting on the sidelines when it comes to putting new money to work in the local equity market, as they wait and see the results from local elections. Khonie lays out why we continue to like local equities and would use this current uncertainty as an opportunity to accumulate positions.

International Section

By the Numbers

Most major market indices pulled back in April as sticky inflation and robust economic growth in the U.S. supported the narrative of "higher-for-longer". This weighed on investor sentiment with the market reducing the potential number of rate cuts for this year from 3 to 1.

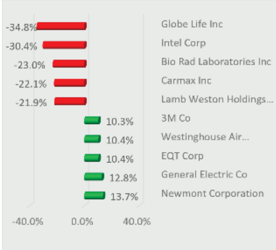
S&P 500 (-4.2%, +6.1% YTD) and Nasdaq (-4.6%, +4.6% YTD) were down for the month, but are still up year-to-date. Over half of S&P 500 companies reported 1Q24 earnings in April, with aggregate earnings up 6% year-over-year; well ahead of expectations. Some of the big movers include Alphabet (+8.3%) who beat estimates with strong performance in Search, YouTube, and Cloud. The company also announced its first ever quarterly dividend and a $70bn buyback program. On the other hand, Meta (-12.7%) issued disappointing revenue guidance and heavy AI spend that shocked investors. Intel (-30.4%) also dropped on weaker guidance and disappointing progress in AI.

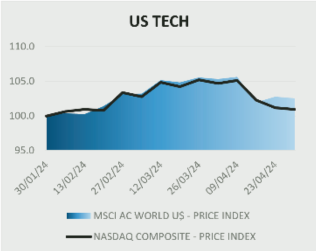
In Europe and the UK, easing inflation and slower economic growth reinforced that the ECB & BoE may cut rates before the Fed. Anglo American (+35.9%) jumped after BHP's takeover offer for £31bn. Nordic Semiconductor (+47.1%) rallied after the chip maker published guidance above expectations on stronger demand and noting inventory issues being largely over. HSBC (+12.4%) moved higher after reporting solid results as well as a surprise retirement announcement from the CEO

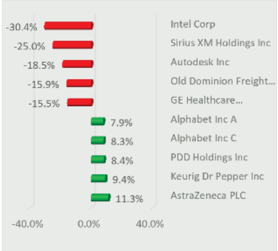
In China, momentum has shifted as sentiment improves and regulators announce support-measures. Shares of real estate developers moved higher on positive regulation changes and additional support measures that were announced at the end of the month (China Overseas Land +36.3%). Casino & Gaming companies Sands China (-13.9%) and Galaxy Entertainment (-10.4%) moved lower after analysts downgraded industry names as revenues drift lower and shares lack positive catalysts.

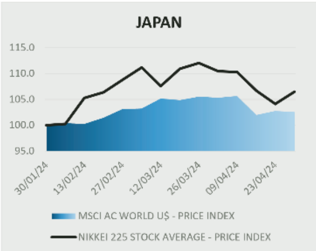
LAST QUARTER IN USD

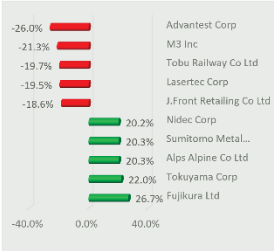
1 MONTH UPS AND DOWNS

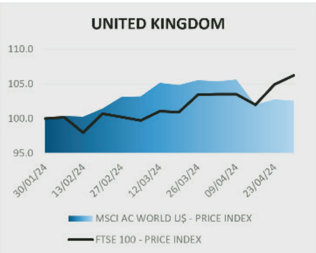


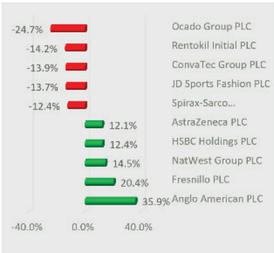


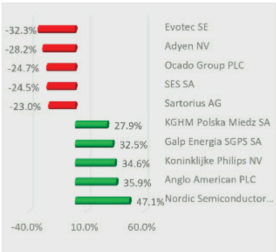


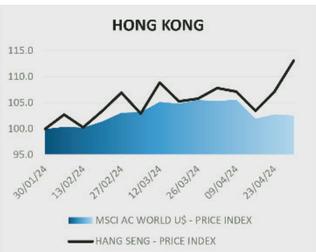


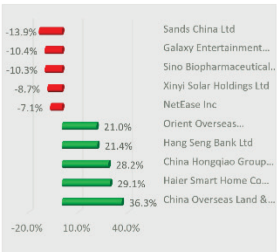


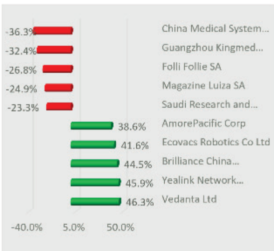












Q1 Offshore Earnings Wrap

The first quarter of 2024 marked a stellar start to the year. Equity indices were supported by strong economic data, potential soft landing, and optimism around AI. Consequently, investors were eager to delve into financial performance and management insights this earnings season.

Tech Sector – AI Continues to Drive Strong Growth

Results and comments underscored robust demand for AI-related products and services. Notably, **Alphabet**, the parent of Google, rallied over 10% after their results blew past expectations. Total revenues were up 15%, driven by Cloud (+28%), Search (+14%) and YouTube (+21%) – all showing an acceleration in growth. Additionally, Alphabet authorized their first-ever quarterly dividend, plus a $70 billion share buyback program. Alphabet and its search engine, Google, have a treasure chest of data for AI and this quarter's results show that AI investment is starting to translate into growth.

Microsoft shares moved higher after reporting better-than-expected results; driven by strong accelerating cloud performance (+21%). Microsoft has been at the forefront of the AI revolution with ChatGPT. CEO Satya Nadella emphasized the importance of cloud computing and AI for the company's future growth and highlighted investments in these areas.

Analysts are estimating that big tech companies will ramp up AI-related investments, with capital expenditure (capex) reaching over $200 billion from Alphabet ($50bn), Microsoft ($52bn), Amazon ($66bn), and Meta ($37bn). To put this into perspective, this equates to over R3.7 trillion in 2024 alone.

However, this ramp up in capex wasn't well received by Meta investors, with shares dropping 11% after raising their capex guidance for the full year to $35-40 billion. The difference in market reaction is due to Meta's less clear pathway to monetize AI products, and investors are cognizant of the potential lag between investment and return.

TSMC, a producer of semiconductor chips, is at the center of this ramp up in capex. CEO Wei solidified this on the earnings call with analysts; "TSMC is a key enabler of AI applications". Accordingly, shares continue to march higher showcasing an impressive year-to-date performance of +36%. The company beat expectations, with revenues up 16.5%, and full-year revenue guidance accelerating to low-to-mid 20% growth. Management noted on the earnings call that demand for AI is very strong and the company is still not meeting customer demand.

Apple rallied 6% after reporting stronger-than-expected results and announcing a $110 billion share buyback program. A big topic of conversation for Apple, has been around their business in China. However, CEO Timothy Cook put investors at ease noting iPhone sales in Mainland China are still growing and maintain a good view of the Chinese market over the long-term. Apple will hold its annual developer conference in June, where it is expected to make several AI-related announcements.

Banks – Higher Net Interest Income & Increased Capital Markets Activity

Big banks reported solid results this quarter, with an uptick in Net Interest Income (income from lending minus payments on deposits), good momentum in investment banking, and no credit quality fears. **JP Morgan**'s CEO, Jamie Dimon, reiterated the strength in the economy, but expressed concern over sticky inflation and unsettling geopolitics.

On the investment banking side, **Goldman Sachs**, traded higher after boasting strong results that beat both top- and bottom-line. Revenue grew 16% for the quarter, with EPS growing +32% year-over-year. CEO David Solomon confirmed “a reopening of the capital markets” and a growth in risk appetite. The CEO also noted how AI is a big topic coming up in nearly every conversation with clients. Management believes that financing for AI investments will be a tailwind for the company.

UK and European banks have shown strong performance this year. Notably, **ING Bank** (+18% YTD) who continues to return large sums of capital. The company announced another €2.5 billion share buyback program over the next 3 months. ING is one of the best capital return stories in the industry, with a potential €12.5 billion still to be distributed, on top of the €10 billion already distributed to shareholders. In total, this equates to approximately 40% of their market cap.

Another large capital distributor is **HSBC**, who traded higher after announcing a $3 billon share buyback program over the next 3 months. They also announced a special dividend of $0.21 after the completed sale of their Canada business. A surprise retirement was announced by the CEO, Noel Quinn, who has been in the position for nearly 5 years.

Consumer – Volume Growth & Healthy Consumer Spending

In consumer staples, we have started to see a moderation in pricing with volumes recovering and returning to growth. **Unilever**’s results echoed this, with revenues up 4.4% – price +2.2%, volume +2.2%. Management expects a higher contribution from volume growth as the year progresses and the consumer remains in good health. Companies such as Nestle, Coca-Cola, PepsiCo and McDonalds noted that the lower-income consumers are taking strain, but better-off consumers continue to spend.

Visa also offered insights on the consumer, stating that spending remains stable (+8%), and they continue to see strong international travel volumes (+16%). Strong US economic data continues to be fueled by resilient consumer spending.

Energy – Strong Capital Discipline

The energy sector has seen strong performance year-to-date, on the back of higher oil prices as tension in the Middle East has supported the price of oil. **Shell** is a posterchild of this movement; up 12.5% YTD.

Shell delivered strong results for the quarter, with adjusted earnings beating expectations by 10% and cash flow from operations beating by 17% – showing strong cash conversion. Management announced a share buyback of $3.5 billon over the next 3 months, leading to 41% shareholder distribution which is ahead of their policy (30-40% of cash flow from operations).

We remain bullish on the price of oil on a fundamental basis and have high conviction in resource scarcity names such as Shell. A unique combination of supply constraints and years of underinvestment has resulted in favourable multi-year outlook.

Local Section

By the Numbers

The momentum on the JSE carried through to April as the ALSI rose by 2.07%. The gains were broad-based, led by the retailers (+6.53%), followed by resources (+6.20%), Industrials (+1.04%) and then financials (+0.54%). Property (-2.27%) on the other hand, was down for the month.

Anglo American rallied +34.5%, driving the gains in resources, after the company confirmed on 25 April that it had received a non-binding all-share offer from BHP Group. However, the offer was rejected the next day, with the company citing that BHP's proposal significantly undervalued it. On the flip side, Amplats (-15.0%) sold off, as the announcement stated the company would be spun off from Anglo as part of the deal with BHP.

African rainbow minerals (+21.7%) also rallied after the company announced an agreement to acquire 15% of Surge Copper Corp on a private placement basis for C$3.8 million. South32 (+18%), Northam (+15.9%) and Tharisa (13.6%) supported the gains, while Montauk (-14.6%), Omnia (-5.6%) and Sasol (-5.6%) were weaker for the month.

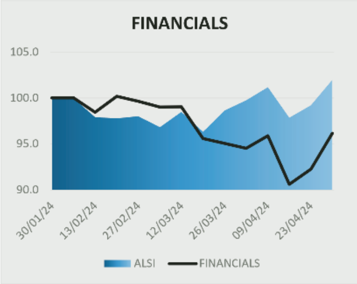
The gain in retailers this month was from a decent run from Cashbuild (+10.3%) and RCL Foods (+10.4%), while Pepkor (-5.4%), Italtile (-5.1%) and Motus (-3.3%) detracted from this performance.

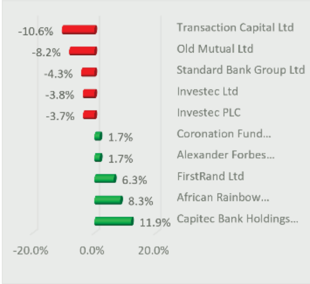
Barloword (+41.7%) was the best performer on the JSE in April and drove the performance in Industrials, following the release of a cautionary announcement stating that it had entered discussions, which, if successfully concluded, may have a material effect on its share price. On the other hand, Telkom fell 20.2% and was the worst performer in April. Metair (-16.5%), Blur Label (-7.7%) and Vodacom (-6.9%) were also down for the month.

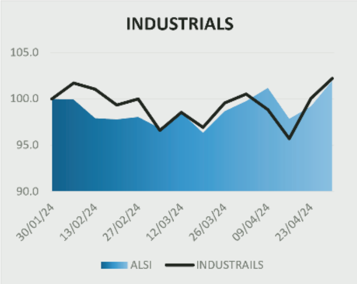
Within the financial sector, Capitec gained 11.9% in April following the release of better-than-expected FY24 results. African Rainbow Capital (+8.3%) and Firstrand (+6.3%) also saw decent gains this month. Transaction capital (-10.6%), Old mutual (-8.2%) and Standard Bank (-4.3%) detracted from this performance.

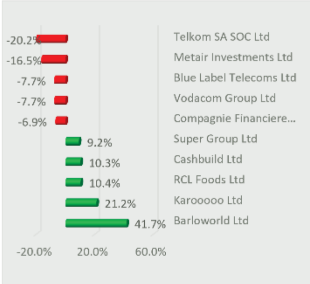
While property lagged in April, the sector is up YTD (+1.5%). Emira recorded a solid gain of 11.9% after the company announced that it and its wholly owned subsidiaries have agreed to dispose of 13 predominantly industrial and office properties situated in the Western Cape to Spear for R1.15bn. SA Corp (+2.0%) and Vukile (+1.3%) were also up. The detractors this month were Burstone (-10.2%), Attacq (-6.5%), Fortress (-6.5%) and Resilient (-5.0%).

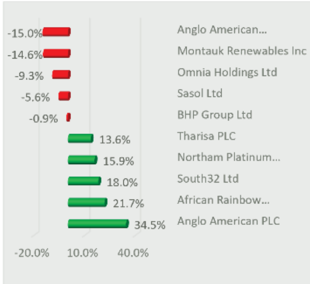
LAST QUARTER IN ZAR | **1 MONTH UPS AND DOWNS**

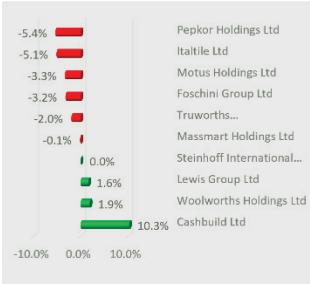


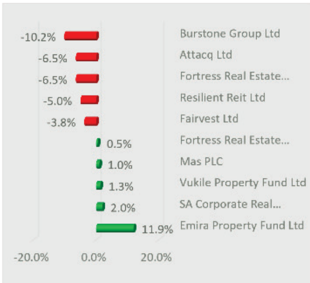


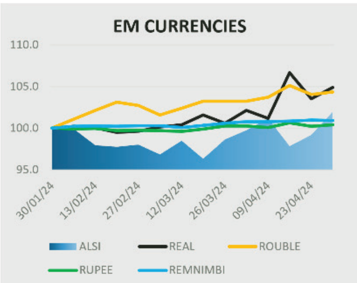












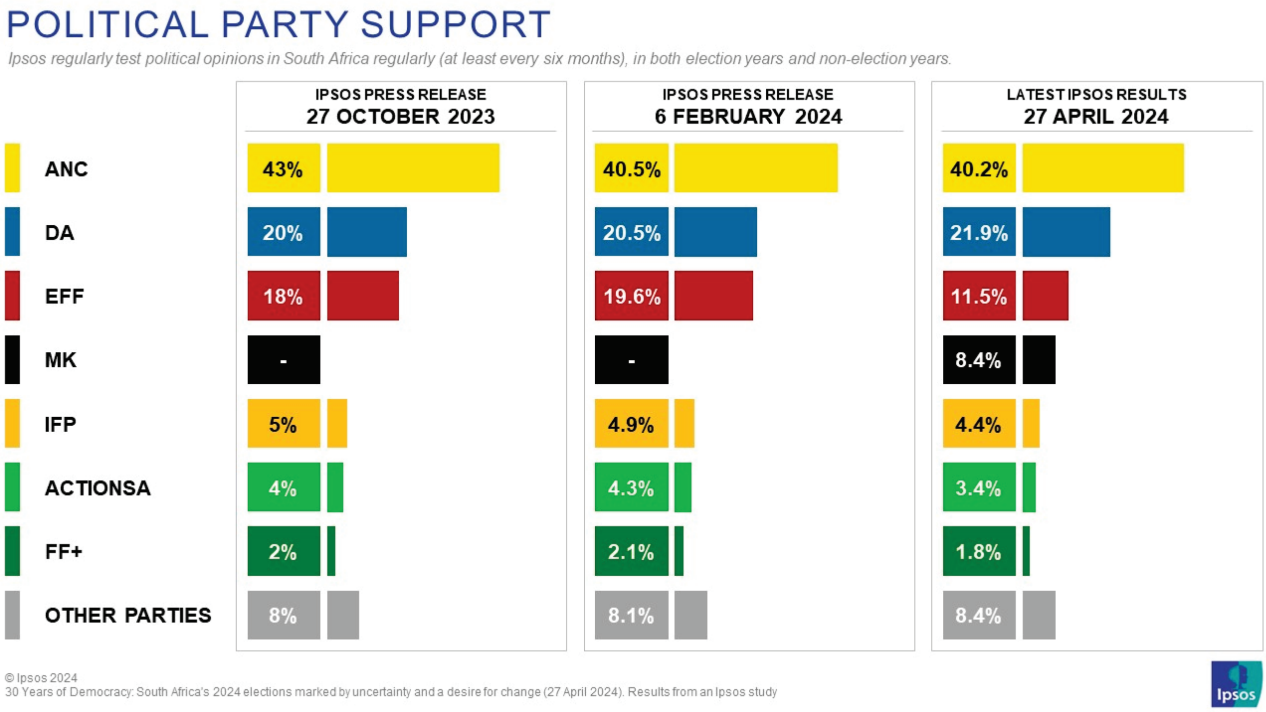
SA Election Update – The Clock is Ticking

Three weeks to go and investors are increasingly jittery as the clock ticks down to South Africa's national elections. As covered in February's WFTT, the ANC risks losing its 50% majority of the vote for the first time in 30 years. Polling stats, which are based on the opinions of the average South African appear to confirm this. Assumptions around coalitions are skewed to the negative and this sentiment has fed into the local equity environment. With this negative sentiment being priced in, if the ANC loses its majority but forms a favourable coalition contrary to popular believe, it will likely be bullish for equity markets.

Political Opinions Shift Lower for the Ruling Party

With a month to go, Ipsos released its updated political opinion polls conducted through face-to-face interviews throughout March and April. The poll showed the ANC struggling to impress voters with their share of the vote dropping closer to the 40% level.

KZN remains the most hotly contested area with the MK party gaining from the likes of the ANC, EFF and IFP. In addition, their latest numbers indicate the DA's ability to maintain around a fifth of the electorate.

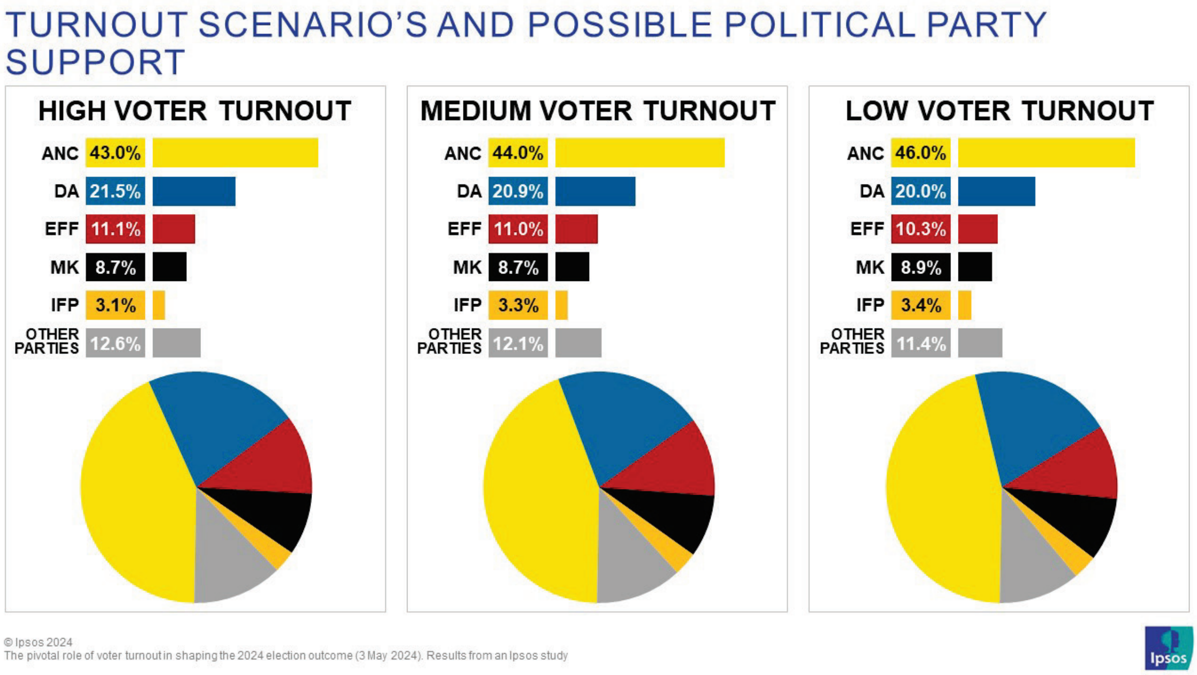


The Pivotal Role of Voter Turnout

The ability of a political party to mobilise their voter base inspiring them to cast their ballots plays a pivotal role in election outcomes. Ipsos' latest voter turnout models outline three scenarios:

- Low voter turnout – between 41% and 43% of registered voters (most committed voters)
- Medium voter turnout – between 57% and 59% of registered voters
- High voter turnout – between 74% and 76% (voter enthusiasm is at a peak)

Contrary to popular belief, in Ipsos' opinion the lower the turnout the better the outcome for the ANC and the MK party and the higher the turnout the more advantageous it is for the DA and EFF. Given the current sentiment amongst voters, the higher turnout is less realistic which based on their research is favourable to the ANC.



Base Case Remains Unchanged

Despite political opinion polls and voter turnout, political analyst expectations remain unchanged. The base case being the ANC receiving somewhere between 43%-47% of the vote, leading to a majority loss and the formation of a coalition. The IFP remains the top pick for a coalition partner (given its ability to work with the ANC in the past) and as a result government policy shall remain on track.

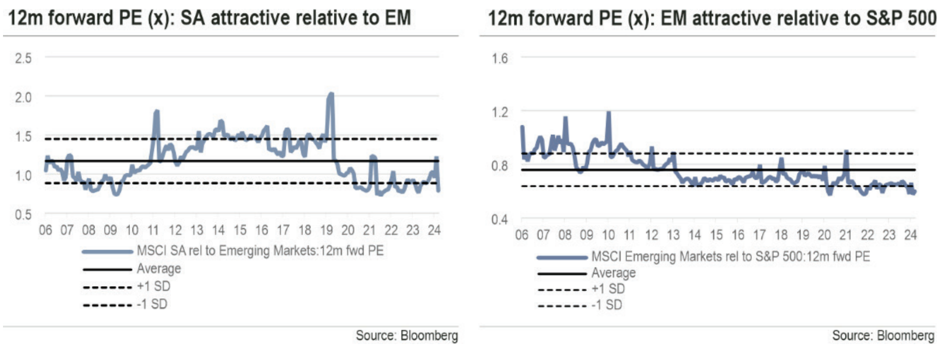
The probability of the ANC receiving 42% or less of the vote remains low. This outcome would require the involvement of a larger political party namely, the DA or the EFF and despite popular opinion, the ANC is touted to choose the DA over the EFF in this scenario. Importantly, the DA have not ruled out working with the ANC and markets view this as a far more favourable outcome relative to a coalition formed with the far-left EFF.

Now We Wait

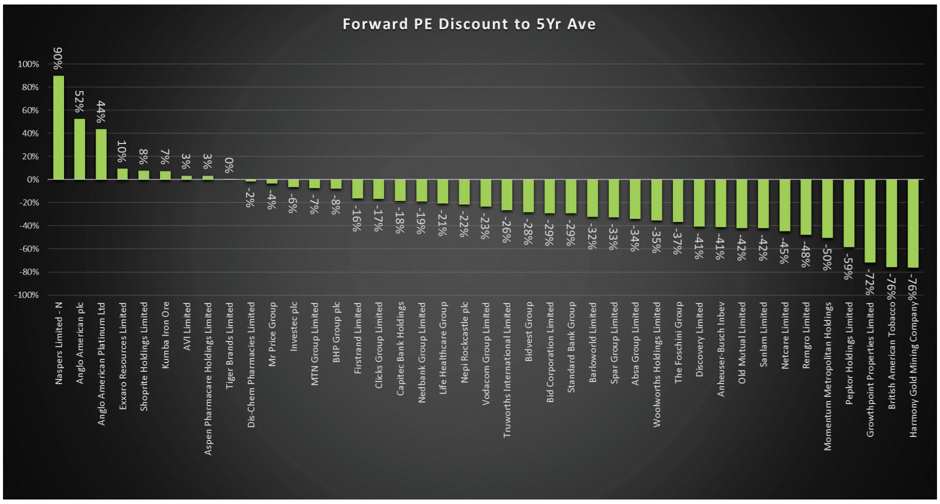
The man on the street places a far greater probability on the tail risk scenarios of the ANC falling below 42%. This negative sentiment has put pressure on SA focussed stocks and an outcome contrary to this will be supportive of the local equity market. The base case result of an ANC IFP coalition is the most likely and least tumultuous outcome. SA Inc equity is anticipated to rally on the back of this outcome. SA equity valuations remain low and a favourable outcome to the May 29 elections will go a long way in removing some of the risk priced in over the past few months. We advise investors to sit tight.

SA Equities are Cheap, Tailwinds on the Horizon

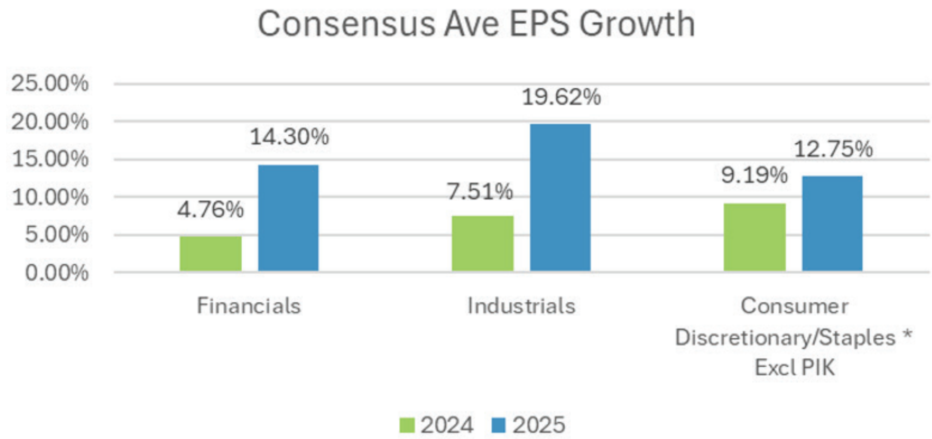
South African equities remain out of favour. While the ALSI outperformed its global counterparts in April, the market is still down year-to-date and SA equities continue to price attractively relative to emerging market peers.



Local shares continue to trade at significant discounts relative to 5-year average forward PEs; begging the question, is this justified? To a certain extent, one would believe it is due to the structural challenges faced in the SA operating environment.



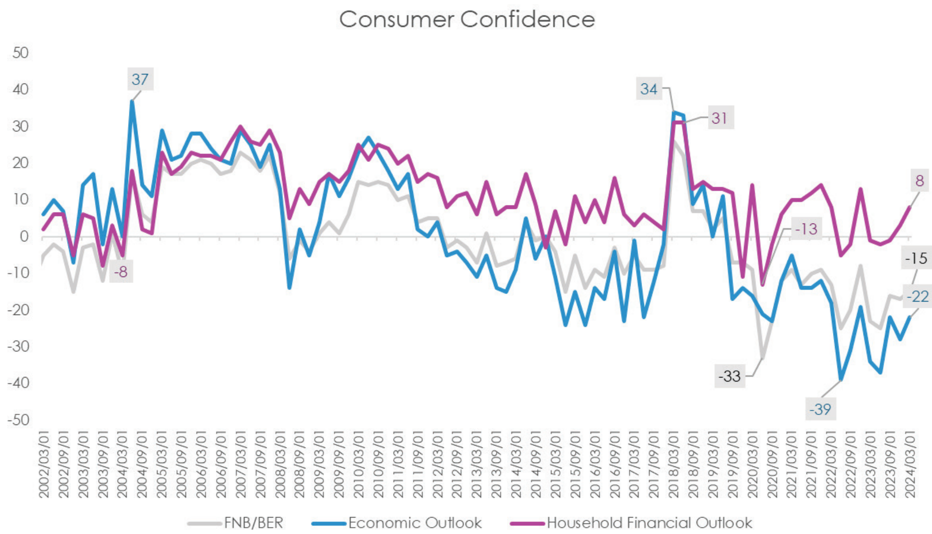
However, looking at earnings growth expectations, this seems a bit unfair. Consensus is still expecting healthy earnings growth in 2024, with double-digit growth expected going into 2025 across the board.



Considering the headwinds faced by SA Inc (namely Eskom and Transnet) as well as lackluster economic growth, double digit growth is decent. In addition, these headwinds are already priced into expectations, therefore any slight improvement in these will be accretive to earnings growth.

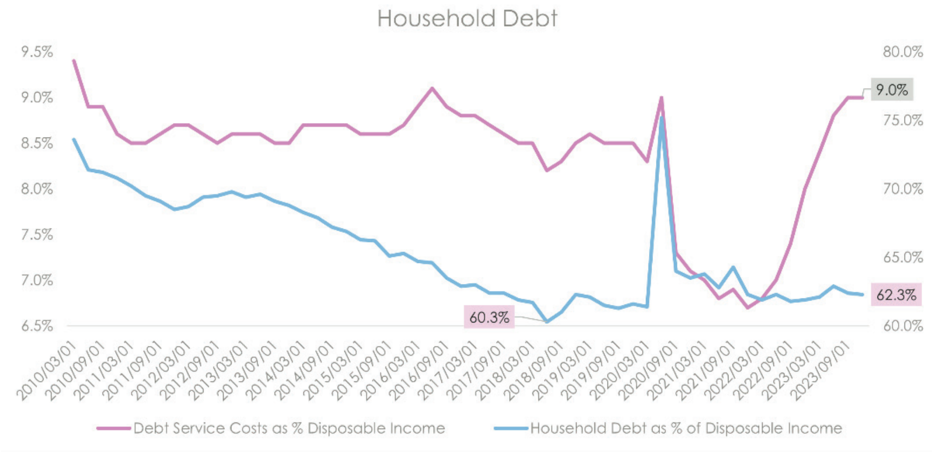
Consumer Sentiment is Low but Expected to Improve

While sentiment towards SA's economic outlook remains negative, households continue to have positive sentiment towards their own finances, with the first quarter confidence data noting an improvement in both.



While unemployment remains high, more people are currently employed compared to pre-Covid levels. Earnings growth and easing inflation have also been supportive of household incomes.

Further, household debt levels remain well-managed, despite sticky interest rates. This is also evidenced by the subdued private sector credit extension growth.



Retail sales have slowed down in line with the economic environment; growing at an average rate of 3.4% year-to-date as of February.

What Will Get the Consumer Going?

The consumer remains resilient albeit showing signs of pressure from a higher interest rate environment and tough economic conditions. What is going to change this?

There are several factors that could boost consumer confidence and drive spending.

- A favourable election outcome will be positive for consumers and the overall market.
- Expected interest rate cuts in the second half of 2024 will provide much-needed relief to household incomes.
- The implementation of the two-pot system, to take effect from 1 September 2024, is expected to boost household incomes and drive spending. The National Treasury estimates that approximately R40 billion pre-tax will be injected into the economy in the fourth quarter of 2024.

In all, South African equities are cheap and price in a lot of negative factors. Looking ahead, there are several tailwinds that could drive consumer spending and support earnings growth for South African companies. A favourable election outcome and anticipated interest rate cuts are poised to fuel a rally in the local markets. Despite anticipated volatility leading up to the elections, we advise investors to remain invested to capitalize on this potential rally.

BHP Makes a Bid for Anglo American

Anglo American Plc confirmed press speculation that it has received an unsolicited, non-binding and highly conditional combination proposal from BHP Group Limited.

The Proposal

- An all-share offer for Anglo American (AGL) by the BHP Group
- Preceded by separate demergers by AGL of its entire shareholdings in Anglo American Platinum limited (AMS) and Kumba Iron Ore Limited (KIO) to AGL shareholders
- The two parts of the proposal are inter-conditional:

Under the proposal, ordinary shareholders of Anglo American (AGL) would receive:

- 0.7097 BHP shares for each ordinary share in AGL
- Ordinary shares in AMS and KIO – in direct proportion to their effective interest in AMS and KIO via their AGL holding

At closing market prices (23 April 2024) the proposal represents:

- Total value of approx. £25.08 per AGL share held, including £4.86 in AMS and £3.40 in KIO
    - Valuing AGL's share capital at £31.1bn
- The offer is 13.7% higher than the closing price of AGL's on the 23 April 2024

The announcement does not amount to a firm intention to make an offer and there is no certainty an offer will be made. UK takeover rules state BHP must, by no later than 5pm on 22 May 2024, either announce a firm intention to make an offer or walk away.

BHP reserves the right to amend the offer and vary the transaction structure.

If it proceeds, this will be the biggest merger and acquisition since Glencore's acquisition of Xstrata in 2013.

Our Thoughts

All in all, it is anticipated that a merger would create synergies between the two businesses given the number of commodities shared. The copper assets are the jewel in the crown and the SA exposure is clearly not desired (AMS and KIO).
Some are of the opinion this deal is unlikely to be accepted at this level. AGL has significant assets not yet at full earnings potential. In addition, there is speculation the De Beers assets are potentially up for sale. It is likely AGL would prefer for De Beers to be sold and earnings potential of up-and-coming assets be realised before accepting an offer for the rump.

Despite this, the Copper assets are really the bone of contention. BHP want the copper assets and the copper asset are valuable. This offer may attract additional bidders for the AGL rump assets (AGL less KIO and AMS) as they are unlikely to allow these assets to go for cheap. Glencore has been rumoured to be interested along with Rio Tinto and talk of potential Middle Eastern Money. Analysts believe the value of Anglo's assets are up to 50% higher than the current price.

There are many moving parts at play and for now we will have to wait for further updates. As mentioned, the clock is ticking, and BHP have until 22 May 2024 to clarify their intention.

UPDATE

AGL has rejected BHP's offer stating the proposal is opportunistic and significantly undervalues Anglo American and its future prospects. Further, they believe it significantly dilutes the relative value upside of Anglo American shareholders relative to BHP shareholders.

BHP still has until the 22 May 2024 to "step up or shut up" (technical term…). This is the start of what could become a drawn-out process. We advise shareholders to sit tight.

Conclusion

There are always a lot of moving parts when it comes to investing in equity markets. This seems to be exacerbated as we are continually watching data points for any indications that the rate cutting cycle is imminent as well as tracking the outcome of the upcoming elections.

Despite the resilient economic environment pushing out the first rate cut, the strong operating environment and underlying company earnings continue to support valuations and drive decent returns. From an offshore perspective, we still see plenty of opportunities that can do well.

Locally, sentiment has shifted too far to the negative side and once we get past the elections, if the base case prevails, we expect to see local names primed to rally. As alluded to in this month's newsletter, SA stocks continue to be valued at significant discounts despite delivering strong earnings growth.

All in all, we remain constructive on both local and offshore equities, with several catalysts on the horizon to drive returns.