NEWSLETTER

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IN THIS MONTH'S NEWSLETTER

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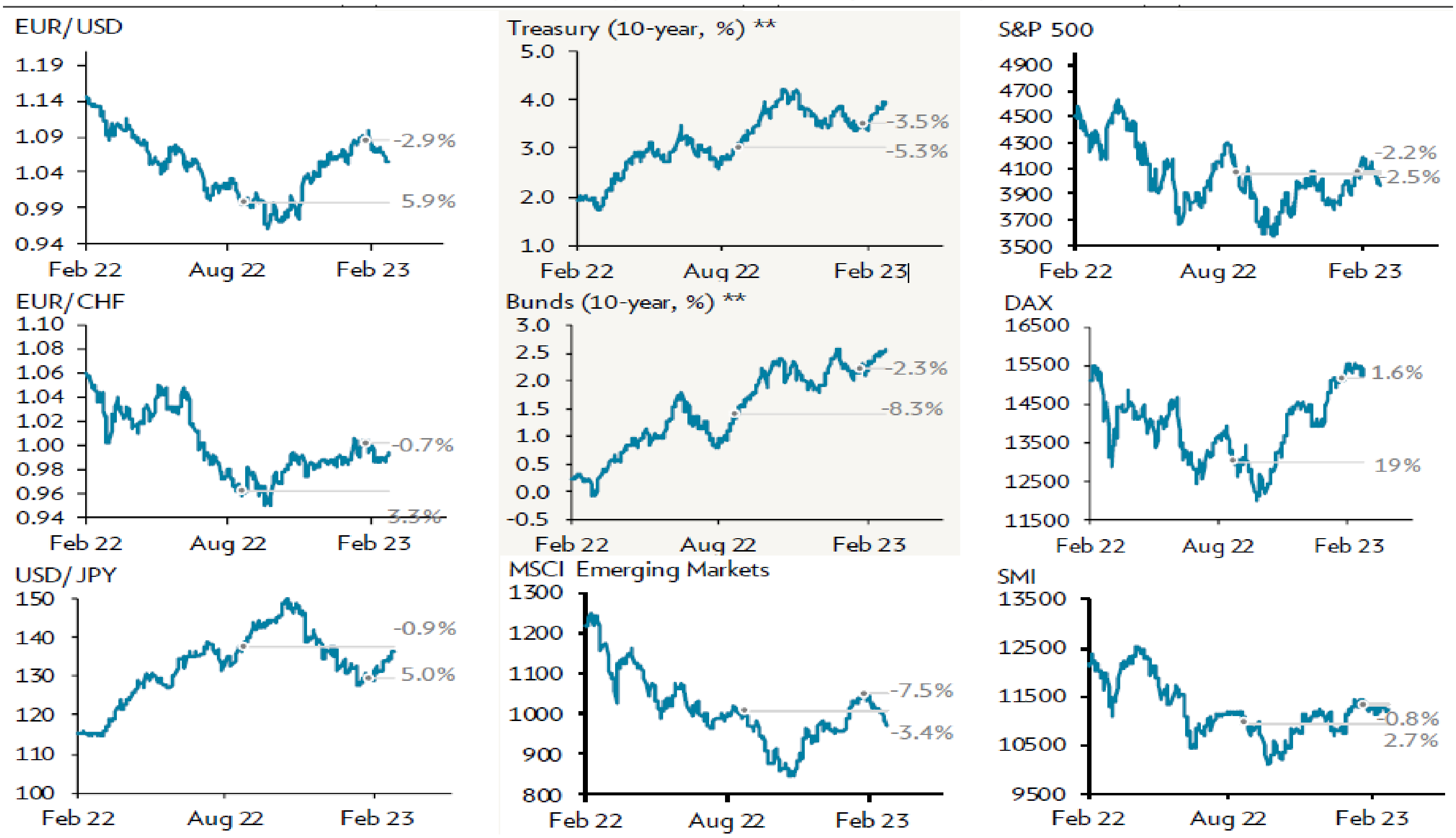
"The stock market is filled with individuals who know the price of everything, but the value of nothing "

- Phillip Fisher

MARKET OVERVIEW

Review (1-month and 6-month performance)



Source: Julius Bear, 27/02/2023

	Last	Month %	YTD %	5Y ann. %
MSCI World	2715	-2.30	4.58	7.46
S&P 500	3970	-2.60	3.68	9.80
NASDAQ 100	11456	-0.50	9.61	10.54
EURO STOXX 50	4238	1.90	12.07	7.65
MSCI EM	964	-6.20	0.91	-1.48
HANG SENG	20577	-9.40	4.03	-4.90
US Equities Volatility Index (VIX)	20.70	2.38	-0.97	22.47

Source: Edmond De Rothschild

The new year started off on a strong footing. Year to date (end February) the MSCI World index gained 4,5%. The rally in global equities was due to the following factors - retreating energy prices, optimism regarding China's reopening and a slightly healthier economic outlook than previously forecast. In particular, the continued strength of the labour market and strong growth momentum in many service sectors point to a continuation of an economic expansion rather than an imminent recession. A side effect of the recent positive economic surprises is that central banks will probably hike interest rates more than consensus. This increases the risk that the slowdown in economic growth and subsequent recovery could be postponed to late 2024.

February's **US** equity rally was tested when stronger-than-expected inflation data was reported on the 24th of February. The inflation data caused share prices to slide and bond yields to test higher levels (inverse to the price of bonds). Traders are now pricing in that the fed fund rate will peak at 5.4% compared to under 5% a month ago. The subsequent increase in the expected rate also revived USD strength (at the expense of the ZAR).

Europe also experienced a strong start to the year. The Eurostoxx 50 gained more than 10% year to date. Improved business confidence and the sharp fall in gas prices supported the economic outlook for Europe.

China's annual session of the National People's Congress will commence on 5 March. Key economic targets and policy priorities will be outlined in the Government Work Report. It is expected that the following will be reiterated – economic growth and a stable property market remain a priority, as well as restoring market confidence. With China open for business and travel we should see easing of supply chain bottlenecks and an increase in demand from Chinese consumers.

What to look out for in the short term:

1. Global inflation: Inflationary pressures have eased globally, but remain above target levels. As mentioned earlier, after a promising US inflation print in January, the February number was higher than expected.

2. US unemployment rate: The jobless claims and unemployment number are important indicators. An early indicator of a possible recession would be a rising unemployment rate. Chances are there that the US will be able to avoid a recession (or soft landing) if the unemployment rate remains low.

3. Company earnings and profit margins: Inflation impacts profit margins negatively. Companies that are successful to protect profit margins will most likely protect profits after tax. In the current market climate, investors are likely to reward these companies at the expense of those whose business models are not able to protect margins.

Possible scenarios ranging from most likely to least likely:

Scenario 1 – inflation decelerate as expected, but growth also retreats and might result in a short-lived recession. In this scenario, we should see bonds outperform equities. If inflation and growth were to decrease this will put downward pressure on yields, increasing the price of bonds. For obvious reasons, companies will struggle to grow earnings in a negative or no growth environment.

Scenario 2 – Inflation remains stubbornly high, but lower than the current level and growth remain robust. Central banks across the globe will remain hawkish. The strong economy makes it easier for central banks to increase interest rates. Equities will outperform bonds in this scenario as increasing inflation and growth should put upward pressure on bond yields, decreasing the price.

Scenario 3 – Inflation eases and the economy avoids a recession. This is the best possible outcome. Equities should do very well in this environment and will outperform cash and fixed income.

Scenario 4 – Inflation remains at uncomfortable levels and the economy goes into a mild recession. Cash will be the best place to hide should this scenario materialise. If economic growth contracts amidst high inflation, central banks are in a peculiar position. Lower rates will stimulate the economy, but this will fuel inflation. Company profits will suffer as a result of margin pressure, lower revenue and high-interest rate charges.

Summary

In the latest Berkshire Hathaway report, Warren Buffet writes: "Charlie and I are **not stock-pickers**; we are **business-pickers.**" This philosophy has served them well. For example, in 1994 Berkshire bought 400 million Coca-Cola shares and received a USD 75 million dividend that year. The dividend grew at a respectable, but fairly modest compounded 8% per annum. Last year Berkshire received a dividend of USD 704m from the same 400 million shares. In other words, Berkshire's dividend stream from Coca-Cola increased by almost ten times in less than three decades.

SOUTH AFRICA

	Last	Month %	YTD %	5Y ann. %
JSE All Share	77734	-2.32	6.41	6.06
JSE Resources	65780	-12.42	-7.07	13.60
South Africa 10Y Bond	10.095%			
Net Foreign Equity Flow	-R6.7bn			
Net Foreign Bond Flow	-R78.4bn			
USDZAR	18.4803	-6.23	-8.26	-9.39
EURZAR	19.5919	-3.51	-8.78	-6.38

Source: RMB

A special thank you to all our clients who contributed to their tax-free investment accounts (TFIA) for the 2023 tax year. Our main focus with the TFIA's is to invest in ETFs with direct exposure to offshore companies. Please remember that we have entered a new tax year which means you are eligible to contribute again to your TFIA.

South Africa has been grey-listed by global anti-money laundering watchdog the **Financial Action Task Force (FATF)**. Although widely expected, it has significant implications for economic growth and global competitiveness. Grey-listing entails that all transactions of South African companies and individuals will be seen as high-risk transactions, resulting in increased and complicated compliance, administrative duties and likely disincentivising investment into and trade with South Africa. According to a report by the International Monetary Fund (IMF), grey-listing leads to a significant decrease in capital inflows. For vulnerable countries, this could result in a balance of payments crisis. South Africa could exit the grey-list within as little as two years if the government and the private sector cooperate to take decisive actions to address the FATF's concerns. Time will tell.

Finance Minister Enoch Godongwana delivered his 2023 **budget speech** in February. He walked a tightrope in providing financial assistance to Eskom, supporting households and increasing investment spending. Here are a few bullet points that are worth mentioning:

- Eskom will receive financial support to the value of R254bn over the next three years to deal with its R426bn debt burden (moving the deck chairs on the Titanic)
- Government debt is now forecast to peak at around 73.6% of GDP
- Individuals who install rooftop solar panels will be able to claim a rebate of 25% of the cost of the panels, up to a maximum of R15,000. This could be used to reduce tax liability in the 2023/24 tax year and is available for one year
- The retirement tax tables for lump sums withdrawn before retirement and for lump sums withdrawn at retirement will be adjusted upwards by 10%. This means that the tax-free amount that can be withdrawn at retirement increases to R550,000.
- The South African Police Service (SAPS) was allocated R7.8bn to appoint 5,000 police trainees per year. **That's R1.56m per police trainee?!**
- The government has proposed to increase the excise duties associated with alcohol and tobacco to 4.9%. However, the bulk of cigarettes sold in SA are illicit and thus effectively exempt from these duties.

If you have not watched **André de Ruyter's** controversial interview with e.tv's Annika Larsen do yourself a favour https://youtu.be/6gF2dYQ-NdM. The former CEO admitted to failing to prevent load shedding in South Africa and touched on what he sees as entrenched corruption within the government and governance around Eskom. The power utility Eskom has appointed Calib Cassim as acting CEO following André de Ruyter's immediate departure.

Outlook

The ZAR has discounted SA's grey-listing to a large extent. There is a consensus view that the strong run in food **inflation** is coming to an end and that food CPI will moderate through the course of 2023. This will drag headline CPI down with it and in so doing settle the concerns of monetary policymakers.

However, **load-shedding** may disrupt this benign view. Also, SA is likely to match the US **interest rate hike** in March and May, but there will be pressure for larger local hikes and possible further **rand weakness** as SA continues to disappoint on the world stage.

Figure 1: February 2023 Top 5 best and worst performing South African shares

Best performing	%	Worst performing	%
Super Group	+22%	Pan African	-23%
PPC	+20%	Amplats	-22%
Attacq	+19%	Steinhoff	-22%
Capital&Counties Prop	+19%	Pick n Pay	-21%
Hudaco	+18%	Sibanye Stillwater	-19%

Source: FactSet

SHARE FOCUS: AEROSPACE AND DEFENSE ETF

The world isn't getting any safer and as long as that remains the case, there is going to be demand for defence companies and the products they manufacture. Defence stocks tend not to be as glamorous as tech stocks but provide reliable revenue and income. Defence stocks tend to be stable contributors to an income-focused portfolio, with predictable long-term revenue streams that translate into solid dividends.

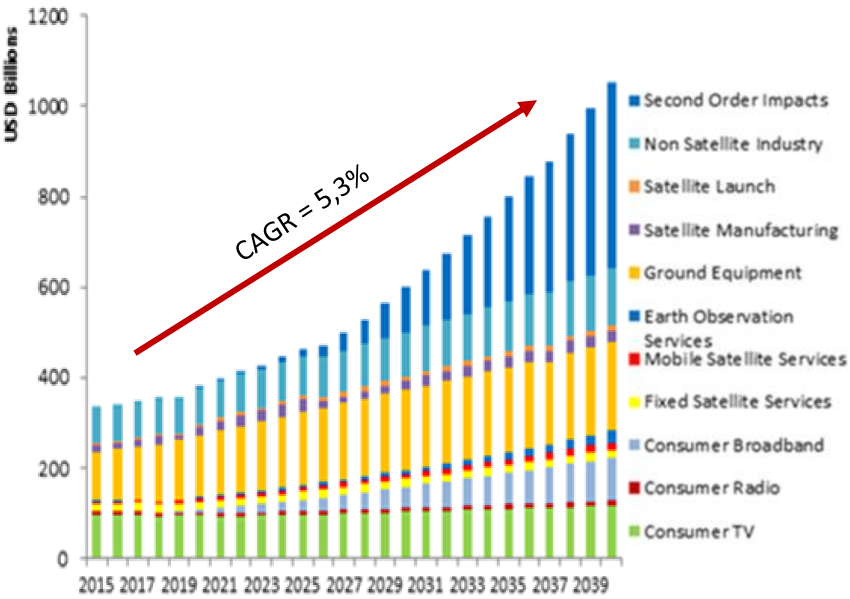
The aerospace and defence industry plays a vital role in the global economy by supporting and facilitating passenger transportation, trades, logistics, security and defence. The industry consists of several players servicing both commercial and military operations across the value chain. These players include aircraft manufacturers such as Boeing and Airbus; part manufacturers such as GE Aviation, Lockheed Martin, BAE Systems and Rolls-Royce Holdings; and Maintenance, Repair and Overhaul (MRO) organisations which are the aftersales service providers. The majority of these large firms are located in the United States of America which accounts for 49% of the total industry value.

According to Morgan Stanley (MS), the current market value of the space economy is $350 billion and is expected to grow to $1 to 1.5 trillion in 2040 or a 5,3% annual compounded growth rate over the 20-year period from 2020 to 2040.

The **figure 3** shows the annual average US military spending by war vs US military aid to Ukraine (in $bn's). It is astonishing to see that the aid to Ukraine exceeds America's spent in the Afghanistan war. Important to note, military aid does not include weapons and equipment.

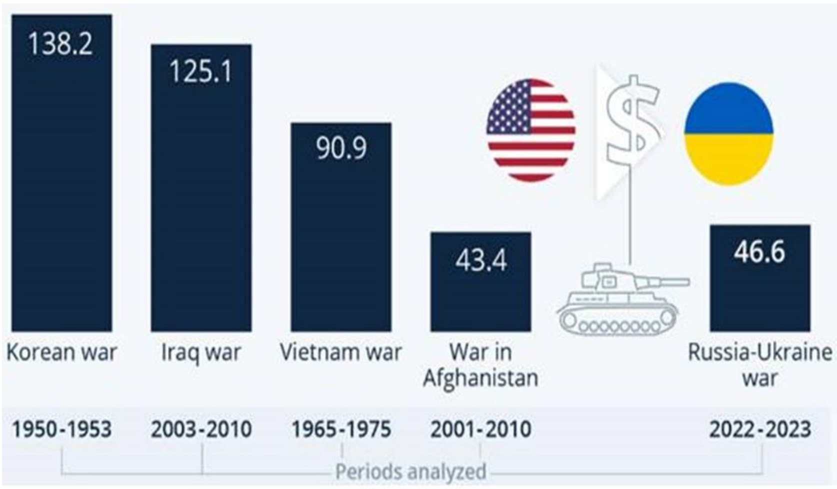
No one defense contractor gives exposure to the entire industry. Therefore, it might make more sense to invest in the defense sector through an exchange-traded fund (ETF). As a result, we prefer to have exposure to the aerospace and defence sector via the **iShares U.S. Aerospace & Defense ETF (ITA)**, which is also the largest ETF focused on defense, with $4.7 billion in net assets as of early December 2022. This ETF is designed to provide exposure to domestic United States aerospace and defense companies, as well as exposure to the commercial aerospace industry.

Figure 2: Space economy and its subsectors/themes forecast up to 2040



Source: Morgan Stanley

Figure 3: Annual average US military spending by war vs US military aid to Ukraine (in $bn's)



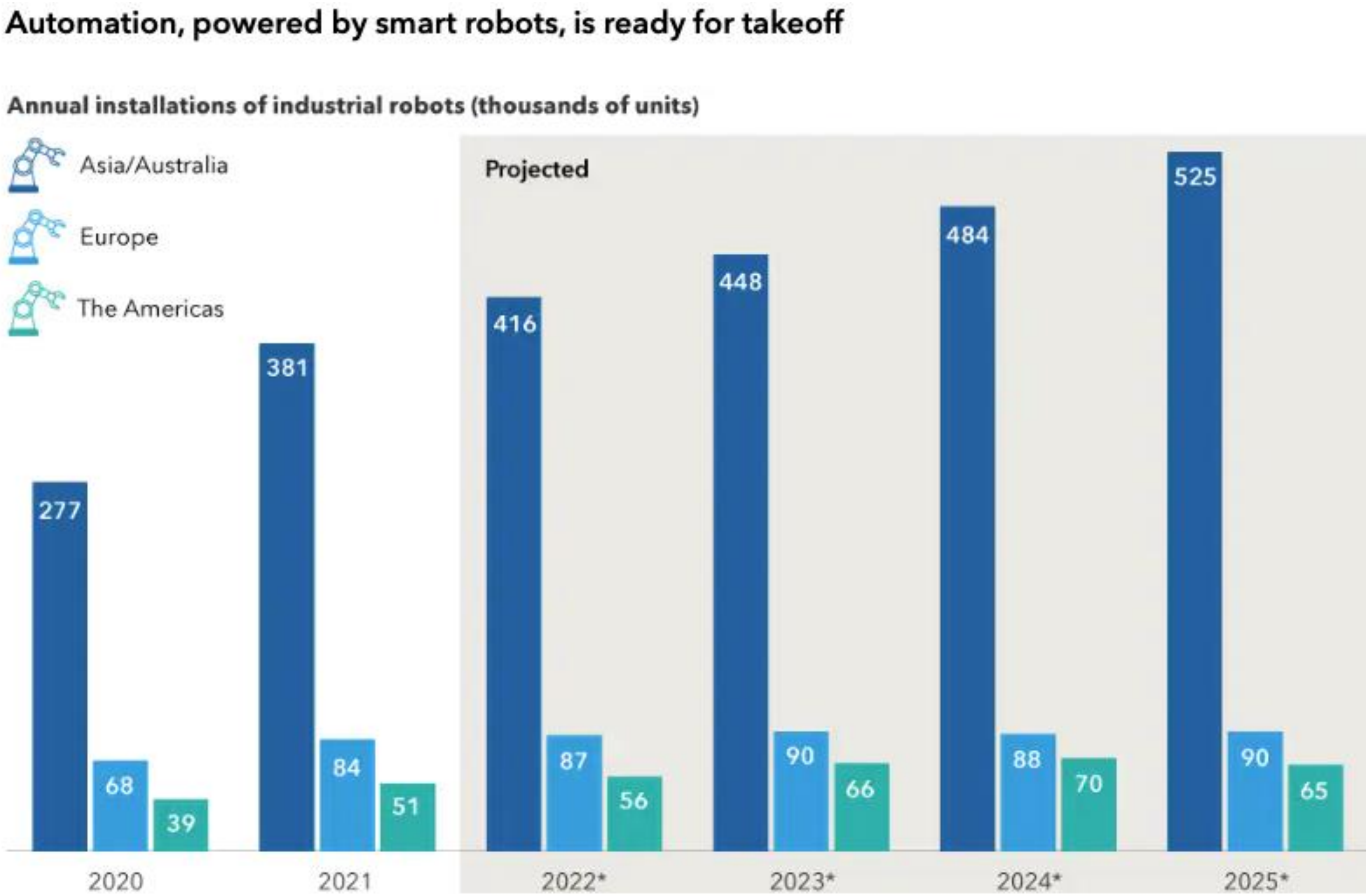
Source: RMB, Morgan Stanley

Figure 4: iShares U.S. Aerospace & Defense ETF (ITA) top 10 holdings (%)

RAYTHEON TECHNOLOGIES CORP	20,5	TEXTRON INC	4,4
LOCKHEED MARTIN CORP	15,6	L3HARRIS TECHNOLOGIES INC	4,1
BOEING	7,8	GENERAL DYNAMICS CORP	4,0
TRANSDIGM GROUP INC	5,2	AXON ENTERPRISE INC	3,9
TRANSDIGM GROUP INC	4,6	NORTHROP GRUMMAN CORP	3,7

Source: iShares, 31/12/2022

GRAPH OF THE MONTH



Source: Capital Group

SOURCES

Sources: BNY Mellon, Credit Suisse, Compound Advisors, Edmond De Rothschild, ETFMG, FactSet, Haver Analytics, JP Morgan, Julius Baer, Morgan Stanley, Refinitive, RMB, Statista, Sygnia, Strategas, UBS

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