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PROSPERITY

IN THIS CLIENT NEWSLETTER

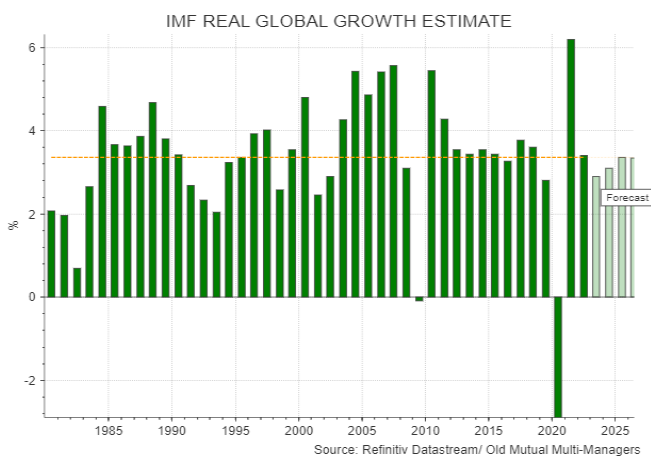
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WEALTH
PRIVATE CLIENT SECURITIES

ECONOMIC UPDATE

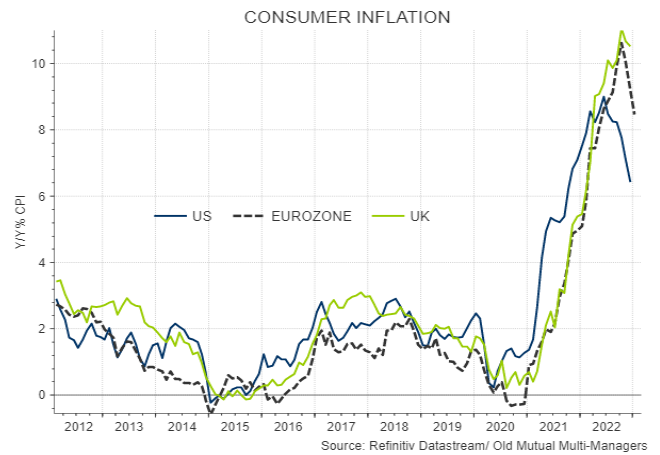
Globally, there is greater optimism that the worst-case scenarios feared in 2022 will not come to pass. Inflation is receding, though unevenly, which limits upward pressure on interest rates. The US dollar has pulled back, providing relief to many emerging markets and US multinationals. The energy crisis has subsided, particularly in Europe as the war in Ukraine grinds into stalemate. Furthermore, China's abrupt U-turn on its COVID-19 policies means a much better growth outlook for the world's second largest economy.



Consequently, the International Monetary Fund (IMF) raised (albeit slightly) its global growth forecast for 2023, projecting global growth of 2.9%. An improvement to 3.1% is expected for 2024. While these numbers are below the long-term average of 3.5%, they are ahead of annual global population growth of around 1%.

US economic data remains solid, particularly around household spending and employment. While this would typically be considered as good news, in this instance it could cause inflation to linger, resulting in the US Fed tightening the screws further. Fortunately, there is enough evidence of a slowdown (both in reported inflation numbers and interest-rate sensitive activity) to suggest that the Fed is near the end of its hiking cycle. However, the evidence is not strong enough for the central bank to start thinking about cutting rates. The Fed wants certainty that once inflation approaches the 2% target, it will settle there and it remains concerned that very low unemployment could place upward pressure on wages and service inflation. The Fed's policy rate is still likely to peak around 5% and remain there for some time.

While this will slow the economy, it will not necessarily cause a recession. The IMF expects growth of 1.4% this year, down from 2% in 2022.



Europe is halfway through winter and there is sufficient gas to meet household and industrial needs. The medium-term outlook is also better, even assuming a complete halt in Russian supplies. As a result, natural gas prices have fallen sharply and are now below their levels just prior to the invasion. Energy price relief will help consumers and businesses, and lower headline inflation rates. However, the European Central Bank remains concerned about high core inflation and is likely to continue raising rates in the first half of the year. Like in the US, this will affect growth, but a recession is no longer the base case scenario for this year.

In China, the economic impact of zero-COVID has been visible in the data. China only grew by 3% in 2022, representing a severe downturn by its standards (in South Africa it would count as a boom). The rapid lifting of COVID restrictions has predictably resulted in a wave of infections, which could get worse over the Lunar New Year holiday. Nevertheless, as infections subside, economic activity can rebound with the help of targeted stimulus measures, including some support for the struggling residential property market. Chinese growth can therefore rise to 5% in 2023, according to IMF estimates.

Longer term, the outlook for the Chinese economy remains constrained. New official data shows that deaths exceeded births in 2022 for the first time since the famine of the Great Leap Forward in the 1960s. With a shrinking population, China

loses a key growth engine. There is certainly not a pressing need to build more housing, for instance. Growth will have to come from productivity, and this probably requires a more market-friendly approach than what Beijing is embarking on under Xi Jinping's leadership.

In contrast to the more optimistic global outlook, the new year in South Africa kicked off with sustained high levels of load shedding that are set to continue for at least another 12 months. This will be a severe drag on economic growth. Local businesses face the twin pressures of lost trading hours and higher input costs from running diesel generators. However, one benefit of 15 years of load shedding is that many businesses are now accustomed to operating in this difficult environment.



Fortunately, there are two silver linings. A better global growth outlook always helps SA, a small open economy. Furthermore, spending on alternative sources of energy by businesses and households is likely to accelerate significantly, as policy and regulatory obstacles are removed and incentives introduced. The IMF expects growth of only 1.2% this year and 1.3% next year, which will barely keep up with population growth. However, it does not point to a collapse in economic activity. So, while the SA economy remains an underperformer relative to the obvious potential, it remains resilient in the face of a seemingly never-ending series of shocks.

MARKET UPDATE

After a year that most managers and investors would want to forget, most markets and sectors had a solid start to 2023. US equities re-gained some losses from last year, with blue chip and technology companies showing early signs of life. During January, the S&P 500 (+5.5%), Russell 2000 (+9.6%) and Nasdaq Composite (+10%) all recorded solid gains. European equities attracted their largest inflows in 12 months, with the Eurostoxx 600 (+6.7%) and the UK's FTSE 100 (+4.3%) performing well. In Hong Kong, while equities climbed by 10.2% during the month, they are still 9% lower than a year ago.



Locally, the JSE had a similar run, with the All Share Index ending the month 8.8% higher. Industrials (+13.2%) led the charge, followed by Resources (+7%) and Financials (+4%). Palladium (-8%) and platinum (-5%) prices fell, while gold was well supported and gained 5.6% to end at US\$1 927/oz following the release of data showing that global central bank buying exceeded 1 000 tonnes in 2022 – the highest level since 1967. Brent crude was slightly weaker by month end at \$84.47. The rand weakened by 2.3% in January, closing the month at R17.41 against the US dollar.

GLOBAL EQUITIES



DANAHER

Diversified industrial group, DanaHER Corporation reported a strong set of results for the fourth quarter of 2022. Revenue for the period was up 2.5% year-on-year to US\$8.3bn and adjusted earnings per share rose 6.5% to US\$2.87. Revenues in North America and Western Europe grew around 10%, driven by continued healthy demand. China, which represents a high growth market, reported low single-digit growth with the reopening and subsequent increased COVID-19 infections resulting in reduced clinical diagnostic patient and testing volumes. The Group invested US\$1.7bn in research and development over the financial year to expand productive capacity in bioprocessing and genomics supporting customer demand and supply security. Management expect core revenue growth to decline in the 2023 financial year as a result of decreased demand for COVID-19 vaccines and therapeutics. The group's impressive free cash flow conversion of over 100% was a highlight and it marked the 31st consecutive year that DanaHER has reported free cash flow in excess of net income.

Givaudan^o GIVAUDAN

Global flavour and fragrance ingredient market leader, Givaudan reported organic sales growth of 5.3% and a 4.3% increase in earnings per share during 2022. This performance was broadly in line with expectations and reflects a challenging operating environment characterised by sharp increases in transport, freight and raw material prices, as well as significant supply chain disruptions owing to the war between Russia and Ukraine, and the zero covid policy in China. While these headwinds are expected to moderate this year, an anticipated global recession driven by slowing growth in the US, UK and Europe has already driven decreases in volumes across the consumer staples industry. As such, we expect 2023 to be another challenging year.

Givaudan remains committed to its five-year growth plan implemented at the onset of 2021. As part of this plan, the company continued to grow its active beauty and plant-based ingredients businesses, both with bolt on acquisitions and in-house innovations. Contractual price increases to claw back input cost inflation is ongoing and should support organic growth throughout the course of the year. Management has proposed a 1.5% increase in the annual dividend to CHF67 per share, which will be considered by the Board at their Annual General Meeting on 23 March 2023.

Johnson & Johnson JOHNSON & JOHNSON

Johnson & Johnson (J&J) reported a resilient set of full year 2022 results, highlighting good operational growth. Over the period, reported sales grew by 1.3%, while earnings per share declined 13.8% year-on-year. Sales within the Pharmaceutical and MedTech segments (which account for 84% of total sales) were particularly weak during the second half of 2022 as a strong US dollar undermined sales growth from outside of the US and demand for COVID-19 vaccines weakened significantly from their elevated levels in 2021. Furthermore, a slowdown in Europe and the impact of widespread COVID-19 lockdowns in China also affected sales growth.

Removing the impact of currency and less meaningful once-off expenses, total sales increased by 6.1%, with Pharmaceutical and MedTech sales (+6% - 7%) and Consumer Health sales (+3.6%) showing good growth and signalling resilient demand across the portfolio. While operational expenses were well managed, higher restructuring and business separation costs linked to the Consumer Health spin-off drove net earnings down by 14.1%. More indicative of underlying performance adjusted earnings per share (excluding once-off costs such as restructuring) improved 3.6% to US\$10.15 per share.

DIAGEO DIAGEO

Global spirits producer, Diageo reported strong half year 2023 results that exceeded management's expectations as the company benefitted from strength in premiumisation trends, increased trading opportunities with limited lockdowns and a stronger US dollar. Total net sales grew 18.4% on double-digit growth across all regions except Africa, where net sales rose 9%. Excluding the impact of currency, acquisitions, disposals and once-off items, organic net sales grew 9.4% driven by volume growth (+1.8%), price increases and product mix effects. Latin America and the Caribbean performed best, with management highlighting a strong premiumisation environment that allowed for meaningful price increases. Asia Pacific was also up strongly, driven by both volumes and pricing despite challenges in Greater China due to reduced on-site consumption (i.e. restaurants, bars and clubs) during extended lockdowns.

In terms of product categories, scotch, tequila and beer performed strongly. Diageo's premium-plus offerings in these categories did the heavy lifting, contributing 65% of organic net sales growth. Premium-plus brands now account for 57% of Diageo's net sales, up 5% from 2019. Inflationary pressures continued during the period and these are expected to persist for the remainder of the year. Higher glass, freight and energy costs caused Diageo's gross margin (61.5%) to decline, but this was offset by productivity savings, which drove a small increase in the organic operating margin (34.6%). Taken together, earnings per share grew 19.7%.



Microsoft

MICROSOFT

Global technology and software giant, Microsoft reported second quarter results that, although impacted by a deteriorating global Personal Computer (PC) market, showed good growth across the Intelligent Cloud and Productivity and Business Process segments. Group revenue grew 2% during the quarter, while operating income decreased by 8%. The stronger dollar remained a meaningful headwind, with constant currency sales up 7% and operating income remaining flat. Microsoft's well-publicised plan to cut 10 000 jobs will cost the business US\$1bn in severance costs and hardware impairments, further affecting operating income. This dynamic is widespread across the technology industry and is largely viewed as a normalisation of the ramp-up in hiring skilled people through the COVID-19 pandemic.

Operationally, sales in both the Intelligent Cloud (+13%) and Productivity and Business Processes (+24%) segments grew well during the quarter. Performance in the Personal Computing segment disappointed, with sales declining by 16%, highlighting two trends underway in the global PC market. The first being a substantial deterioration in demand following elevated PC purchases through the pandemic; and the second being cost pressures resulting in enterprises delaying hardware and software purchases. This dynamic is expected to remain a headwind for at least the next 9-12 months.

LOCAL EQUITIES



Mr Price

MR PRICE

Local fashion and apparel retailer, Mr Price released a 13-week trading update in January that underperformed analyst and investor expectations. While recent acquisitions all achieved double-digit sales growth for the quarter (Oct to Dec 2022), sales growth across flagship brands was weak. Sales in Mr Price Apparel (+2.2%) and Mr Price Home (-3.5%) underperformed during a period that traditionally sees these segments register their strongest sales growth. This underperformance resulted in group retail sales, excluding Studio88, rising 1.2% (incl. Studio88 +36.5%). Mr Price had previously warned that stores were significantly impacted by load shedding as many do not have back up power supplies. The group is addressing this by investing in alternative energy sources, with 70% of their stores being on back-up power by the end of 2023 and the remainder soon thereafter.

Furthermore, the group reduced its credit appetite during the quarter, with its credit approval rating falling to just under 19% from 32% in the prior quarter. This would have negatively impacted consumer purchasing power and consequently sales. New credit applications increased by 31%, highlighting consumers' preference for short-term credit. While Mr Price will continue to advance credit prudently in order to preserve the quality of its credit book, SA consumers' increased appetite for credit is likely to benefit peers with less stringent credit approval processes.

The outlook for Mr Price remains challenging with constrained consumers preferring credit, load shedding impacting operations and the high cost of moving to alternative energy sources. Despite this, we believe that management's focus on fashion and value remains relevant and is appropriate for the SA market and expect the current sales weakness to dissipate as more stores are equipped with back-up power supplies.



VODACOM

Despite facing a challenging operating environment characterised by financial market volatility, a weaker global economic outlook, higher inflation and electricity supply issues in the local market, Vodacom's recent quarterly update (for the period ended 31 December 2022) highlighted the business' resilience and astute capital allocation ability. Revenue from the recent Vodafone Egypt acquisition (finalised on 8 December 2022), was included in the fourth quarter results and along with currency gains, was a key driver of revenue for the group. Vodafone Egypt contributed over R1.8 billion to group service revenue (+16.1%) over the period. Excluding the acquisition, group service revenue grew 3.5% supported by financial services and data revenue growth in South Africa. Total group revenue increased 14.8%, and 4.7% excluding Vodafone Egypt and currency fluctuations.

Vodacom's joint venture with Saficom also boosted results, with the group's financial services segment reporting revenue growth of 30.6% (4.5% on a normalised basis) over the quarter. The M-Pesa platform, which is owned by the joint venture, remains Africa's largest mobile money platform by transaction value, processing US\$366.7 billion (+17%) in transactions over the last 12 months, and is key to Vodacom's ambition to diversify its core revenue streams. Financial Services is fast becoming a meaningful contributor to revenue for the group and it continues to invest in innovation as it transitions from a telecommunications company to a more diversified Internet of Things (IoT) company.

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