NEWSLETTER

September 2023 | www.vegacapital.co.za

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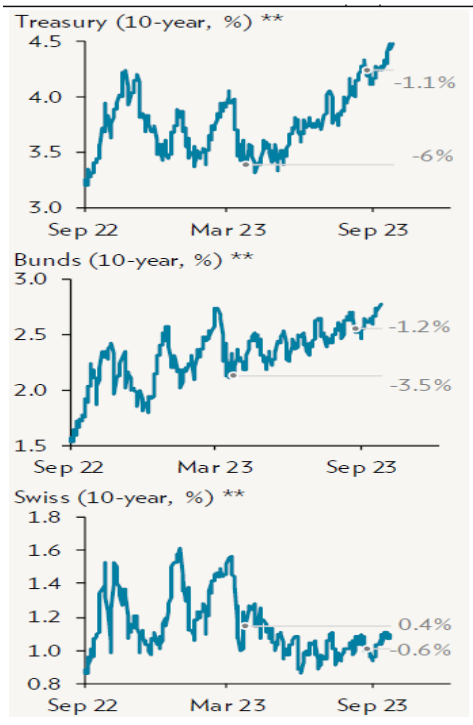
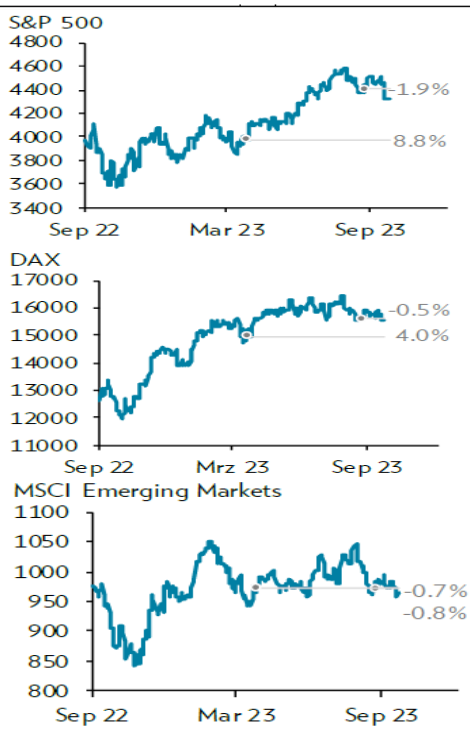
"If you do not take an interest in the affairs of your government, then you are doomed to live under the rule of fools."

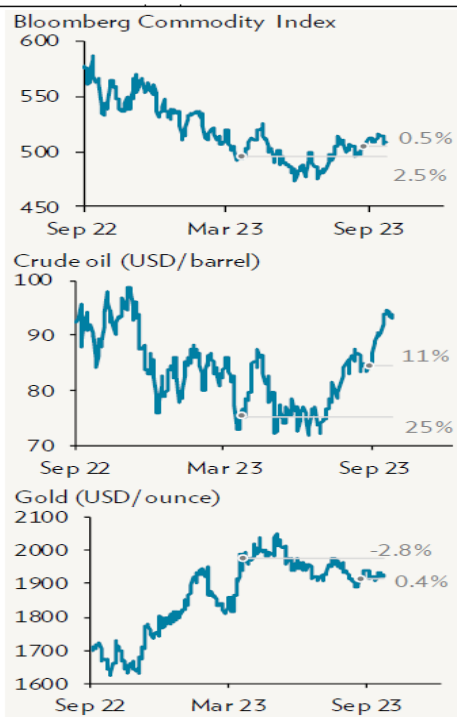
- Plato

MARKET OVERVIEW

Review (1-month and 6-month performance)







Source: Julius Bear, 25/09/2023

VEGA Asset Management (Pty) Ltd • Reg No 2001/017303/07
Authorised Financial Services Provider & Registered Asset Manager • FSP Reg No 776
MW von Wielligh (Non-executive Chairman) • FP du Plessis (Managing Director) • CP Bester (Non-executive Director)

30/09/2023	Last	Month %	YTD %	5Y ann. %
MSCI World	657	-4.27	8.48	4.61
S&P 500	4288	-4.87	12.13	8.24
NASDAQ 100	14715	-5.07	35.47	14.74
EURO STOXX 50	4175	-2.85	8.26	4.53
MSCI EM	953	-2.81	-0.35	-0.90
HANG SENG	17810	-3.11	-11.59	-7.69
US Equities Volatility Index (VIX)	17.52%			

Source: Edmond De Rothschild

Markets reacted negatively to the Fed's announcement of potential further monetary policy tightening by the end of the year and the prospects of higher-than-expected interest rates in the USA and Europe. The European Central Bank (ECB) took an unexpected step by raising its primary interest rate by 25 basis points during its September meeting.

This decision, while substantiated by persistently high inflation forecasts, was underscored by the minutes and statements from ECB President Christine Lagarde, which suggested that this increase would likely be the final adjustment in the foreseeable future.

The Bank of England (BoE) surprisingly concluded a streak of 14 consecutive interest rate hikes, maintaining its key rate at 5.25% despite ongoing inflationary pressures. The BoE signaled its readiness to resume a tightening monetary policy approach should inflationary trends persist.

Equity markets displayed strong performance from January to July, but gave back some gains over the past two months due to investor concerns. These concerns can be attributed to several key factors:

1. Inflation in the US surprising to the upside

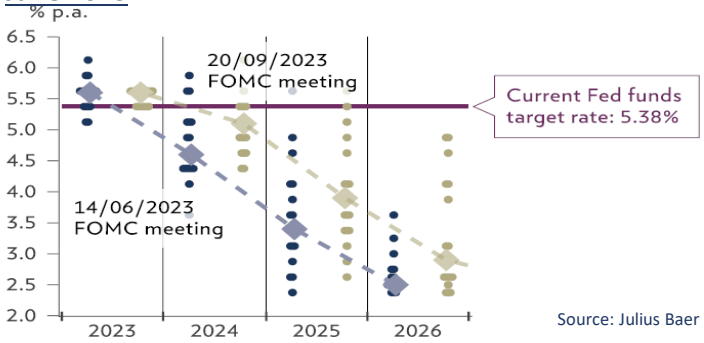
The main contributor to the inflation surprise was the jump in oil prices. The OPEC+ countries decided to cut oil production in August to boost prices. Oil supply will remain tight as Russia and Saudi Arabia extended production cuts to the end of the year. The short to medium term is likely to witness heightened oil prices due to increased demand and supply constraints.

2. Fed interest rate projection – higher for longer

The Fed delivered the expected interest rate pause in September. The increase in its "dot plot forecasts" is what scared the markets. Markets were expecting much more pronounced interest rate cuts in the United States in 2024. The Fed indicated that their Fed fund rate projections for 2024 are much more hawkish than the market anticipated. Investors are concerned that the "higher for longer" narrative will put too much pressure on the US economy.

Figure 1 illustrates the increase in future interest rates in the US. If the current projections are indeed correct, that would mean that the US is still in the early stages of a long restrictive monetary policy regime (the Fed Fund rate is greater than the CPI). That would be an enormous shift from the ultra-easy policy that has prevailed since 2008.

Figure 1: Federal Reserve 'dot plot' September versus June 2023



Source: Julius Baer

The silver lining is that historically the Fed's projections have not been accurate at all. This is why investors should not be putting too much weight on the current forecasts. The Fed wants to slow down inflation as it is the main concern however when economic data starts to deteriorate, that narrative will likely change fast and so will the Fed's forecasts about the future.

3. Global growth slowing

The Federal Reserve is currently in a more favorable position compared to many other central banks worldwide. The U.S. economy remains robust, marked by low unemployment rates and overall strength. This makes it easier for the Fed to hike interest rates to keep inflation under control. Conversely, the European Central Bank (ECB) confronts a more complex scenario.

Several of the largest economies in Europe are experiencing low to no growth, while inflation is still relatively high. This presents a considerable challenge as the ECB would like to hike rates more to tame inflation.

4. Equity risk premium

The equity risk premium represents the additional return that investing in the stock market offers over a risk-free asset (typically measured by the yield of the 10-year US Treasury bond). No investment is completely risk-free but the US treasury bonds are considered to be less risky than equities and for that reason, equities should yield higher returns. The equity risk premium of the S&P 500 has been diminishing, primarily due to the increasing yield of the 10-year bond.

The yield of the US 10-year bond has risen substantially, currently trading at approximately 4.5%, a notable shift from its low point of around 0.6% in 2020. It's important to note that bond prices move inversely to yields, which means that bond prices have experienced a significant decline over the past three years, rendering them an appealing proposition for investors.

Summary

Going forward, we expect policy rates to remain on hold until the third quarter of 2024 before the rate-cutting cycle begins. Looking at previous end-of-tightening cycles since the early 1970s, the evidence suggests that equity returns tend to be positive following the last rate hike. In eight out of eleven instances, S&P 500 returns were positive over the next 12 months after the last rate hike. We also see opportunities in the bond markets as interest rates decrease.

SOUTH AFRICA

30/09/2023	Last	Month %	YTD %	5Y ann. %
JSE All Share	72383	-3.43	-0.91	5.47
JSE Resources	57555	0.14	-18.71	5.56
South Africa 10Y Bond	10.81%			
CPI	4.80%			
Prime Rate	11.75%			
USDZAR	18.7840	-0.52	-11.43	-5.69
EURZAR	19.9242	2.07	-10.37	-3.83

Source: RMB

The JSE All-Share index followed global markets lower, ending 3.4% down the month. South Africa's rand depreciated to a three-month low against the dollar and yields on the benchmark government bonds reached record highs amid a selloff fueled by concern about the country's fiscal outlook as well as the risk-off mood globally.

During the latest meeting, the South African Reserve Bank (SARB) kept rates unchanged. However, the hawkish remarks articulated by Governor Lesetja Kganyago prompted money markets to factor in an anticipation of a 42 basis points increment over the course of the subsequent two meetings. The escalation of US Treasury yields and the resurgence of the dollar have adversely affected riskier assets on a global scale.

This is further compounded by a surge in oil prices, which in turn fosters expectations of a prolonged period of elevated interest rates in the world's largest economy. The price of petrol increased by R1.71 per liter and diesel has seen a nearly R3 per liter surge. This recent surge in fuel prices can be attributed to a dual causation: a considerable depreciation of the exchange rate and a markedly elevated oil price.

In other news, the 2023 Global Organised Crime Index was released during the month South Africa scored a 7.18 criminality score (out of 10) - **the seventh highest in the world** (out of 193 countries) and the third in Africa. South Africa's score was 6.63 in 2021 - the last time the index was published.

Outlook

Political uncertainty going into an election year in 2024 together with still rather lackluster policy initiatives to elevate growth keeps us relatively defensively positioned. A higher oil price will likely add to inflationary pressure, although the impact of higher fuel prices is usually overstated.

Naspers (NPN)/Prosus (PRX)

Prosus' shares traded sharply lower earlier this month as shareholders received rights to an upcoming share issue similar to a share split. Existing shareholders received the right to 1.18 new shares for each share they held.

This initiative forms a crucial component of Prosus' strategy to unravel a complex cross-holding arrangement with its parent company, Naspers of South Africa. It is imperative to recognize that the ostensibly dramatic 55% reduction in the Prosus share price on September 13 is, in essence, the adjustment for the fact that shareholders will soon have more Prosus shares due to the capitalisation award than they had before.

During the month, Bob van Dijk announced his immediate resignation as CEO by 'mutual agreement.' Following Van Dijk's abrupt departure, Ervin Tu was appointed as the interim CEO of the group. One of the pivotal challenges faced by Naspers, a responsibility entrusted to Van Dijk, was mitigating the historical discount at which the company's shares traded relative to its investment in the Chinese internet behemoth, Tencent Holdings.

Astral (ARL)

Astral issued a trading update this month, projecting a headline loss ranging from R18.02 to R18.08 per share for the fiscal year ending on September 30. This contrasts sharply with the previous year's profit of R27.62 per share. The primary cause of this downturn is attributed to persistent power outages. Astral has indicated that it is incurring a monthly expenditure of R45 million to operate diesel generators.

Furthermore, Astral stated that the ongoing electricity crisis has significantly disrupted the poultry industry, resulting in escalated operational expenses. These challenges have been further exacerbated by additional costs associated with what has been described as "the worst" bird flu outbreak, spreading rapidly across South Africa's Gauteng and Mpumalanga provinces. The rate of spread is deemed alarming.

Spar (SPP)

The Spar Group issued a trading update this month, disclosing an anticipated loss of R1.4 billion stemming from challenges encountered in the implementation of a new SAP system in KwaZulu-Natal. Nonetheless, the management is content to report that the KZN distribution center has successfully resumed service to all stores in the region. The SAP solution has demonstrated stability and maintained consistent performance.

Additionally, The Spar Group has conveyed its intention to divest its struggling Spar Poland business, thereby effecting its withdrawal from the Polish market. We interpret this decision as a potential indication that the new management team may adopt a more rigorous approach to capital allocation, a development we believe could augur well for the company's stock. At present, Spar is trading at a 12-month forward Price-to-Earnings (PE) ratio of 9.8x.

Transaction Capital (TCP)

Earlier this month, Transaction Capital's shares experienced a precipitous decline of 20% subsequent to the announcement of CEO David Hurwitz's forthcoming departure in the early part of the next year. The group, which has witnessed an 80% reduction in its share price this year, following an unexpected profit warning in March, is grappling with the challenge of revitalizing its SA Taxi enterprise.

This endeavor is further complicated by unforeseen underperformance at WeBuyCars and a lackluster performance at the debt-collection entity, Nutun. The SA Taxi unit is particularly vulnerable, necessitating support from debt financiers to maintain its operational viability. Transaction Capital's outlook remains bleak and we continue to avoid the counter.

The psychology of money: Part 1 of 2

The Psychology of Money by Morgan Housel is a popular book that explores the psychological and behavioral aspects of money management and financial decision-making. The author delves into various anecdotes, stories, and insights to shed light on how human emotions and behaviors can significantly impact our financial well-being. In this series, we delve into 20 lessons that stood out for us from this book.

Lesson 1: Our Worldview is limited

This lesson emphasizes that our understanding of the world is primarily shaped by our personal experiences, which represent only a fraction of what's happening globally. When it comes to money, our past experiences influence our attitudes and beliefs about it. Recognizing this limitation can encourage us to be more open to new ideas and perspectives, which may lead to better financial decisions.

Lesson 2: Luck vs. risk

Distinguishing between luck and risk is crucial for making sound financial decisions. Luck refers to events or circumstances that are beyond our control, while risk involves the uncertainty associated with a particular decision or investment.

Understanding this difference helps us recognize that sometimes, even a well-thought-out decision can be affected by bad luck, and conversely, a poor decision might appear successful due to good luck. This awareness aids in making more informed choices and avoiding unnecessary risks.

Lesson 3: Knowing when enough is enough

This lesson highlights the tendency of many people to continually seek more, even when they already have enough to meet their basic needs. It encourages us to recognize when we have reached a point where we have sufficient resources to live comfortably. Being content with what we have can lead to greater financial satisfaction and overall well-being.

Lesson 4: Don't risk what's important

This lesson underscores the idea that certain aspects of our lives, such as reputation, freedom, family, friends, and happiness, should never be jeopardized for the sake of financial gain. It emphasizes the importance of prioritizing non-monetary values and not taking unnecessary risks that could negatively impact these essential aspects of life.

Lesson 5: The magic of compound interest

Compound interest is a financial concept where the interest earned on an investment is reinvested, leading to exponential growth over time. This lesson emphasizes the power of compound interest in building wealth when used wisely. It suggests that consistently investing money in low-cost index funds over an extended period can lead to significant financial growth.

Lesson 6: Plan for the worst

This lesson emphasizes the importance of being prepared for unexpected financial challenges or emergencies. Having an emergency fund, which ideally covers six months to a year's worth of living expenses, provides a safety net to help weather difficult situations. By planning for the worst, individuals can reduce financial stress and maintain stability during unforeseen circumstances.

Lesson 7: Take control of your finances

Taking control of your finances means being proactive and making decisions that align with your own financial goals and values, even if they differ from conventional wisdom or societal norms. It's about recognizing that you have the power to shape your financial future and should make choices that are right for you, rather than simply following the crowd.

Lesson 8: Freedom is key

This lesson underscores the significance of prioritizing personal freedom in one's life. It suggests that even if you enjoy your current job or situation, it's important to focus on building financial freedom. This is because circumstances can change unexpectedly, and having a level of financial independence provides flexibility and options in how you live your life.

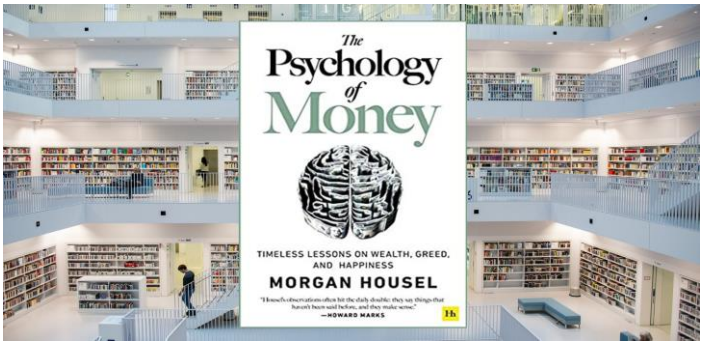
Lesson 9: Nobody cares about your stuff

Often, people believe that owning impressive material possessions will earn them admiration or respect from others. However, this lesson reminds us that, in reality, most people don't place much importance on our material belongings. Recognizing this can be liberating, as it means we don't need to seek validation or approval through material wealth.

Lesson 10: Be wealthy, not flashy

True wealth, according to this lesson, is not determined by extravagant displays of affluence or how much money is spent on conspicuous consumption. Instead, it's defined by the freedom and security that financial well-being provides. The focus should be on building wealth in a way that allows you to lead a life aligned with your own values and preferences.

These lessons provide valuable insights into the psychological and behavioral aspects of money management, helping individuals make more informed and balanced financial decisions.



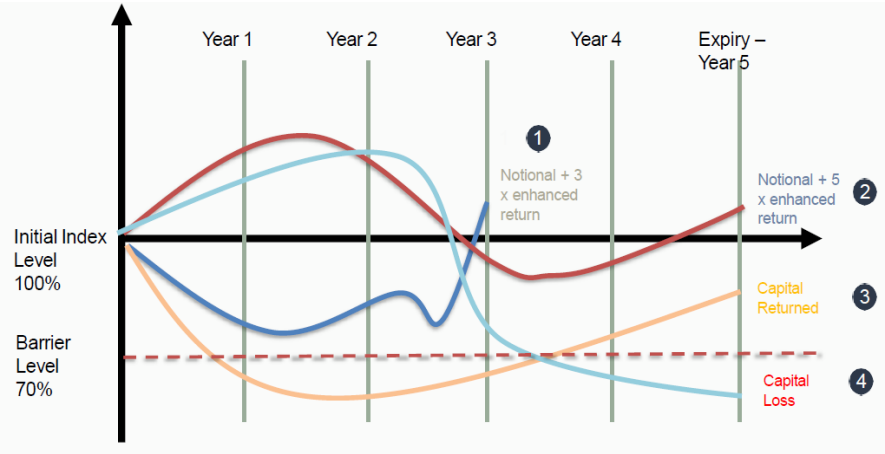
New Investec USD S&P 500 autocall (SPXIIN)

During the month, there was an autocall of the **SPXIIJ structured product** on the local portfolios. The final terms of the product were 8.5% x 3 = 25.5% x the USD/ZAR exchange rate on 22 September 2023 (18.8950). The cash settlement amount was R1,414.66 per instrument yielding a return of 12.26% p.a. in ZAR.

We are pleased to announce a replacement for the SPXIIJ product with a new 5-year autocall on the S&P 500 index. Salient features of the new product (SPXIIN):

- A maximum 5-year investment linked to the performance of the S&P 500 Index.
- The autocall pays an 8.4% return p.a. in USD if the index is flat or above the initial index level on an automatic call date.
- The automatic call dates are in years 3, 4 and at maturity.
- 100% capital protection in US dollars provided the Index does not end more than 70% below the initial index level at maturity.
- The credit reference entity is Barclay PLC.

Payoff profile



Important dates:

- Closing date: 16 October 2023
- Trade date: 20 October 2023
- Listing date: 25 October 2023
- Maturity date: 20 October 2028

Examples (corresponding to numbers on the graph).

Assuming $10 000 is invested in the USD Autocall with an unchanged exchange rate:

1. Pay out = 10 000 x (8.4% x 3) = 12 520
2. Pay out = 10 000 x (8.4% x 5) = 14 200
3. Pay out = 10 000
4. Pay out = 10 000 x final index level / initial index level

Example

Index Scenario at Maturity Date	Initial of R100,000 Investment at R18/$	Enhanced Return in USD	Final Investment Value in $	Final Investment Value at R22/$	Resulting Return at R22/$	Final Investment Value at R16/$	Resulting Return at R16/$
Index +10%	$5,556	(8.4% x 5) =42%	$7,889	R173,558	73%	R126,224	26%
Index -10%	$5,556	0%	$5,556	R122,222	22%	R88,889	-11%
Index -35%	$5,556	-35%	$3,611	R79,444	-21%	R57,778	-42%

The table above illustrates how the autocall's return is affected by changes in the value of the Rand. If the Rand depreciates over the investment term, the return on the autocall will be enhanced, and conversely, if the Rand appreciates, the return will be lower.

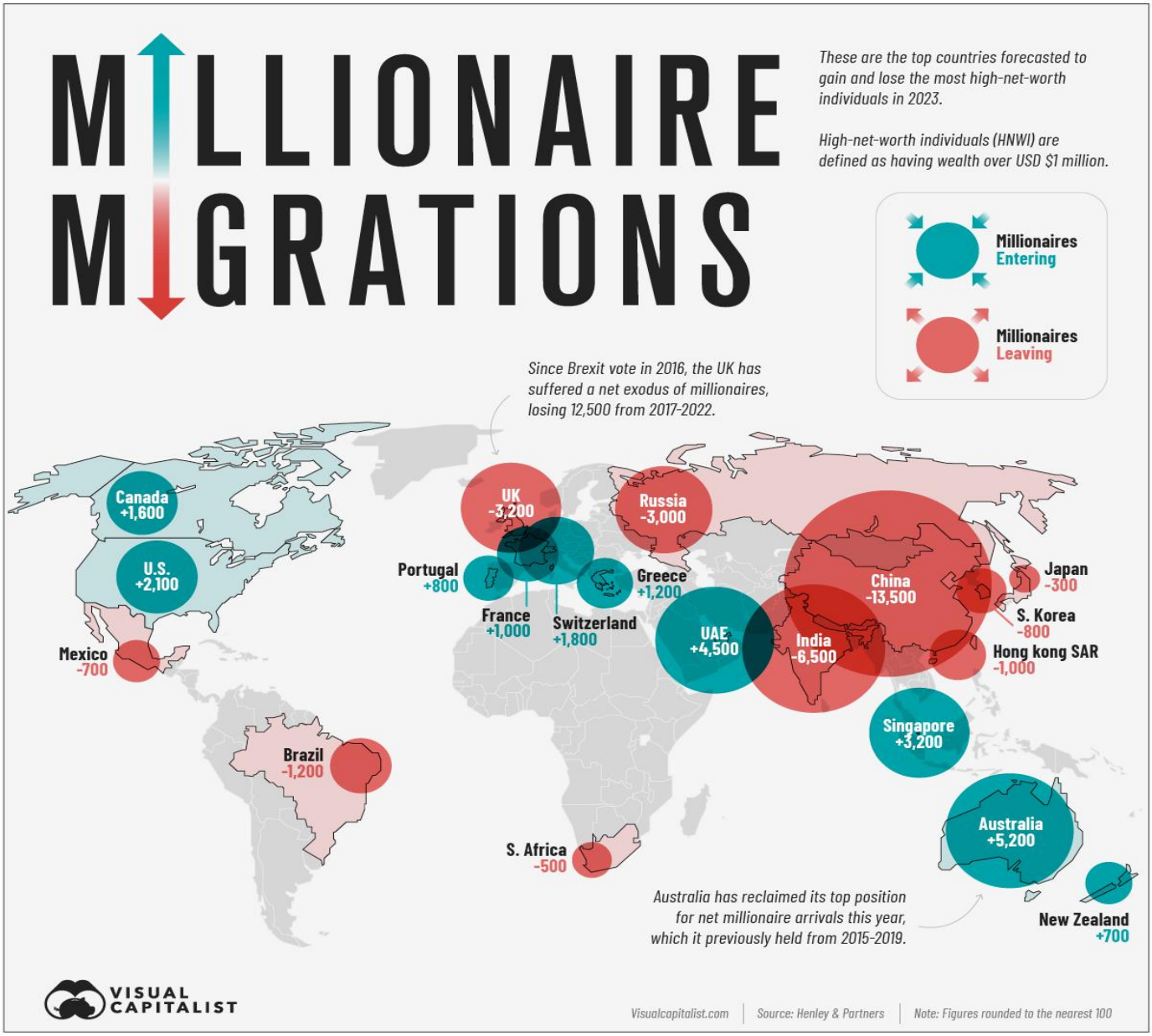
This investment may be right for you if:

- You think the Index will equal or exceed current levels over the next five years.
- You are looking for an investment that offers enhanced upside and potential to limit the downside exposure.
- You do not need immediate access to your money for the term of the investment.
- You have a minimum of R100,000 to invest.

This investment may not be right for you if:

- You want 100% capital protection under all conditions.
- You think the Index may be up more than 8.4% per annum.
- You want to receive regular dividends and income.
- You cannot commit to the full term of the investment.
- You do not want to take credit risk on Barclays PLC.

GRAPH OF THE MONTH:MIGRATIONS OF THE WORLD'S MILLIONAIRES IN 2023



Source: Visual Capitalist

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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