

Prosperity

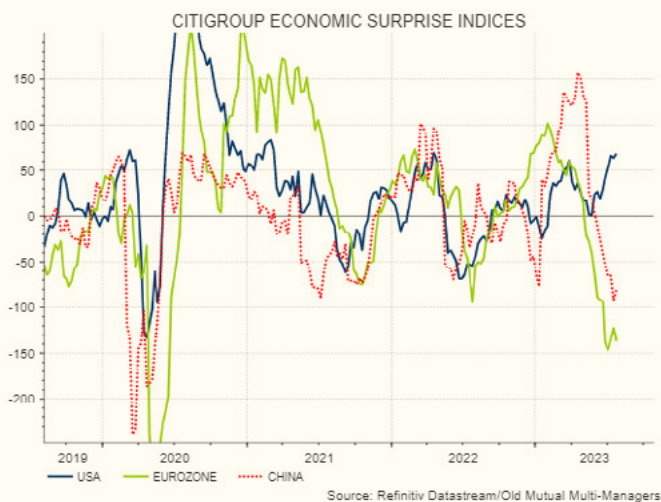
July 2023

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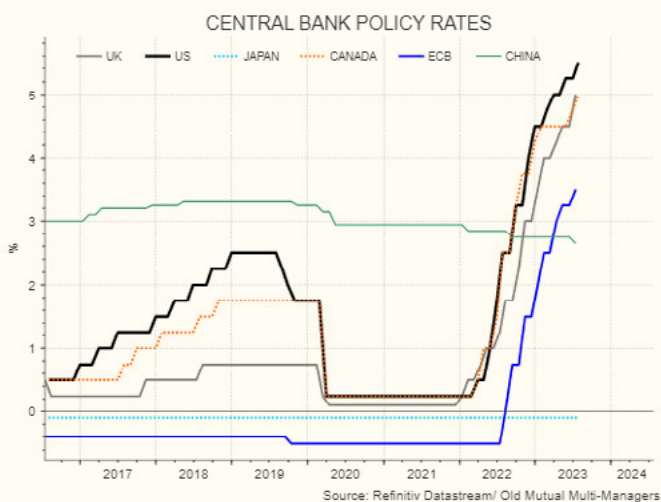
Private Clients
by  Old Mutual Wealth

ECONOMIC UPDATE

Much is being written about the deteriorating relationship between the US and China and the long-term geopolitical shifts underway. A very different, confrontational future is being imagined and many argue that the centre of global power is shifting East. Currently, however, the contrast in economic momentum between the world's two largest economies is stark, with the US doing better than expected while China is struggling.



The US is still experiencing solid economic growth, low unemployment and elevated inflation. US GDP growth accelerated in the second quarter to 2.4% year-on-year. As a result, after a pause at its June policy meeting, the US Federal Reserve (Fed) hiked rates in July. This means that the federal funds target range is 525 basis points higher since the start of the cycle, at 5.25% - 5.5%. The next meeting is in September and Fed officials will have two months' inflation, labour market and economic growth data to analyse and input into their models. There is a good chance that the hiking cycle is over, but no decisions have been made and future guidance has not been given. It will depend on how the outlook evolves between now and then. However, recent inflation news has been encouraging and rates have risen to restrictive levels. While the rate hikes to date have not had a big impact on consumers and businesses, interest rates always take time to take full effect. There probably is no need to increase rates further, but there is also no reason to cut any time soon. While inflation is lower, it can rebound again if consumer spending remains strong and wage growth remains elevated.



Chinese growth missed expectations in the second quarter, rising by only 4.8% year-on-year. Given that the economy was still in lockdown last year, this is a flattering base. Compared to the first quarter of 2023, the economy only grew at an annualised rate of 3%. While this would be considered a boom in SA, in China it is almost recessionary. Real growth was faster than nominal growth, meaning that the economy is experiencing deflation. Deflation in an economy with high debt levels can be extremely problematic, since it means that the real debt burden rises. Youth unemployment has shot up to 21%, highlighting that there are structural as well as cyclical problems.

Chinese authorities have responded with measured stimulus efforts. The People's Bank of China (PBOC) cut interest rates slightly, in contrast to the Fed and other developed central banks (notably the European Central Bank and the Bank of England) who are still hiking. However, like the Fed, the PBOC faces the problem that its rates are not necessarily gaining traction. In the US, the issue is that most mortgages have fixed interest rates, and therefore most homeowners are not bothered by higher rates. US household incomes have also grown faster than debt levels in recent years. In China, household income growth is tepid while debt levels have increased sharply over the past decade. Crucially, the asset typically linked to this debt – residential property – has questionable value. House prices have been falling across major Chinese cities, a big blow to consumer confidence in a country where homeownership levels are high, and property is the main form of wealth.

Ironically, the slowdown in China's property sector was triggered by regulatory tightening to deleverage and de-risk property developers. Authorities must now deal with the unintended consequences. Therefore, China's cabinet announced its intention to stabilise the economy and the property sector at its July meeting, but was vague on details. In the tightly controlled Chinese system, authorities can prevent the kinds of financial crises associated with property bubbles in other countries. However, it is very unlikely to be able to revive growth in the property sector to anything near pre-COVID levels. At best, it can stabilise activity and hope for a modest rebound. The country will have to find other growth engines. Demographics is another structural headwind, as the working age population is declining.

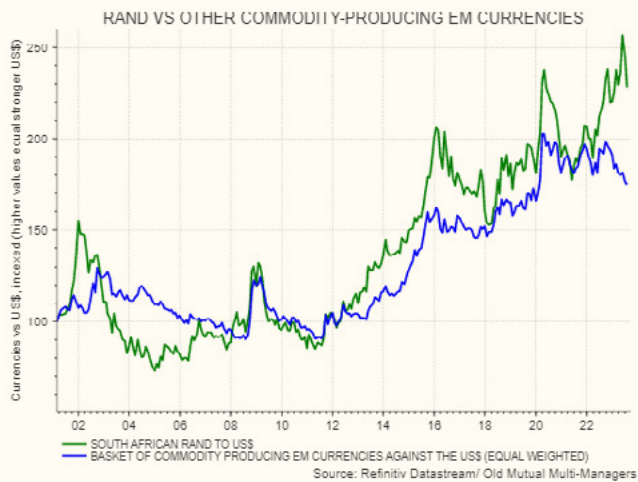


Locally, while the US Fed hiked in July and the PBOC cut rates, the SA Reserve Bank held steady. In a 3/2 vote, the Monetary Policy Committee kept the repo rate at 8.25%. Consumer inflation slowed to 5.4% year-on-year in June. This is down from a peak of 7.8% in July 2022. Inflation is likely to continue falling, notwithstanding increases in global oil and grain prices in July, and this means the repo rate will rise in real terms in the months ahead. This implies an effective policy tightening and therefore the MPC need not raise rates anymore. While it is also unlikely to be in any hurry to cut, it means the worst is probably over for SA consumers.

MARKET UPDATE

July was another month of solid returns across most sectors as global markets performed well. With the current strong US earnings season, the three major indices all closed the month higher – the Dow Jones Industrial Average (+3.3%), S&P 500 (+3.1%) and Nasdaq Composite (+4%). In the UK, the FTSE 100 rallied 2.2% in July.

Asian markets also reported largely positive performance, with the Hang Seng (+6.1%) and Shanghai Composite (+2.8%) recording monthly gains. The Nikkei, however, was down 0.1% as a surprise change in the Bank of Japan’s yield curve control programme sent yields higher. This change allowed the central bank more flexibility to manage their medium and long-term interest rates but sent the Yen whipsawing as a result.



In SA, the JSE All Share Index rose 3.9% in July. Financials (+7.9%) were the strongest performers, as higher commodity prices led gold and platinum counters to rally. Resources (+3.7%) and Industrials (+2.5%) also ended the month in positive territory.

The rand was 5.6% firmer, ending July at R17.85. Brent crude oil was 14.2% higher in July due to OPEC production cuts and renewed optimism around Chinese demand and the global growth outlook. Iron ore was up 2% and the gold price rose 2.4% during the month to close at US\$1 965/ounce.

GLOBAL EQUITIES



Microsoft

Global technology and software giant, Microsoft reported solid full-year results with strong growth from Intelligent Cloud and Productivity & Business Processes. Group revenue grew 7% over the year, while operating income was up 6%. The stronger dollar continued to be a headwind, with constant currency revenue up 11% and operating income up 14%, highlighting more robust underlying performance. Costs were well managed, benefitting from reduced hiring but offset by higher spending to support cloud growth. Following the upward normalisation of the group tax rate relative to last year, net income and earnings per share were both mostly unchanged year-on-year at US\$72.3bn and US\$9.68 per share, respectively.

L'ORÉAL

L'Oréal

Global beauty leader, L'Oréal reported market-leading interim results with organic sales growth of 13%, well ahead of the market's 10% increase over the period. Four of the group's five beauty categories – Haircare, Make-up, Skincare and Fragrances – reported double-digit growth over the period, with large brands gaining market share in key regions. Contrary to the severe slowdown reported across the consumer goods industry in North America, the group saw sales in the region grow 13% in constant currency to €5.3bn. L'Oréal continued to report strong demand from Europe (+18.2%) and emerging markets (+23.6% in constant currency). North Asia remained a laggard for the group, with constant currency growth of 3.9% over the six-month period.

Any share price weakness in response to the deceleration of economic growth in key markets can be exploited through a new share repurchase programme, which the Board has authorised. In terms of the buyback programme, management may acquire up to two million shares for a total of €500m. The shares will be cancelled subsequent to acquisition.



Nestlé

Nestlé, the world's largest food company, reported solid half-year results underpinned by strong pricing and resilient demand. Sales growth of 1.6% was driven by pricing (+9.5%), however offset by currency headwinds (-6.7%), the net impact of mergers and acquisitions (-0.4%), and negative volume/mix effect (-0.8%). From an organic growth perspective (like-for-like, excluding currency and net M&A), sales growth was a strong 8.7%.

Sales growth was broad-based across the four largest geographic operating segments, with continued strong pricing in Latin America, Europe and North America offset by low single-digit volume/mix declines, most extreme at -2.4% in Europe. The latter point should be contextualised following 6% growth in volume/mix over the prior two years. Overall, emerging markets outgrew developed markets, 9.6% vs. 8% on an organic basis, with emerging markets showing strong pricing power together with flat volume/mix effects. Input cost inflation remained a headwind, dragging the gross margin down by 40bps year-on-year. Operating expenses were well managed, with lower distribution costs offsetting the recovery in advertising and marketing expenses to drive the underlying trading profit margin 20bps higher to 17.1% - still within management's guided 17% - 17.5% range. Underlying earnings per share (on a constant currency basis) increased 11.1% to CHF 2.59. Reported earnings per share increased by 10.6% to CHF 2.13.



Givaudan

Global flavour and fragrance ingredient market leader, Givaudan reported mixed half-year performance as a slowdown in sales was offset by margin expansion and a recovery in free cash flow. As expected, and in line with prior guidance, 2023 is proving to be another challenging year for the ingredients industry driven by a consumption slowdown in developed markets, particularly North America. Excluding currency fluctuations and acquisitions, Givaudan sales increased 2.4%, driven entirely by growth markets (+8.9%) and strong momentum in Fragrance & Beauty sales. Price increases implemented in 2022 aided gross margin expansion, which supported a 9% (constant currency) increase in net income.

An organisational restructure is underway following a slew of acquisitions. While this will increase expenses in 2023 by CHF60 million, the restructure is expected to be completed by the end of the year and contribute to operational efficiencies going forward. The group re-affirmed its medium-term organic growth targets and remain committed to gaining market share in growth markets (which include India and the Middle East) and strategic growth areas, particularly plant-based proteins and active cosmetics.



LVMH

In its 2023 interim results, global luxury goods conglomerate, LVMH continued to enjoy strong customer support for its flagship brands in Fashion and Leather Goods, with revenue for the division up 20% in constant currency. At a group level, incorporating the deceleration in sales of Wines and Spirits (-3%), group revenue was up 17% in constant currency. Operating profit increased 13%, supported by

revenue growth, while increased marketing expenditure related to various fashion shows weighed on the operating margin.

A severe slowdown was evident in North America, with sales growth turning negative in the second quarter. While growth slowed marginally in Europe and Japan, demand remained robust with double-digit sales growth, while Asia rebounded with growth of 23% driven by China's re-opening. Management remain vigilant amid the economic slowdown evident in key markets but are optimistic on the outlook of the business driven by high demand and strong brand desirability for flagships Louis Vuitton and Christian Dior. An interim dividend of EUR5.50 was declared, representing growth of 10%.



Johnson & Johnson

Johnson & Johnson (J&J) reported strong second quarter results, beating both revenue and earnings per share growth expectations. Over the period, reported sales were up 6.3%, while earnings per share grew 8.1% year-on-year. Sales within the MedTech and Consumer segments were particularly strong, driven by the inclusion of recent acquisition, Abiomed, as well as global procedure volume recovery and growth, and a combination of higher prices and higher over-the-counter (OTC) demand for cough, cold and flu medication. Offsetting this, the strong US dollar undermined sales growth from outside of the US across all segments while declining sales of COVID-19 vaccines impacted international sales within Pharmaceuticals.

Kenvue Inc., the renamed Consumer Health segment spin-off, closed its initial public offering in early May 2023. Johnson & Johnson continues to own 89.6% of the total shares outstanding. The group announced the next step towards a full separation, which will encompass an exchange offer. As part of the offer, Johnson & Johnson shareholders will have the choice to exchange all, some, or none of their shares of Johnson & Johnson for shares of Kenvue. The intention is to set up Kenvue with a shareholder base that want to own its shares therefore mitigating the risk of undue selling pressure when the full spin-off takes place. We expect further information on this process in due course.



DanaHER

Healthcare group, DanaHER Corporation reported a weak set of results for the second quarter of 2023. The poor performance was largely due to the tough comparable period a year ago when the group was enjoying the benefits of increased COVID testing and vaccine utilisation. With a lower contribution from COVID-related sales, revenue for the group declined 7.5% during the quarter to US\$7.2bn. The group's biotechnology segment (which provides bioproduction tools for drug makers) was the laggard, with a 17% decline in revenue. Given the lower volumes, group margins

contracted during the period, which caused a steep decline in earnings per share to US\$2.05 from US\$2.76. Despite the weak absolute numbers reported, it is worth noting that both revenue and earnings per share were ahead of analyst expectations, highlighting how the weakness in the current period was largely anticipated following the strong performance in 2022.

Excluding the contribution from the COVID testing and vaccine sales during the current and prior periods, the rest of DanaHER's business grew revenue by 2% during the quarter. More positively, DanaHER's free cash flow held up better than the decline in earnings, with free cash flow down by 7% over the reporting period. Management provided a cautious outlook for the rest of 2023, with the current year now appearing to be one where the business resets to a normalised base. Beyond the current year, we expect DanaHER to return to normal growth patterns, which include earnings increases of low double digits and cash conversion ahead of reported earnings.



Honeywell

US industrial manufacturer, Honeywell's second quarter results were in line with expectations, with organic sales and earnings rising 3% and 6%, respectively. Abating supply chain issues supported productivity over the period, and this combined with cost containment initiatives, drove operating margin expansion of 150bps, exceeding management's target of 90bps - 130bps. Furthermore, free cash flow generation was up 34%. During the quarter, Honeywell completed three acquisitions, strengthened its carbon capture control capabilities and enhanced its cybersecurity, avionics and safety portfolios. Management continues to pursue bolt-on acquisitions, positioning the group for accelerated growth over the medium term.

Despite the cyclical downturn in safety and productivity solutions and slowdown in building technologies, Honeywell remains optimistic. A strong recovery in commercial aerospace, defence and space as well as sustained growth momentum in processing solutions resulted in management increasing full year guidance. Organic sales growth of 4% - 6% is now expected for 2023 (up from 2% - 5%); the operating margin is expected to expand by 70bps - 90bps (previously 50bps - 90bps), and earnings per share are expected to rise 3% - 6% (up from between 0% - 5%).



Alphabet

Alphabet reported second quarter results that impressed the market, with continued growth in Search and YouTube and increasing profitability from Cloud. Total revenue grew by 7% (9% in constant currency) with the large Google Services segment doing the heavy lifting. Operating income grew 12.3% on well-managed operating expenditure growth, offset by an increase

in content acquisition and hardware costs. Taken together with a net gain on equity and debt instruments (versus a loss in the prior period), earnings per share grew 19% to US\$1.44.

S&P Global

S&P Global

Financial information services provider and credit rating agency, S&P Global reported a good set of results for the second quarter of 2023. Earnings per share (US\$3.12) were broadly in line with average analyst expectations (US\$3.14), while revenue for the period (US\$3.1bn) was ahead of forecasts. The group continued to recover from the prior year, which was negatively impacted by the weak bond issuance environment when corporates were reluctant to issue bonds given the sharp rise in interest rates. Overall, comparable revenue for the period rose 7% from the same period in the prior year, with all the group's segments reporting growth. Adjusted earnings per share for the period rose by 11%, which was in line with management's expectations of double-digit earnings growth for the current financial year.

Given the importance of debt issuance trends for S&P Global, management provided an updated outlook on the debt market. Overall, the group expects the amount of debt issued for the rest of the year to increase between 4% - 8% for 2023. This is a notable improvement from the declines experienced in 2022 and marginally higher than expectations at the start of this year. As corporates become more certain of the future path of interest rates, they are returning to the debt market, which is positive for S&P Global's Ratings division. Over the long term, this remains a strong tailwind for the group. There is over US\$13 trillion of debt rated by S&P Global that is maturing over the next five years and we expect this to continue to drive profitability.

LOCAL EQUITIES



Anglo American

As anticipated, Anglo American reported weak half-year results against a challenging economic backdrop characterised by lower commodity prices and input cost inflation. Revenue declined 13% to US\$15.6bn year-on-year, while underlying earnings before interest, tax, depreciation and amortisation (EBITDA) fell 41% to US\$5.1bn at a margin of 41% (vs. 52% prior). Higher volumes (+10%), primarily driven by the ramp-up of the new Quellaveco copper mine in Peru, as well as favourable currency movements, helped to limit unit production cost increases to just 1%. Further, lower commodity prices had a material impact on results, with Anglo's average commodity basket price down 19% over the period. From an earnings contribution perspective, 29% lower PGM basket prices were most significant, followed by 31% lower prices for steelmaking coal, 23% lower prices for diamonds, and 28% lower iron ore prices. The board proposed an interim dividend of US\$0.55 per share, equivalent to 40% of underlying earnings.

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