VEGA
ASSET MANAGEMENT
BATEBESTUUR

NEWSLETTER

November 2022 | www.vegacapital.co.za

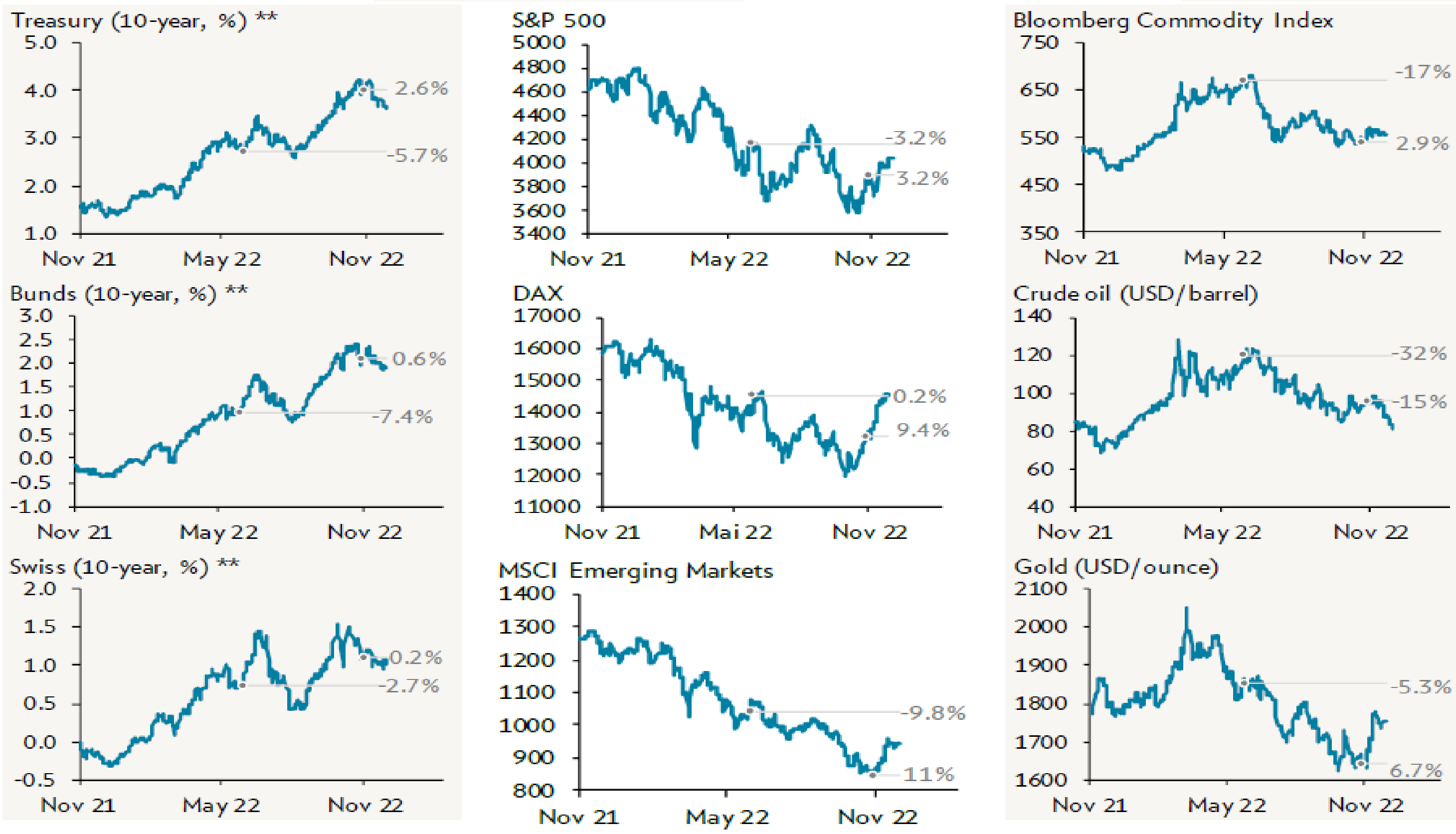
IN THIS MONTH'S NEWSLETTER

- Market overview
- Share focus: Healthcare ETFs
- Graph of the month

"How did you go bankrupt?
Two ways. Gradually, then suddenly."
- Ernest Hemingway, The Sun Also Rises

MARKET OVERVIEW

Review (1-month and 6-month performance)



Source: Julius Bear, 28/11/2022

INTERNATIONAL

	Last	Month %	YTD %	5Y ann. %
MSCI World	2721	6.8	-14.09	7.93
S&P 500	4080	5.4	-13.12	10.95
NASDAQ 100	114468	5.7	-26.12	11.82
EURO STOXX 50	3965	9.7	-4.70	5.39
MSCI EM	972	14.6	-18.71	0.01
HANG SENG	18869	26.6	-16.60	-5.26
US Equities Volatility Index (VIX)	20.58	-5.23	3.36	11.43

Source: Edmond De Rothschild

The lower-than-expected US consumer price index release for October bodes well for the beginning of the decline of core CPI inflation from a 6.6% peak. Inflation should continue to slow from here due to the following factors:

- US house prices decreasing
- Price declines in the second-hand car market
- Fertilizer prices are down 39% since its peak in late March
- Global container freight rates are at 23-month lows.

All of these factors are discussed in more detail below.

The relative strength of US inflation compared to other major economies is fading. Earlier this year, core inflation was higher and wage growth was stronger in the US compared to Europe and Japan. The gap has recently narrowed on all these measures. Several central banks have recently surprised market expectations with a dovish tone. The dovish surprises have mainly been led by the central bank hiking rates less than expected. This will support the recovery of equity and bonds.

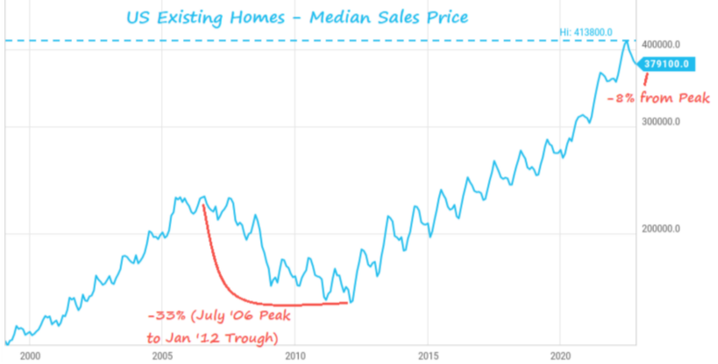
This year the **USD Index (DXY)** is on track for one of its best annual performances in decades in. We are of the opinion that this unusual strength, which has created a substantial overvaluation of the DXY, is justified. The US economy has been strong, resulting in a tight labour market. With underlying inflation substantially more elevated than the US Federal Reserve's inflation target, the Fed initiated the fastest policy tightening in decades. This caused a major source of USD support through increased carry trade attractiveness.

Furthermore, the USD's safe-haven characteristics proved attractive at a time of deteriorating risk sentiment globally. A dovish Fed pivot together with an improving global economic outlook would be needed for the USD to give back its gains.

The **Manheim used car index** is now down 14% over the past year. This was a leading indicator of higher inflation rates in 2020 and the recent downturn is likely a leading indicator that inflation is slowing down.

US housing market – According to Redfin single-family homes fell 32% year on year in the third quarter. Beyond the lockdown in 2020, it was the steepest fall since the housing bust. The majority of these properties are classified as buy-to-let. The spike in mortgage rates caught many of these investors off-guard and are currently cash flow negative (rents not covering the mortgage). The overall US Housing Markit Index, which is a measure of homebuilder confidence, fell for the 11th consecutive month to its lowest level since April 2020. 37% of homebuilders reported cutting prices in November, with an average price reduction of 6%. US existing home sales fell for the 9th consecutive month, down 28% over the last year. This is the largest year-on-year decline since February 2008. The median price of an existing home in the US has now fallen 8% from its peak in June, this is the largest 4-month decline since November 2008 to February 2009. After the last housing bubble burst, prices fell 33%. The same decline today would only bring prices back to February 2020 levels.

Figure 1: US Existing home sales over the last 22 years



Source: Compound @ CharlieBilello

Fertilizer prices peaked in late March 2022 and are now down 39% since. The price is now trading at the same level as September 2021. Fertilizer prices have a very high correlation to food prices.

Global container freight rates are down 73% from their peak. The price is still twice as high as pre-pandemic levels. However, the price continues to move in the right direction.

Various cities in **China** are once again in lockdown as cases of Covid-19 were detected. The zero Covid policy will hurt the Chinese economy and their companies. China is already seen as "uninvestable" by some investors. The Chinese government will have to drastically change its policies if they want to turn investor sentiment.

Outlook

Slowing inflation and central banks that seem to be less hawkish are positive signs for the recovery of equities and bonds. Indicators show that there is a possibility of a recession in 2023 due to overtightening however, this has mostly been priced into the market. The other main risk is the US housing market. We are still seeing strong employment trends which decrease recessionary fears.

	Last	Month %	YTD %	5Y ann. %
JSE All Share	74828	9.62	5.98	4.71
JSE Resources	73434	16.61	10.15	14.89
South Africa 10Y Bond	10.25%			
Net Foreign Equity Flow	-R1.5bn			
Net Foreign Bond Flow	-R24.5bn			
USDZAR	17.1979	5.59	-8.44	-4.61
EURZAR	17.9299	0.37	-0.06	-1.89

Source: RMB

South African equities continued their strong run after resilient months, which saw the JSE All Share index increase by 9,6% in November. Non-residents remain net sellers of SA Inc. The cumulative equity market outflow for the last 12 months is R1.5bn and the cumulative bond outflow for the last 12 months to R24.5bn (according to Bloomberg data).

President Cyril Ramaphosa is currently under pressure to resign as president of South Africa following the section 89 report on Phala Phala. The president postponed addressing the nation as he is currently consulting with role players over his options. The uncertainty over the president's resignation weighs heavily on the way forward for our local market.

Most South African **household budgets** are in for another squeeze, as consumers with home loans, vehicle financing and other forms of credit face more pressure on the back of the South African Reserve Bank's (SARB's) latest interest rate hike. The central bank delivered its final monetary policy statement of the year, hiking the repo rate by a widely expected 75bps to 7% – pushing it to above pre-pandemic levels. Over the same period, the prime lending rate – the rate at which commercial banks lend to consumers – has risen from 7.25% to 10.5%.

The following table illustrates how repayments on different asset-backed credit have changed since the start of 2022 – before the interest rate hikes.

Figure 2: Impact of the cumulative 325bps repo rate hikes in 2022:

BONDS	Bond Amount	January 2022 Repayment	Current Repayment
	R 800 000	R 6 323	R 7 987
	R 1 250 000	R 9 880	R 12 480
	R 3 000 000	R 23 711	R 29 951

*Based on a 20-year bond at prime

CAR FINANCE	Car Finance Amount	January 2022 Repayment	Current Repayment
	R 250 000	R 4 537	R 4 953
	R 430 000	R 7 804	R 8 519

*Based on a 72-month car payment plan at prime +2%

CREDIT CARD	Debt Repayment Term	Repayment at 15% in January 2022	Repayment at 18,25% currently
	6 Months	R 3 689,52	R 3 723,78
	12 Months	R 1 913,48	R 1 946,14
	18 Months	R 1 322,56	R 1 355,21

*Based at a 15% interest rate

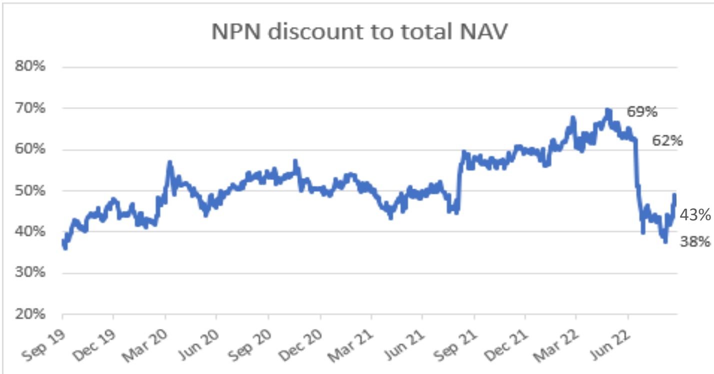
Source: Moneyweb

Company results:

Spar released a disappointing set of full-year financial results. Group turnover growth of 6% was weaker than expected. The group's Polish business reported another loss of R455 million after expecting it to break even by 2022, mainly because of a group of retailers quitting their contracts with the wholesale division due to unfavorable terms which require them to buy almost 40% of their goods from Spar. Spar declared a final dividend of R2.25, bringing the total payout for the year to R4 per share, down from R8.16, to fund an upgrade of its IT systems across Southern Africa and Europe and its loss-making operations in Poland. Spar is currently trading on a forward P/E of 11.5x which is a discount to its long-term average of 14.7x.

Richemont posted a strong set of half-year results for the 2023 financial year. At actual exchange rates, sales for the group increased by 24%. Going forward the group spoke of a lack of visibility on future trends, although there is pent-up demand in certain regions from Covid-19. Richemont is currently trading on a forward P/E of 17.5x and a dividend yield of 2.2%.

Naspers published its interim results and reported a loss of $13 million (R223 million) in the six months to the end of September. The losses come amid reports that US-based e-commerce giant Amazon is set to open in South Africa taking on the likes of Takealot. The group stated that its revenue from contracts with customers increased to $3.7bn from $3.3bn posted in the corresponding period of the previous year. Naspers is currently trading on a discount to NAV of 43%.



Source: Investec

Outlook

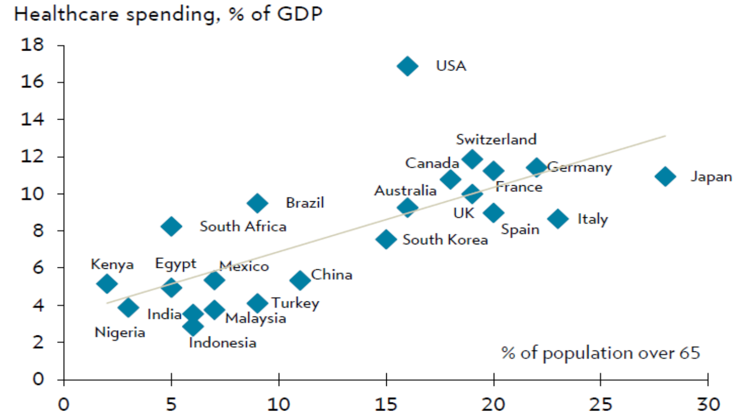
We expect the SARB's next interest rate decision to depend largely on the two sets of CPI data releases and the Bureau for Economic Research (BER) 4Q22 inflation expectations survey, as well as the resilience of the rand. We expect inflation to ease, but probably not fast enough to end the hiking cycle. A possible resignation of the president has been a risk factor that investors have been aware of for some time. The performance of the rand, local bonds and local markets will heavily depend on the outcome. Further gains would depend critically on the resilience of global commodity prices and the dollar's trajectory.

SHARE FOCUS – HEALTHCARE ETFs

Due to attractive growth prospects and undemanding valuations, healthcare remains our preferred defensive sector. We expect the global healthcare sector to generate better organic earnings growth than almost all other defensive sectors. This above-average growth potential continues to be driven by favorable demographic changes, new drug developments and general innovations in the area of cures and disease prevention. Growth related to demographic changes primarily results from the sharp rise in the number of people over the age of 65 (+3.4% per annum according to the United Nations), who tend to spend three times more on healthcare than the rest of the population.

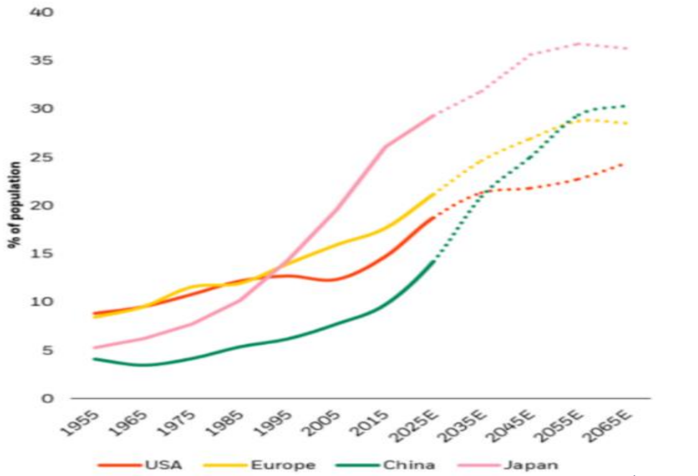
In addition to this, we expect the increased discovery of cures and preventions to become a growth contributor. The rise of big data, gene editing and nanotechnology is also expected to be supportive of this investment theme. On a regional basis the prospects for expansion are promising in emerging markets, primarily Asia, where the share of GDP dedicated to healthcare is abnormally low and expected to rise structurally over the coming years. Moreover, the pipeline for new drugs looks attractive and should be able to more than offset the wave of major patent expiries starting in the mid-2020s.

Figure 3: Healthcare spending set to increase with ageing population



Source: United Nations, Bloomberg Finance L.P., Julius Baer

Figure 4: Percentage of population +65 years



Source: Credit Suisse

What are the different types of healthcare stocks to invest in?

The healthcare sector is so broad and very diverse. Four of the most important subsectors are:

- **Drug companies:** Drugmakers focus on developing drugs that treat or prevent diseases. Biotech companies use live organisms such as bacteria or enzymes to develop drugs, while pharmaceutical companies use chemicals. Drug companies range from multinationals to small biotech firms which focus heavily on research and development. Companies include Johnson & Johnson, Pfizer, Roche, AbbVie, Novartis and Merck & Co.
- **Medical device companies:** These companies design and manufacture devices to care for patients. The devices range from disposable gloves and thermometers to artificial heart valves and robotic surgical systems. Companies include Medtronic, Abbott Laboratories, Siemens Healthineers and Stryker.
- **Payer companies:** Payers, including health insurers and pharmacy benefit managers (PBMs), play an important role in the global healthcare system. Insurers charge premiums to individuals and employers to insure against healthcare costs, while PBMs administer prescription drug benefits for health plans. Companies include Kaiser, UnitedHealthcare and Florida Blue.
- **Healthcare provider companies:** Healthcare providers are on the front lines of delivering healthcare services to patients. These include hospitals, physician practices, home health companies, and long-term care facilities. Companies include CVS Health, UnitedHealthcare, Cardinal Health and McKesson.

How do we invest in the leading healthcare companies?

Healthcare presents the opportunity to invest in a sector that is constantly innovating to improve quality of life and raise productivity. The **iShares U.S. Medical Devices ETF (IHI)** and the **iShares Global Healthcare ETF (IXJ)** are available on international investment platforms. The **Sygnia Itrix Solactive Healthcare 150 ETF (SYGH)** is available on the JSE and forms a core holding in our tax-free investment portfolios. Top holdings of the respective exchange traded funds -

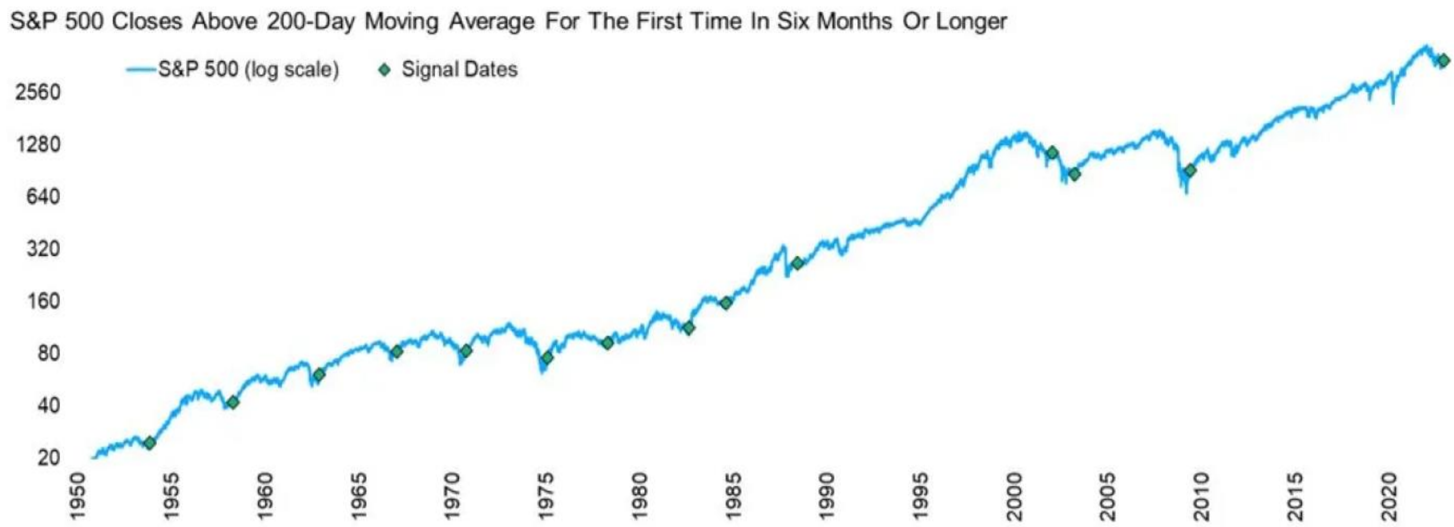
OFFSHORE			
IHI		IXJ	
Share	**%**	**Share**	**%**
Thermo Fisher	17,6	UnitedHealthcare	7,5
Abbott Laboratories	15,0	Johnson & Johnson	6,8
Medtronic PLC	9,5	Eli Lilly	4,1
Stryker	4,7	Pfizer	3,9
Boston Scientific	4,6	Abbvie	3,8
Edwards Lifesciences	4,4	Roche	3,7
Intuitive Surgical	4,4	Merck & Co	3,5
Becton Dickinson	4,2	Thermo Fisher	3,2
Resmed	3,3	Novartis	2,9
Dexcom	3,2	Astrazeneca PLC	2,7

Local	
SYGH	
Share	**%**
UnitedHealthcare	7,2
Johnson & Johnson	6,4
Eli Lilly	4,2
Pfizer	3,6
Abbvie	3,6
Merck & Co	3,5
Roche	3,2
Thermo Fisher	2,8
Novartis	2,5
Novo Nordisk	2,5

Source: iShares, Sygnia

GRAPH OF THE MONTH

The S&P 500 Just Closed Above The 200-Day MA For The First Time In More Than Seven Months



Source: Callum Thomas

Sources: Credit Suisse, Compound Advisors, Edmond De Rothschild, ETFMG, FactSet, JP Morgan, Julius Baer, RMB, Statista, Sygnia.

CONTACT US

Francois Du Plessis, CFP

082 492 9199

fduplessis@vegacapital.co.za

Louis Storm

083 552 2343

lstorm@vegacapital.co.za

Abrie Smit

082 087 0883

asmit@vegacapital.co.za

Disclaimer