NEWSLETTER

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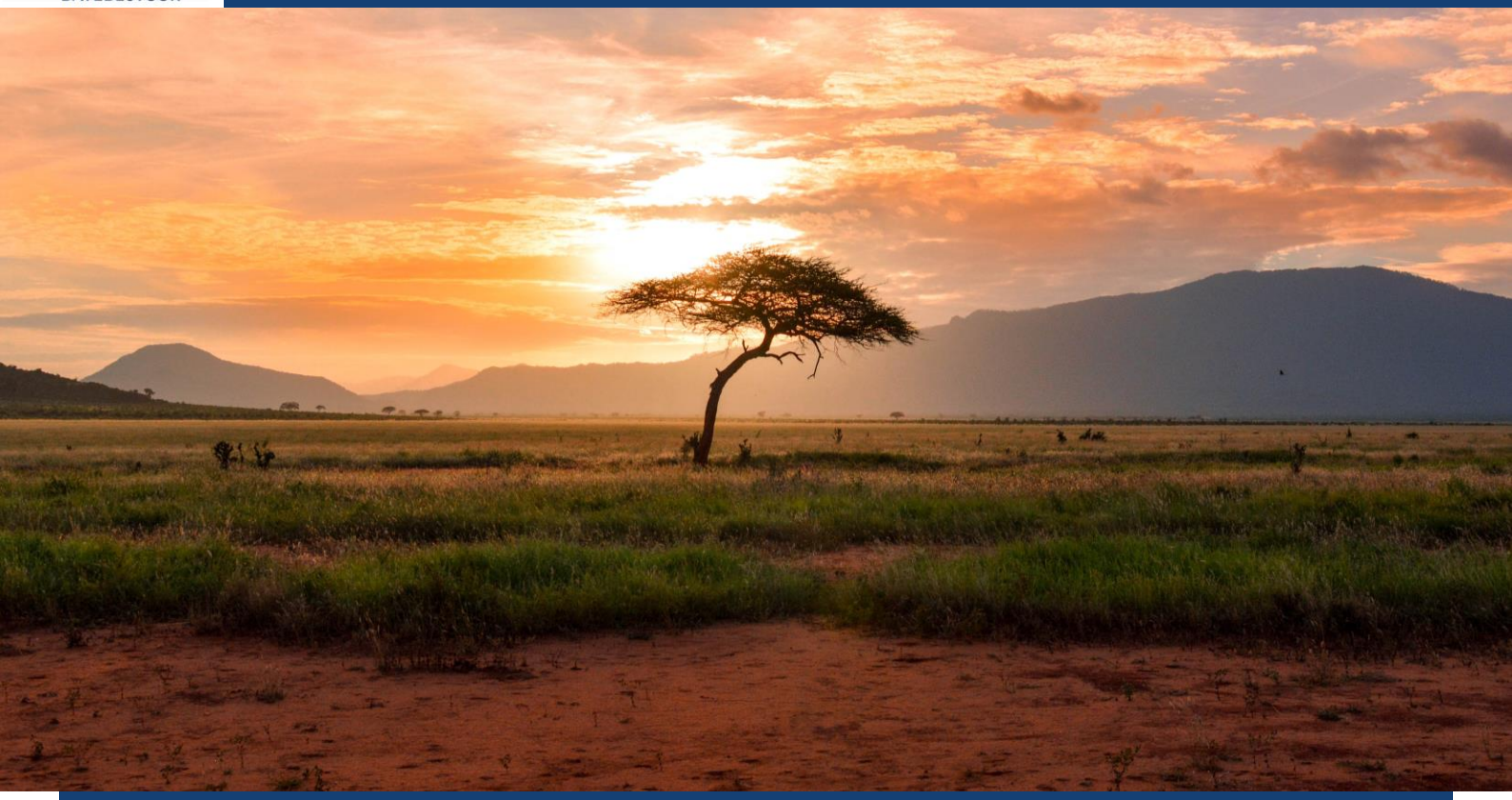


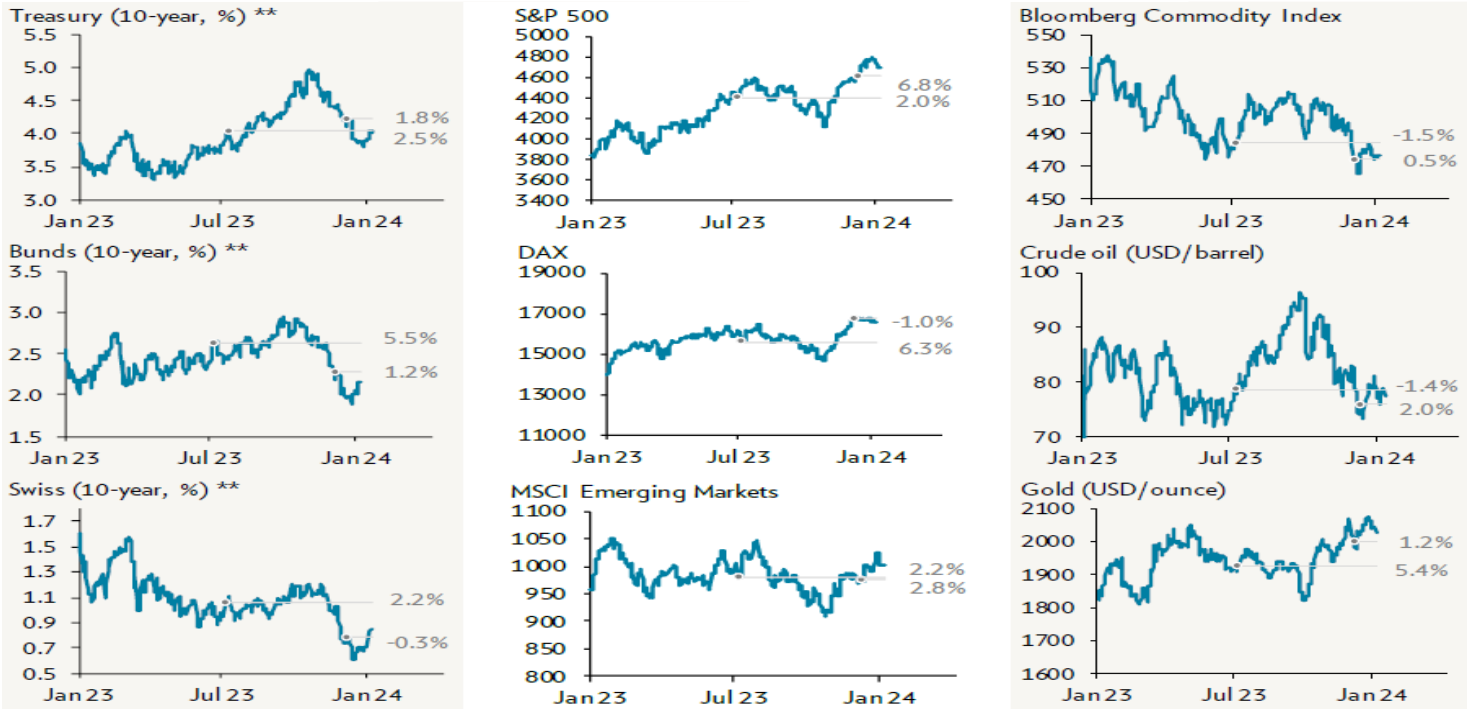
IN THIS MONTH'S NEWSLETTER

- Market overview
- Graph of the month: The Magnificent Seven
- Psychology of money: Lesson 1

"Political language is designed to make lies sound truthful and murder respectable, and to give an appearance of solidity to pure wind."
- George Orwel

MARKET OVERVIEW

Review (1-month and 6-month performance)



Source: Julius Baer, 08/01/2024

INTERNATIONAL

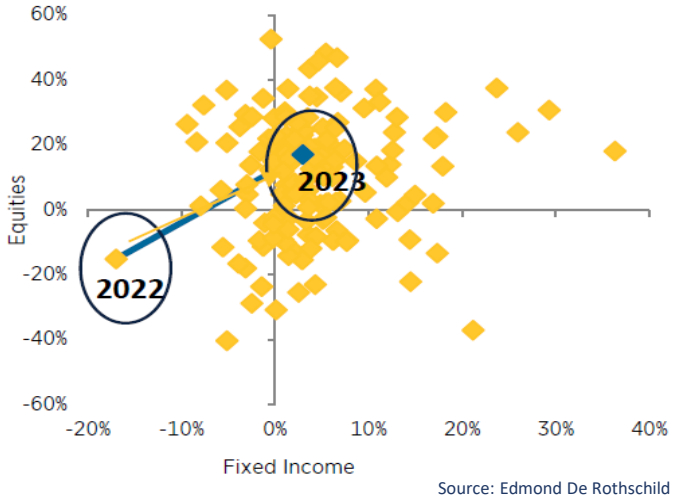
31/12/2023	Last	Month %	YTD %	5Y ann. %
MSCI ACWI	727	4.70	20.09	9.59
S&P 500	4697	4.42	24.23	12.94
NASDAQ 100	16826	5.51	53.81	20.58
EURO STOXX 50	4522	3.18	19.19	8.05
MSCI EM	1024	3.63	-0.75	-0.52
HANG SENG	17047	0.03	-13.82	-9.46
US Equities Volatility Index (VIX)				

Source: Edmond De Rothschild

After a dismal 2022, the markets in 2023 saw a return to a performance closer to the annual average for both bonds and equities. Enclosed within this newsletter is a comprehensive review of the events and trends of 2023, coupled with a detailed analysis of returns.

Achieving satisfactory returns in 2023 might seem straightforward due to the strong performance of the global indices. However, when delving into the return composition of the indices, it becomes clear that 2023 was a stock picker's year. The dispersion in performance between individual stocks and sectors was immense.

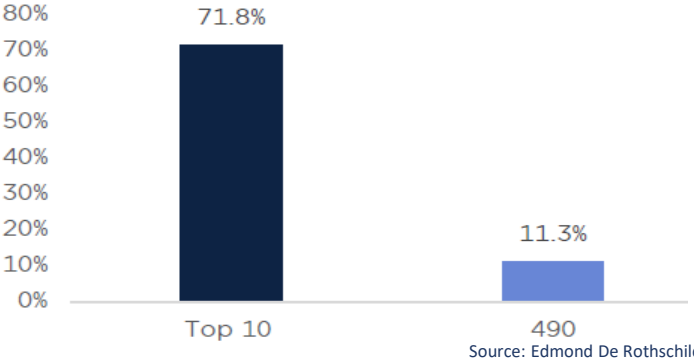
Figure 1: Annual performance of S&P 500 and 10-year US government bonds since 1870.



Source: Edmond De Rothschild

The technology sector (+54%) was the main driver of the S&P 500 index (+24%). Ten stocks contributed an absolute 18% of the S&P 500 performance, while the remaining 490 stocks contributed 6%. Choosing specific themes and stocks proved critical in 2023.

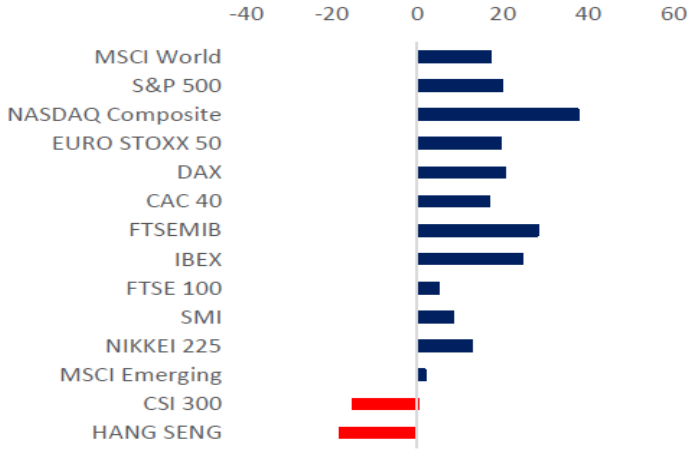
Figure 2: 2023 performance of the S&P 500 top 10 stocks versus the other 490 stocks.



Source: Edmond De Rothschild

There was also a significant divergence between countries, with the US outperforming and the UK underperforming, along with most emerging markets and China.

Figure 3: Equity market performance in 2023, in USD.



Source: Edmond De Rothschild

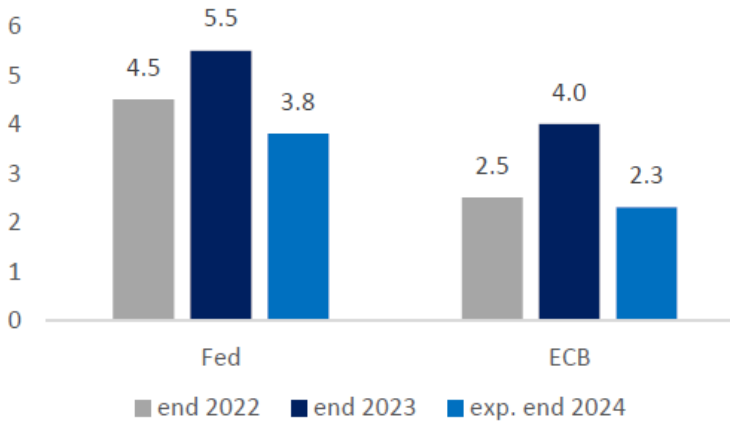
In 2023, markets were impacted by the following factors:

- **The fear of a deep global recession at the start of the year –** Resilient economic data supports the current consensus expectation that a deep recession will be avoided in 2024. The US economy seems more robust than the rest of the world.

- **Hopes of a Chinese rebound evaporated early in the year -** The optimism at the beginning of the year led to European luxury goods performing well. Towards the end of the year, these stocks came under pressure as optimism regarding China faded. Hong Kong's Hang Seng Index underperformed US equity markets by a considerable margin, delivering a loss of 14% in 2023.

- **Concerns over resilient inflation decreased during the year -** Markets started pricing in a pivot in interest rates globally much sooner than was initially expected due to inflation falling faster than expected. This led to more enthusiasm in terms of economic growth. Subsequently, equity and bond prices rallied.

Figure 4: Interest rate levels at the end of 2022 and 2023, as well as interest rate expectations for December 2024 for the Fed and ECB.



Source: Edmond De Rothschild

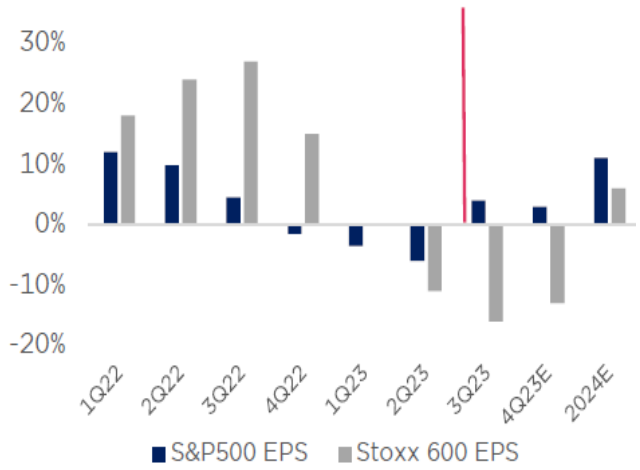
- **Geopolitical risk increased in October 2023 with the conflict in the Middle East -** For now, the war is still contained in the area. The war in the Middle East still poses a massive threat to markets due to the effect it could have on oil prices, which will put upward pressure on inflation.

- **Positivity around the generative AI technology revolution –** As previously mentioned, technology companies notably outpaced the broader market considerably. The superior performance of these technology shares was partly fueled by the enthusiasm surrounding AI technology and its projected substantial revenue growth over the long term.

- **Falling energy prices -** Energy prices suffered a more significant decline than initially anticipated, with WTI oil dropping by 10% and European natural gas prices plummeting by 58%. Initially, the expectation in early 2023 foresaw a potential natural gas shortage in Europe for the year. The substantial decrease in energy prices emerged as a critical factor contributing to inflation performing better than expected.

- **Company earnings –** Both the US and Europe underwent a period of negative corporate earnings growth, followed by a resurgence in the third quarter of 2023 in the US, with a positive outlook for 2024. However, the earnings and prospects for the Stoxx 600 index in Europe continue to exhibit relative weakness.

Figure 5: The S&P 500 and Euro Stoxx 600 earnings per share

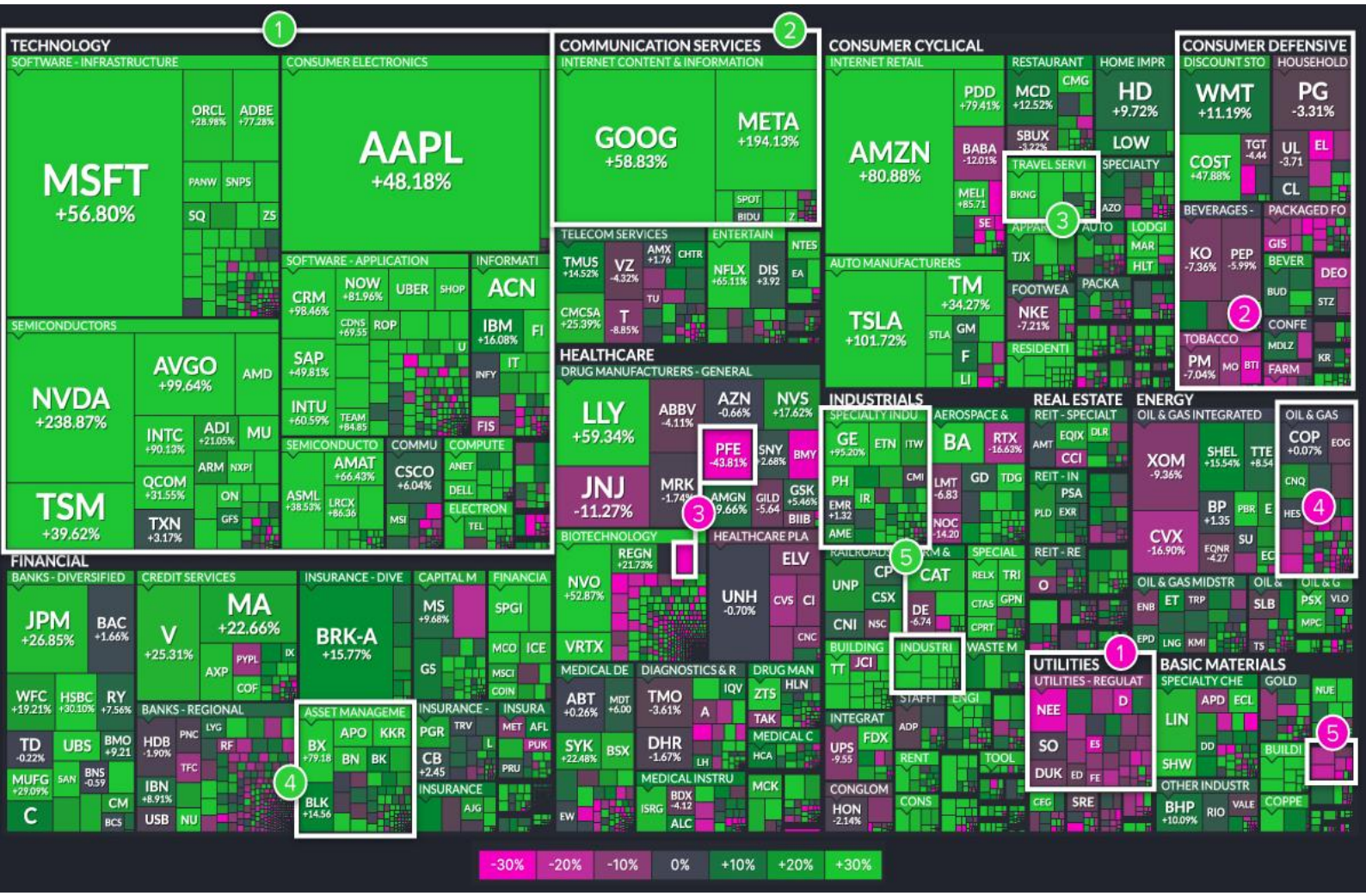


Source: Edmond De Rothschild

During the latter part of 2023, markets were supported by expectations of a soft landing, falling inflation, more accommodating central banks, and a rebound in earnings expected in 2024. Although a deep recession is not likely, global economic growth will likely remain subdued.

The January newsletter will discuss our outlook for 2024 and stock picks in more detail.

Figure 6: The best and worst performing sectors and shares in 2023



Source: Visual Capitalist

SOUTH AFRICA

31/12/2023	Last	Month %	YTD %	5Y ann. %
JSE All Share	76893	1.80	5.26	8.06
JSE Resources	57533	-1.32	-18.74	7.26
South Africa 10Y Bond	9.77%			
CPI	5.50%			
Prime Rate	11.75%			
USDZAR	18.5826	0.80	-9.18	-5.87
EURZAR	20.5839	-0.38	-13.10	-5.17

Source: Moneyweb

The **JSE All-Share** concluded the year on a positive note, returning 1.8% for December and a return of 8% (including dividends) in 2023. The performance of the JSE All-Share was notably affected by substantial exposure to the Chinese market, which emerged as the most disappointing market for investors in December (+0.03%) and throughout 2023 (-13.8%).

The **SA All Bond Index** returned gains of 1.5% for December and 9.7% in 2023, benefiting from a high yield and a globally softening rate environment (soft landing). **The rand** depreciated by 9% against the US dollar throughout 2023, marking a trend where the rand weakened against the dollar in seven of the last ten years.

In the past three years, **the rand** lost nearly 30% against the US dollar due to various challenges such as the impact of Covid, load shedding, being grey-listed by the Financial Action Task Force and issues at Transnet.

It's been nearly a decade of waning foreign interest in South African shares, with **outflows exceeding $50 billion**. Last year was the eighth year in a row that foreign investors sold South African equities selling stocks worth $8.3 billion. That took the total since 2016 to $53 billion (R1 trillion), based on data reported by exchange operator JSE.

Prosus/Naspers

The Prosus/Naspers group lost 10% in December, primarily attributed to the performance of the group's most prominent investment, Tencent. Tencent's share price declined following reports that Chinese gaming regulators had introduced additional restrictions on practices intended to encourage increased spending or time engagement in online games.

The newly proposed regulations aim to restrict expenditure on online gaming by prohibiting rewards to players for daily logins, the initial spending by users on the game and consecutive spending by users. Game publishers will be mandated to establish limitations on how much players can recharge their digital wallets for in-game expenditures. Prosus and Napers are trading on a **discount** to net asset value (NAV) of 35% and 42%, respectively.

British American Tobacco PLC (BAT)

The manufacturer of Lucky Strike cigarettes and Vuse vapes has announced its intention to incur a non-cash impairment charge totaling approximately £25 billion ($31.5 billion) related to its stable US cigarette brands. This write-down arises due to an increasing number of smokers quitting, transitioning to more economical brands, or embracing alternative smoking options.

The group anticipates that organic revenue growth for 2023 will likely align with the lower end of its previously forecasted range of 3% to 5% at constant currencies. The share is currently trading on a 12-month forward PE of 6.5x and a dividend yield of 11%.

Renergen released a positive quarterly update for the end of September 2023. The company announced a significant decision to advance the scheduled annual maintenance of the natural gas processing plant during the period when the helium segment of the plant was inactive. Stefano Marani (CEO) confirmed the successful restoration of the helium cold box and foresees a period of steady production for the upcoming year, including helium production. Renergen's share price advanced 32% in December.

Outlook for 2024

The base case scenario – South Africa faces a tough H1 in 2024 as election uncertainty holds back investment and high interest rates curtail consumption. SA exports have to contend with challenges at Transnet, weakening prices in the face of USD strength and slowing global growth. By the second half of 2024, the backdrop should start to improve:

- The conclusion of elections, likely occurring around May 2024, alleviates uncertainty (with polls indicating a potential ANC support below 50% for the first time since 1994, potentially signaling the advent of coalition politics).
- The trajectory for domestic growth and earnings should improve due to the influence of lower interest rates and lower inflation.
- A reduction in power outages is anticipated as increased private sector investment in renewable energy becomes operational.

The bull case scenario is an optimistic outlook with a soft landing in the US, a cyclical recovery in China and a national election result that raises expectations of enhanced structural reform of SOEs.

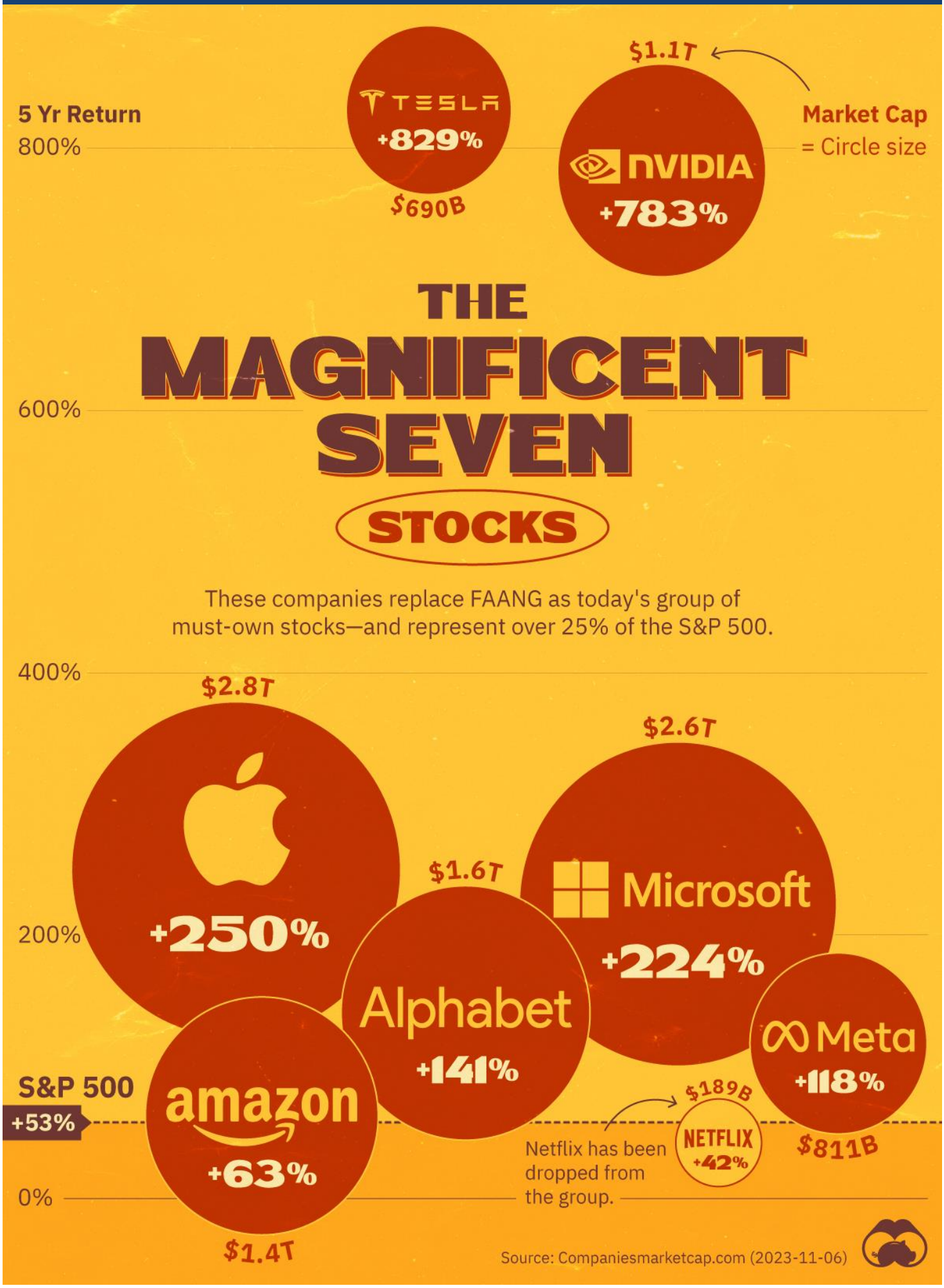
The bear case scenario - envisages a decline in global growth coupled with a market-negative confidence shock triggered by the elections, steering SA bond and equity returns into negative territory.

Figure 7: JSE Top 40 best and worst performing in 2023

Best performing	%	Worst performing	%
Gold Fields	+58%	Impala Platinum	-57%
Sanlam	+50%	Anglo American Platinum	-32%
Aspen	+49%	MultiChoice	-31%
Reinet Invest	+42%	Sasol	-33%
Bid Corp	+29%	Anglo American	-29%
Mondi	+22%	Northam Platinum	-25%
Nepi Rockcastle	+20%	British American Tobacco	-21%
Standard Bank	+20%	Growthpoint	-20%
Old Mutual	+18%	Absa	-18%

Source: Factset

GRAPH OF THE MONTH : THE MAGNIFICENT SEVEN STOCKS 5-YEAR RETURN



Source: Visual Capitalist

THE PSYCHOLOGY OF MONEY – LESSON 1

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 the 20 lessons that stood out for us from this book.

Lesson 1: No one's crazy

> "Your personal experience with money make up maybe 0.00000001% of what's happened in the world, but maybe 80% of how you think the world works."

In the first chapter of "The Psychology of Money," Morgan Housel emphasizes that financial decisions often appear irrational or nonsensical to outsiders, but they typically make perfect sense to the individuals making those choices. He highlights that people's behaviors with money are often driven by their unique experiences, emotions and personal circumstances.

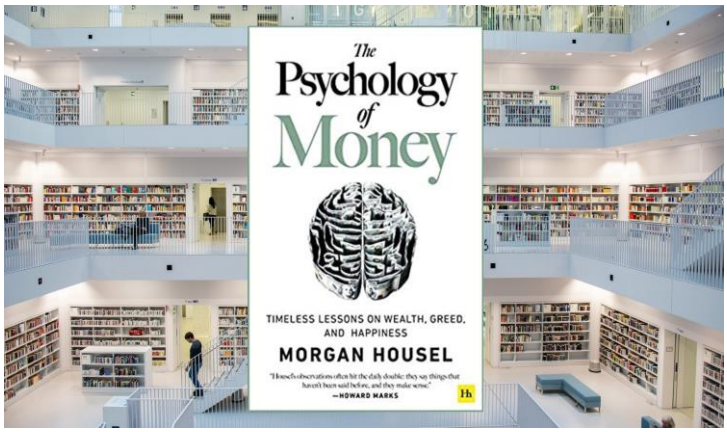
The phrase "No one's crazy" encapsulates the idea that what might seem like irrational financial behavior from the outside usually stems from an individual's rational response to their perceptions, biases and context. Housel uses anecdotes and examples to illustrate how seemingly odd financial decisions, like taking significant risks or avoiding seemingly lucrative opportunities, can make sense when understood within the framework of an individual's life experiences and mindset.

The chapter essentially serves as an introduction to the book's overarching theme: **that understanding the human psychology behind financial decisions is crucial to making sense of the diverse ways people approach money management.** Housel encourages readers to appreciate the complexity of financial behaviors and to approach them with empathy and understanding rather than judgment.

What does this mean for investors?

Investors often overlook potential future returns and struggle to craft the most efficient investment portfolios due to the biases outlined in this chapter of the book. While it's natural to base decisions on past experiences, this approach can hinder the creation of an optimal portfolio.

Overcoming this challenge is easier said than done, yet investors should endeavor to decouple their investment decisions from being excessively influenced by prior experiences. Striving to make more impartial investment choices, detached from the strong sway of historical experiences, is crucial in constructing a more effective investment strategy.



SOURCES

Sources: Alpine Macro, 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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