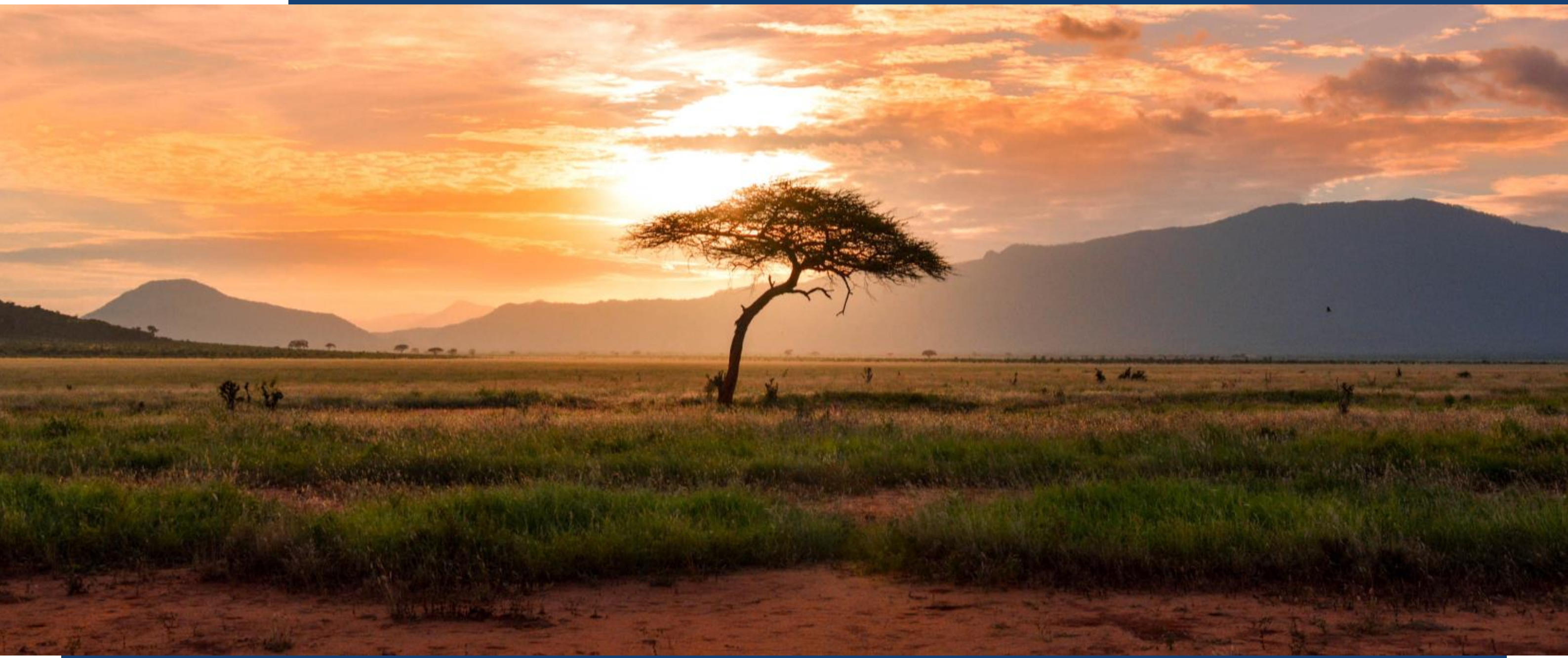
VEGA ASSET MANAGEMENT BATEBESTUUR

NEWSLETTER

July 2023 | www.vegacapital.co.za



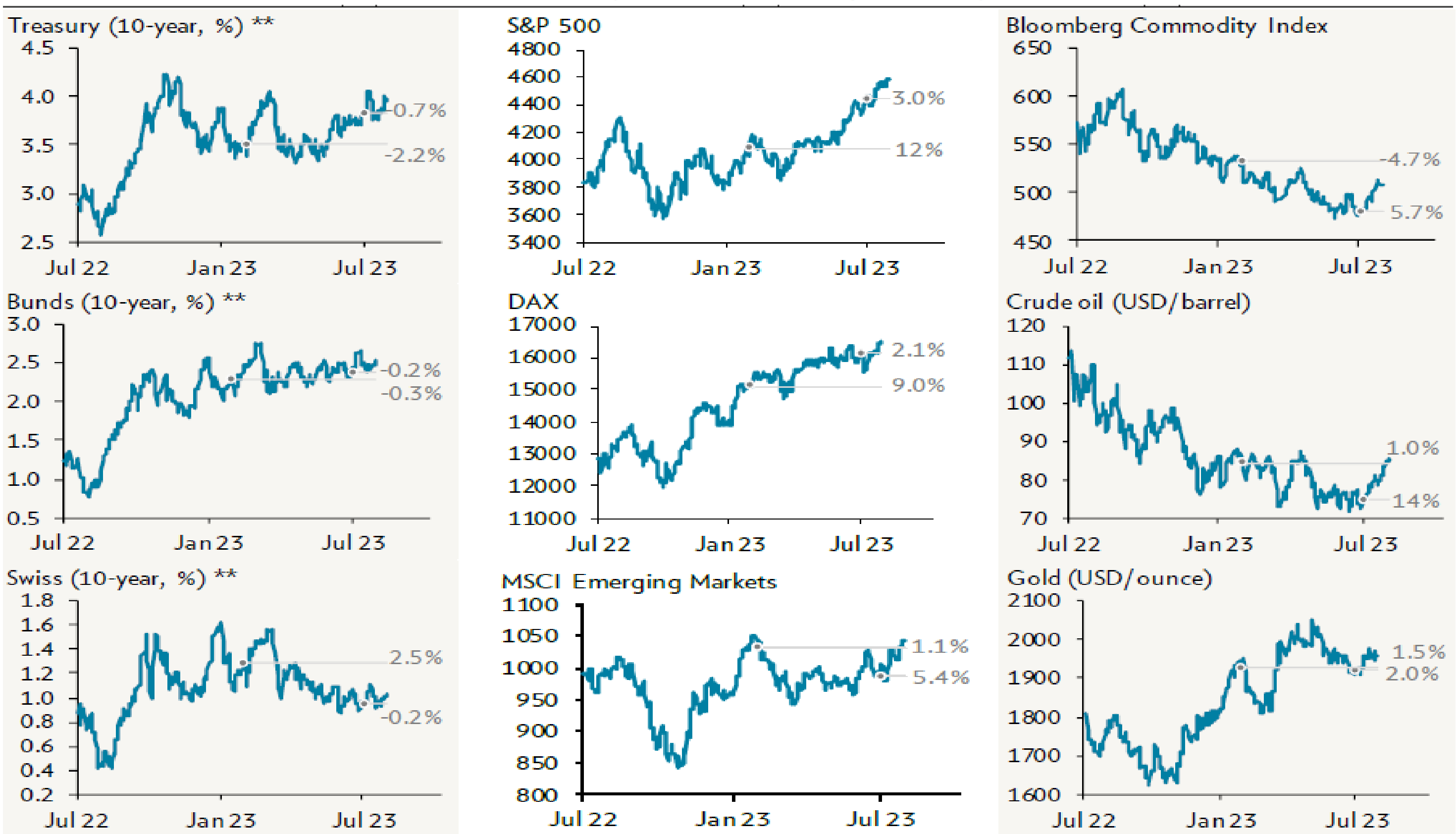
IN THIS MONTH'S NEWSLETTER

- Market overview
- Three megatrends shaping the future
- Graph of the month

"The most important quality for an investor is temperament, not intellect."
- Warren Buffett

MARKET OVERVIEW

Review (1-month and 6-month performance)



Source: Julius Bear, 01/08/2023

INTERNATIONAL

31/07/2023	Last	Month %	YTD %	5Y ann. %
MSCI World	3058	3.07	17.49	7.25
S&P 500	4589	3.11	20.00	10.07
NASDAQ 100	14346	3.83	38.12	12.93
EURO STOXX 50	4467	1.53	15.83	5.04
MSCI EM	1046	7.79	5.89	-0.17
HANG SENG	20079	6.15	-0.33	-6.28
US Equities Volatility Index (VIX)	13.33			

Source: Edmond De Rothschild

SOUTH AFRICA

31/07/2023	Last	Month %	YTD %	5Y ann. %
JSE All Share	78978	3.89	8.12	6.59
JSE Resources	64265	3.66	-9.24	9.29
South Africa 10Y Bond	11%			
CPI	5.4%			
Prime Rate	11.75%			
USDZAR	17.7117	6.41	-4.30	-6.05
EURZAR	19.5076	4.93	-7.67	-4.84

Source: RMB

During July the Q2 '23 reporting season commenced. In the United States companies continue to impress with positive earnings surprises, albeit off a low base. Three quarters US companies beat profit estimates. Nearly half of the European companies in the Stoxx 600 index have released its second quarter figures. Only 52% of them have managed to surpass consensus earnings expectations.

The US Federal Reserve (Fed) and the European Central Bank (ECB) recently implemented 25 basis point rate hikes, in line with market expectations. However, financial markets were left disappointed as they were seeking further clues on the central banks' future monetary policy direction.

Given the prevailing high uncertainty surrounding economic growth and inflation prospects, neither central bank was willing to make pre-commitments regarding their future actions. The most recent US consumer price index (CPI) reading came in lower than expected.

The largest contributor to the CPI number is still shelter (cost of renting). However, the most recent data shows that shelter inflation is decreasing. We therefore concur with consensus that the Fed will most likely pause its rate hiking cycle and probably start to cut rates gradually over the twelve months.

Despite numerous headwinds the JSE kicked off the second half of the year on a strong footing. The index gained 3.9%. A weaker USD resulted in a stronger ZAR which enticed investors back into the market. The best performing sectors for the month were financials (+7.9%) followed by resources (+3.7%),

Notable events in July 2023:

- Headline inflation came in at 5.4% y/y (May: 6.3%) which was better than expected and at its lowest reading in a year.
- President Cyril Ramaphosa has announced that Russian President Vladimir Putin will not attend the summit of the BRICS group of nations in South Africa in August "by mutual agreement".
- Just shy of four months into its current financial year, Eskom has already blown R12.4bn on diesel to run its emergency generation fleet — nearly half its budget for the entire year (R27.9-billion).
- The new VEGA/ABSA structured product listed on the 7th of July (Ticker: **AMB326**). This 5 year product will yield 10.3% per annum in US dollars if the return of the worst performing index is greater than 0% at maturity.

Figure 1: July 2023 Top 5 best and worst performing international shares

Best performing	%	Worst performing	%
Etsy	+20%	AT&T	-9%
MSCI Inc	+16%	Estee Lauder	-8%
Partners Group	+16%	Ericsson	-7%
PayPal	+14%	Spotify	-7%
Adobe	+12%	Lonza	-5%

Source: Financial Times

Figure 2: July 2023 Top 5 best and worst performing South African shares

Best performing	%	Worst performing	%
Liberty Two Degrees	+50%	Arcelormittal	-32%
Truworths	+27%	Richemont	-10%
Northam Platinum	+20%	Datatec	-10%
Sibanye Stillwater	+17%	Thungela	-10%
Transaction Capital	+16%	Murray & Roberts	-8%

Source: Financial Times

THREE MEGATRENDS SHAPING THE FUTURE

In this newsletter, we will delve into the investment themes that form the core of our long-term investment strategy. Our focus is on identifying opportunities that have the potential to outperform the general market over the long term. While short-term performance may vary, we remain steadfast in our belief that these megatrends have the potential to deliver favourable returns and create value for investors.

Megatrends encompass enduring demographic, ecological, economic, social and technological shifts that fundamentally alter the world we inhabit. Although not a recent phenomenon, the pace and scale of these trends may have intensified in recent years, leading to a heightened public awareness of their significance. Throughout history megatrends have played a crucial role in shaping our global landscape, reflecting the ongoing changes that humanity both confronts and propels.

A pertinent illustration of this phenomenon is the theme of 'Energy Transition,' which has garnered significance in response to mounting concerns about sustainability, escalating evidence of climate change and the ramifications of the recent energy crisis. Thematic investments therefore, present themselves as a compelling approach for investors seeking to align their portfolios with prevailing societal and environmental trends.

While we coexist within the realm of these transformative forces, comprehending their intricacies can prove challenging. Some of these trends may begin modestly, seemingly lacking immediate significance. However, over time their potency can grow exponentially to a point where they become unstoppable and irreversible once recognized. Often, these trends operate in a self-sustaining manner, intricately interwoven and overlapping, further amplifying their impact and permanence.

The transformations instigated by megatrends give rise to novel, superior solutions and services, subsequently bolstering the economy's productivity. Our conviction lies in the notion that economic factors predominantly dictate the long-term success or failure of these megatrends, despite the fact that governmental support frequently nurtures these new solutions and services. Some perceive regulators as instrumental in promoting new technologies. As an illustrative example, clean energy has now attained cost competitiveness without subsidies in the majority of the world, while electric vehicles often outperform their conventional counterparts in terms of lower total cost.

Upon identifying an investment theme, our primary objective is to assess which companies are positioned to capitalize on the anticipated structural changes. Equally relevant we also evaluate those companies that may face challenges due to their business models' inability to adapt to these transformations. In essence, our task revolves around comprehending the comparative advantages and disadvantages inherent in each industry, enabling us to discern the probable beneficiaries and casualties of such structural shifts, thus distinguishing the leaders from the laggards.

To accomplish this several prerequisites come into play. Firstly, a thorough understanding of the theme's value chain is essential, along with a comprehensive analysis of the strengths and weaknesses exhibited by the involved companies. Additionally, we must be vigilant about identifying the various opportunities and threats that might be overtly evident or lurking in the background. This calls for a comprehensive toolkit, enabling us to conduct in-depth economic and financial analyses for the companies under scrutiny. Such rigorous assessment empowers us to make informed investment decisions based on the prospects of success or challenges posed by the structural changes at hand.

Megatrend 1: Artificial Intelligence

Artificial intelligence (AI) has transcended its previous abstract status and has emerged as a versatile technology with widespread applications across various domains, including healthcare, finance, advertising and numerous others. The recent surge of interest in ChatGPT, a program specifically designed to enhance language models for conversational purposes, has intensified discussions surrounding the economic and societal implications of AI. The objective of AI is to enhance the intelligence and utility of machines, resulting in improved efficiency and productivity. By employing AI judiciously, companies can gain a competitive advantage, gain deeper insights into customer needs and ultimately experience increased revenues or reduced costs. While the rationale behind investing in AI is primarily based on structural considerations, the evolution of AI will be shaped by two key factors:

1. The availability of extensive data: The abundance of data plays a crucial role in the development and advancement of AI. As data volumes continue to grow significantly in the coming decades, the speed and accuracy of AI systems are expected to improve correspondingly.

2. Increasing computing power: The progress in computing power is another pivotal factor influencing the evolution of AI. Continued advancements in computational capabilities will contribute to the refinement and effectiveness of AI technologies.

Concerns regarding data collection, security and privacy have emerged leading to a public debate surrounding these issues. Despite the optimistic outlook for the growth of computing power and data availability, the unresolved concerns related to data handling have added complexity to the AI landscape.

There are four clusters of companies that are expected to reap the benefits of artificial intelligence (AI):

1. Large technology companies: These companies are poised to be the primary beneficiaries of the widespread adoption of AI. They possess extensive expertise in AI, accumulated through years of substantial investment. As a result, they are well-positioned to introduce and market AI-enhanced products and services. Furthermore, these companies have significant financial resources, enabling them to swiftly invest and allocate capital in high-growth areas, such as AI, which constitutes a pivotal component of their future growth strategies.

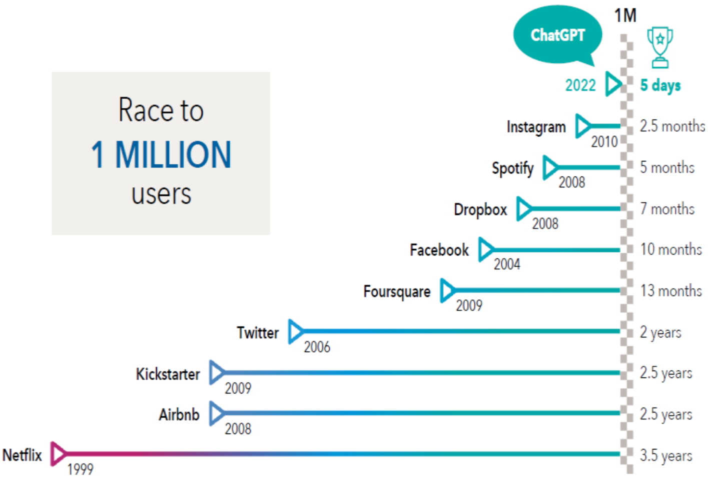
2. Software companies, cloud services, data analytics and cybersecurity firms: The AI software market is projected to reach USD 192 billion by 2025, with a compound annual growth rate (CAGR) of 31%, according to IDC. Despite concerns about inflation and an impending economic downturn, spending on AI and automation technologies and solutions continues to surge, as stated by Ritu Jyoti, Vice President at IDC. Software companies, providers of cloud services and firms specializing in data analytics and cybersecurity are well-positioned to capitalize on this growth.

3. Semiconductors: The expansion of cloud computing and AI is generating substantial demand for semiconductors, including computing units, memory, and other components specifically designed for AI applications. Industry estimates project that sales of AI-specific chips will reach USD 77 billion by 2025, a significant increase from USD 11.2 billion in 2021. This heightened demand will greatly benefit chipmakers and companies involved in the production of semiconductor equipment.

4. Healthcare and defence: AI is poised to revolutionize research and development (R&D) across various industries, particularly in the field of medicine and pharmaceuticals. One of the most significant impacts of AI in this context is the accelerated development of new medications. According to Edmond du Rothschild, AI could reduce the time needed for the development of a new drug from 10 years to 5 years and also halve the (R&D) budget from the current USD 1 billion to USD 2 billion needed per new treatment.

Figure 3 illustrates the pace at which general AI uptake is increasing. It took ChatGPT just 5 days to reach one million users compared to Facebook which managed to reach one million users after 10 months.

Figure 3: Time for selected online services to reach one million users

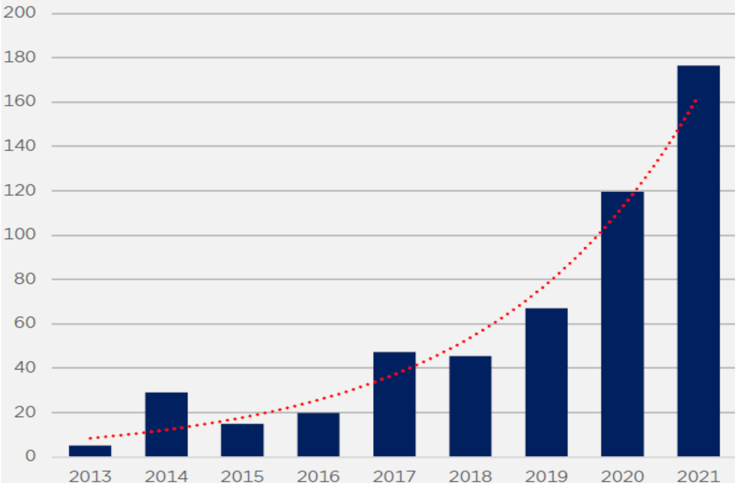


Source: Capital Group

The global investment landscape and businesses alike are increasingly acknowledging the significant positive impact that AI adoption can have across various industries. Simultaneously, they are also recognizing the potential risk of being left behind or replaced by competitors if they fail to embrace AI technology.

Private sector investment in AI has been experiencing rapid growth, with an average yearly increase of 55% since 2013. This substantial growth in AI investments reflects the growing confidence in AI's ability to drive innovation, improve efficiency and create new business opportunities. Companies are actively seeking to leverage AI to enhance their products, services and operations, thereby gaining a competitive edge in the market.

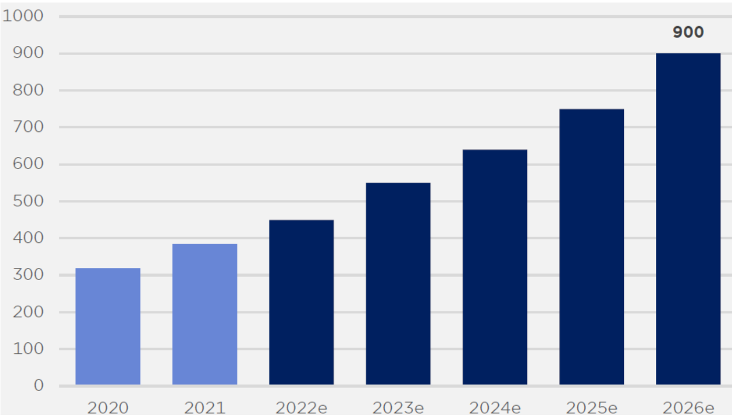
Figure 4: Investments in AI by the private sector since 2013 (in USD billions)



Source: Edmond de Rothschild

The enthusiasm surrounding AI comes as no surprise, considering that the global AI market is predicted to achieve a remarkable valuation of 900 billion US dollars by the year 2026. Figure 5 graphically illustrates the projected trajectory depicting the significant increase in the value of the AI market over time. This anticipated growth highlights the immense potential and opportunities that AI technology holds across various industries and sectors.

Figure 5: Estimated global AI market between 2020 and 2026e, in billions of dollars



Source: Edmond de Rothschild

Companies and Exchange Traded Funds (ETFs) which form part of our investment universe:

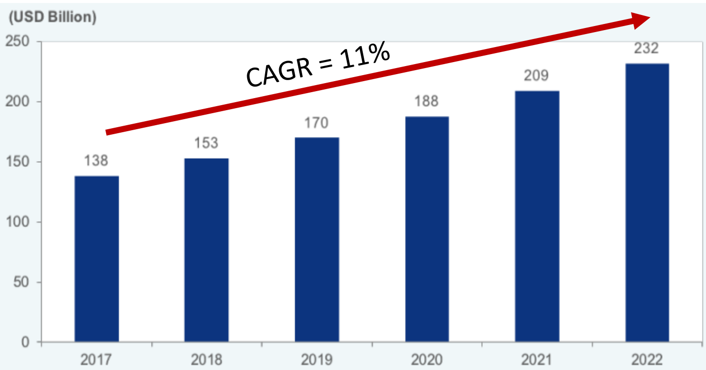
- Microsoft (MSFT)
- Amazon (AMZN)
- Alphabet (GOOGL)
- Nvidia (NVDA)
- Tesla (TSLA)
- iShares Automation & Robotics UCITS ETF USD (RBOT)
- iShares US Technology ETF (IYW)

Megatrend 2: Cybersecurity

In an incrementally digitised world, we live in an era where cyberspace has become indispensable for our everyday activities. The digital era has entered all aspects of our lives – from working, banking, shopping and so on. These advancements have made our lives without a doubt easier. However, our increasing reliance on cyberinfrastructure makes us more vulnerable to cyberattacks. According to the University of Maryland's Clark School of Engineering, a cyber-attack occurs every 39 seconds and affects at least one in three Americans each year.

The global cybersecurity market grew from $3.5 billion in 2004 to about $138 billion in 2017, more than 39x in 13 years. In 2017 the aerospace and defence vertical had the largest share of the cybersecurity market. However, going ahead government, banking, financial services and insurance, IT and telecom verticals are expected to gain traction. From 2017 to 2022, the cybersecurity market is expected to grow at a CAGR of 11% p.a. to reach $232 billion.

Figure 6: Estimated cybersecurity market growth



Source: Statista

How do we protect ourselves against enemies we cannot see or hear and do not even know of?

The answer lies in creating an effective cybersecurity program and structure. Today the cybersecurity market is fragmented and there are different products and solutions that target different needs. Cybersecurity products can be divided into many groups and subgroups:

- **Network security equipment:** is one of the largest markets and includes all appliances that protect the network traffic. Among the products in this group are firewalls and intrusion detection and prevention systems. The largest players within network security equipment are Palo Alto Networks, Cisco, Check Point Software and Fortinet.

- **Endpoint security:** focuses on protecting end-user devices such as desktops and laptops from being exploited during cyberattacks. Within this segment, we are seeing a radical shift in market shares, with incumbents (Symantec, McAfee, Trend Micro) that are anchored to on-premises architectures, losing ground to cloud-native players (CrowdStrike and Carbon Black).

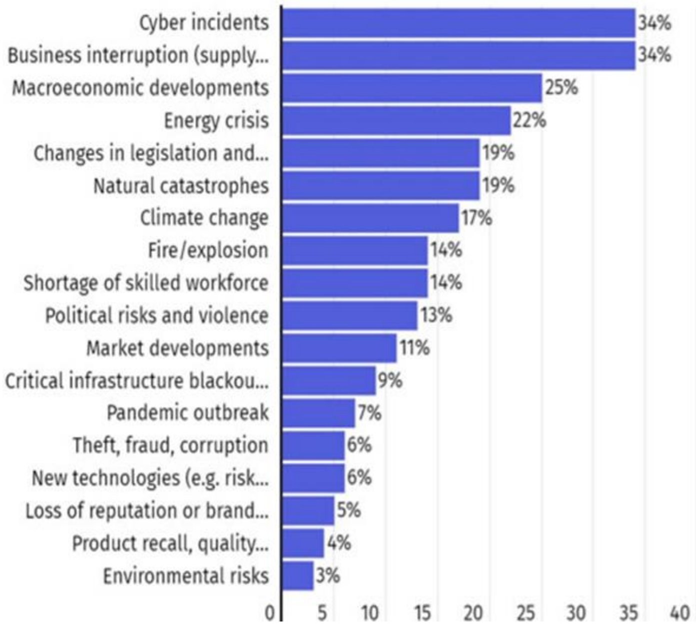
- **Email security:** focuses on protection against malicious attacks hidden in emails but also ensures the security of data contained in outbound traffic. In addition to Microsoft, the largest players are Symantec and Cisco.

- **Identity and access management:** for a long period of time, passwords were the main if not the only method of authentication and when in the wrong hands, giving unauthorised access to internal networks, devices, and professional information. This segment of cybersecurity is benefiting from the transition to the cloud and the shift towards zero-trust securities and is expected to grow in the high single digits in the next few years. Microsoft, Okta, SailPoint, Oracle and IBM are the largest providers.

- **Cloud security:** Cloud workload protection platforms offer network segmentation, traffic visibility, configuration and vulnerability measurement. The market for cloud security offerings is fragmented and still in its infancy but Gartner, a technological research firm values this sector at USD 1 billion. Some of the main providers within the cloud space are Zscaler, Palo Alto Networks and Cloudflare.

- **Application security:** protects data or codes within an application (app) from being stolen or hijacked. Application security includes all processes that minimise vulnerabilities during the software development cycle and solutions to find, fix and prevent security issues. The market is still relatively small, with the main players being Zscaler and Symantec.

Figure 7: Leading risks to businesses worldwide in 2022 and 2023



Source: Statista

Companies and Exchange Traded Funds (ETFs) which form part of our investment universe:

- ETFMG Prime Cyber Security ETF (HACK)
- First Trust NASDAQ Cybersecurity ETF (CIBR)
- Palo Alto Networks (PANW)
- Fortinet (FTNT)
- Check Point Software (CHKP)
- Microsoft (MSFT)

Megatrend 3: Aerospace and defence

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.

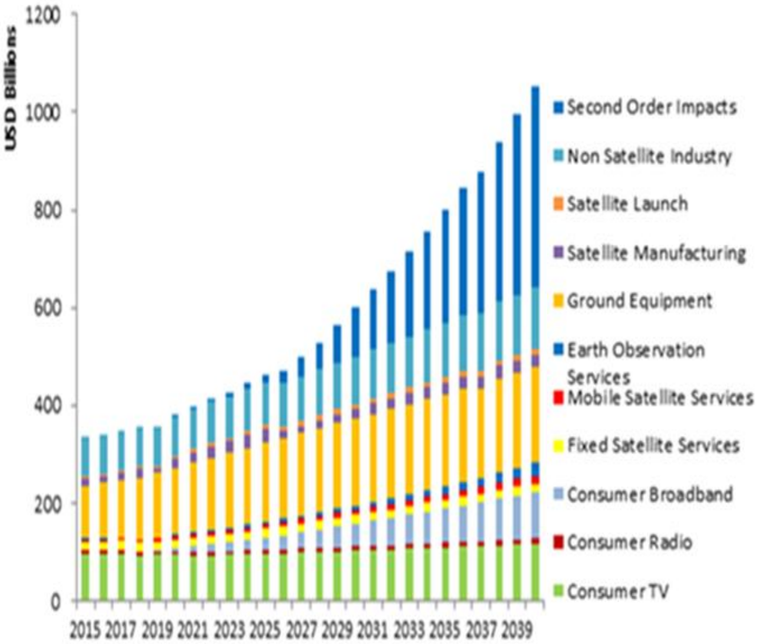
Defence stocks tend to be stable contributors to an income-focused portfolio, with predictable long-term revenue streams that translate into solid dividends. The head of BAE systems recently said that "Before, we had time but no money. Today, we have money but not time."

Most countries have reduced defence budgets over the last decade driving down inventory levels and effectively forcing companies to decrease capacity, especially European countries. European defence ministries have long standing business ties with US weapons makers such as Raytheon Technologies and Lockheed Martin, but America's powerful industry alone cannot fulfil all global demand.

"At one stage this year Russia was firing a similar amount of ammunition at Ukraine in a single day as Europe was able to produce in a month" - Business day

Nato wants to boost the size of its so called high-readiness forces to 300 000, a sevenfold increase, all of whom needs high quality weapons ready for use. As one can imagine orders for weapons are pouring in, but the fear in the industry was that it could expand production only to find that when new facilities open in three to five years' time, there is no demand. To combat this Nato allies recently agreed to a firmer commitment to spend 2% of gross domestic product on defence.

Figure 8: Space economy and its subsectors/themes forecast up to 2040



Source: Morgan Stanley

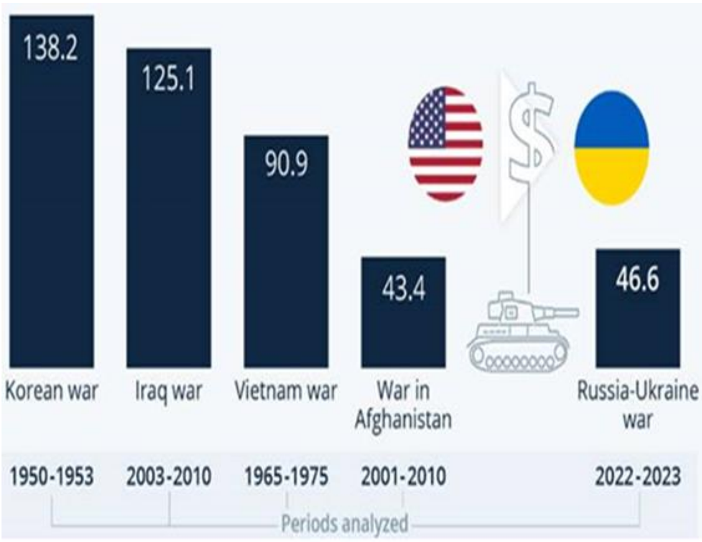
The aerospace and defence industry plays a vital role in the global economy by supporting and facilitating passenger transportation, trades, logistics, security and defence. The industry consists of several players servicing both commercial and military operations across the value chain.

These players include aircraft manufacturers such as Boeing and Airbus; parts 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.

Figure 9 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.

Figure 9: Annual average US military spending by war vs US military aid to Ukraine (in $bn's)

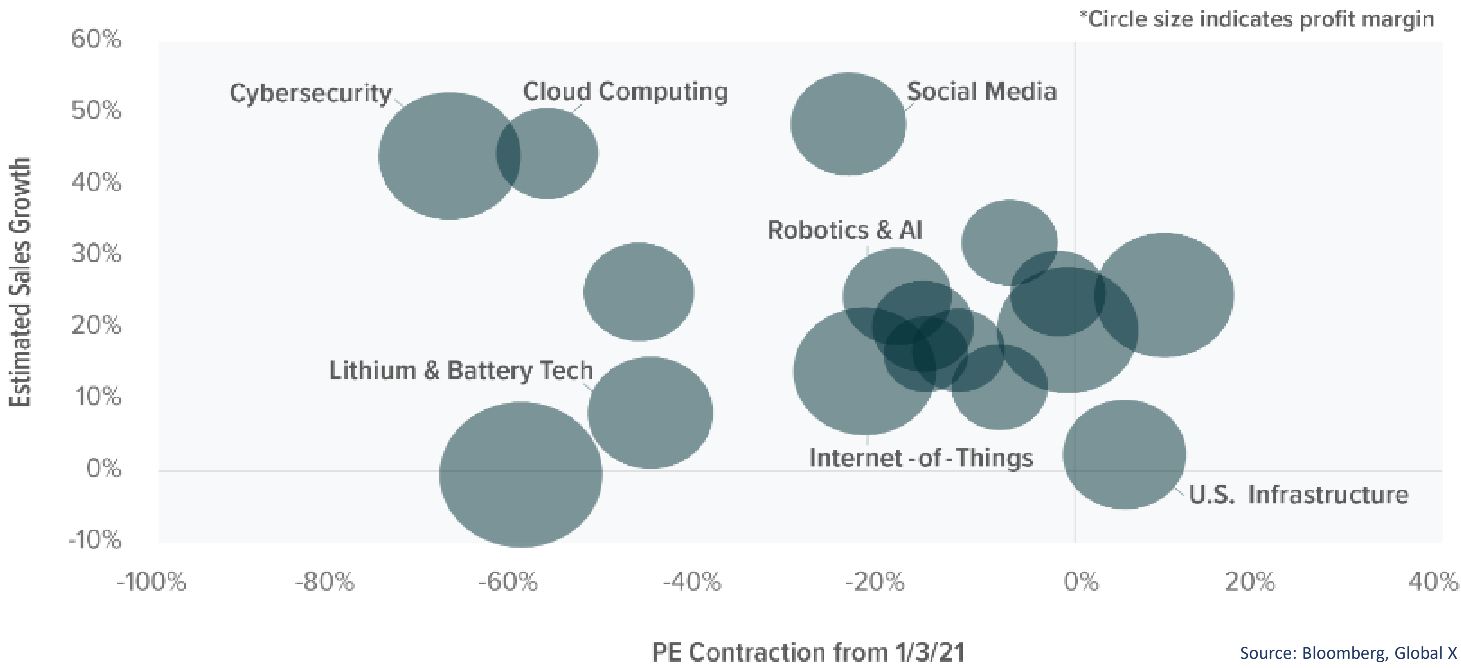


Source: RMB, Morgan Stanley

Companies and Exchange Traded Funds (ETFs) which form part of our investment universe:

- BAE systems (BA)
- Hensoldt (HAG)
- Honeywell (HON)
- Lockheed Martin (LMT)
- Rheinmetall (RHM)
- iShares US Aerospace & Defense ETF (ITA)
- Invesco Aerospace & Defense ETF (PPA)

GRAPH OF THE MONTH: THEME VALUATION, SALES GROWTH AND PROFITABILITY



Source: Bloomberg, Global X

The high-growth megatrends have witnessed a decline in their overall valuation. For instance, the cybersecurity and cloud computing sectors experienced a significant contraction of approximately 60%, despite exhibiting an estimated sales growth of nearly 50%. This observation underscores the presence of quality growth companies and themes with relatively attractive valuations.

SOURCES

Sources: Bloomberg, BNY Mellon, Charlie Bilello, 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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You are more than welcome to pass this newsletter on to friends and family who may wish to learn more about investing. If you know of anybody who is interested in investing in local and offshore equities please do not hesitate to send them our contact details.

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