

# Prosperity

March 2024

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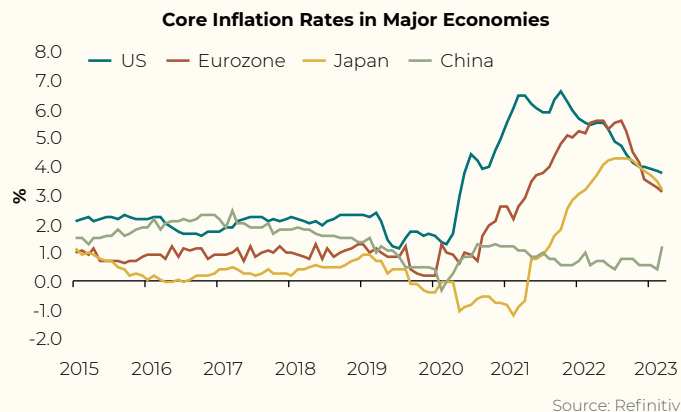
Private Clients  
by  Old Mutual Wealth

## ECONOMIC UPDATE

With the first quarter of the year behind us, the global economy remains resilient despite interest rates being at levels last seen decades ago. In the US, growth in consumer spending is still solid, with household incomes benefiting from ongoing job creation and reasonable wage growth. Europe's economy has been battered by a struggling manufacturing sector, especially in Germany, but the services sector has performed well while the factory sector itself seems to be over the worst of its slump.

Recent Chinese economic data showed some cyclical improvement as Beijing's stimulus measures appear to be taking effect. Structurally, however, growth is likely to trend lower due to the property overhang, high debt levels and unfavourable demographics. While Chinese inflation bounced in the combined January-February release (to account for the shifting Lunar New Year), this does not suggest that deflation risks have completely abated. Further easing by the People's Bank of China cannot be ruled out.

Notably, in the country that is the poster child for deflation and its negative side-effects, confidence is growing that two decades of deflationary torpor are ending. The Bank of Japan hiked policy rates for the first time in 17 years, ending a negative interest rate policy that had been in place since 2016. However, it moved carefully, with its policy rate now only slightly positive in nominal terms, and still negative in real terms. Stronger wage gains for Japanese households support the hope that there will not be a return to stubbornly low or negative inflation in the years ahead. However, the possibility remains and therefore Japanese rates are unlikely to rise much further.



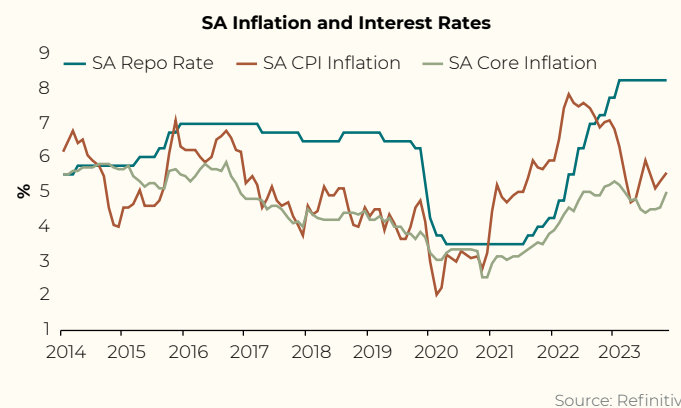
In the US, the Federal Reserve kept rates unchanged at its March policy meeting, despite recent inflation data coming in a bit higher than expected and showing signs of stickiness. Notably, however, the Fed's 'dot plot' projection still points to three 25 basis points rate cuts this year, despite inflation and growth forecasts being marked up somewhat. Real GDP growth of 2.1% is projected this year compared to 1.4% in the

December round of forecasts. The projection for core PCE inflation (the Fed's preferred measure) was raised to 2.6% this year from 2.4%. This is expected to decline to 2.2% by the end of 2025 and only fully reach the 2% inflation target by 2026.

Essentially, Fed officials are still banking on a soft landing where growth slows without contracting, inflation subsides over time and there is room to cut interest rates from current restrictive levels. This remains a positive picture for markets, and against the odds (soft landings are rare), still seems to be where we are headed.

What could go wrong? One possibility is that the Fed (and investors) overestimate the strength of the US (and global economy), implying that the current level of interest rates is way too high, and will cause a hard landing. The opposing and more likely risk scenario is that ongoing resilient economic activity leads to continued upward pressure on inflation, and that expectations for rate cuts must be pared back again.

In South Africa, given the higher February inflation number (5.6% year-on-year) and the fact that expectations of international interest rate reductions have been scaled back since the start of the year, the Reserve Bank's Monetary Policy Committee (MPC) was not expected to cut rates. Indeed, it kept the repo rate unchanged at 8.25% in a unanimous decision. Nonetheless, the MPC is still likely to start a modest cutting cycle towards the middle of the year once it has greater certainty on the global rates cycle and the domestic inflation outlook. The Reserve Bank forecasts inflation to average 5.1% this year and 4.6% next year, with headline inflation reaching the 4.5% mid-point of the target range in the fourth quarter of 2025.



SA's growth forecasts are largely unchanged at 1.2% this year, 1.4% next year and 1.6% in 2026. In other words, unlike in the US and other developed countries, there appears to be little risk of demand-led inflation. Rather, inflationary pressures stem largely from food and fuel prices (set in international markets) and supply-side inefficiencies such as loadshedding.

The SARB estimates that record levels of loadshedding cost South Africa 1.5 percentage points of economic growth last year. In other words, growth would have been 2% instead of 0.6% in 2023. Therefore, as increased private generation eases the electricity constraint in the months and years ahead, growth rates should improve.

## MARKET UPDATE

Global markets were buoyed by renewed optimism that the US central bank would start cutting rates in the second quarter of this year. The MSCI World was up 3.3% in March.

Despite higher-than-expected inflation in the US, the country's three major benchmark indices closed the month stronger. The Dow was up 2.1%, the Nasdaq rose 1.8%, and the S&P 500 rallied 3.1% in March. The UK's FTSE 100 ended the month 4.2% higher. China's equity market recorded modest monthly gains, with the Hang Seng up 0.2% and the Shanghai Composite Index up 0.9%. Japanese equities continued their recent momentum, with the Nikkei closing above 40 000 and ending March 3.1% higher.

On the local front, after lagging global markets in January and February, the JSE bounced back in March, with the All Share Index gaining 2.5%. Resources led the charge (+13.9%), followed by Industrials (+2.4%). Financials, however, ended the month 4.1% lower.

The rand strengthened somewhat against the US dollar, up 1.4% in March ending at R18.92. Gold was up 9.1% and ended the month at US\$2 229.87/oz. Brent crude ended March 4.6% higher (at US\$87.48/bbl) and the platinum price rose 3.5%.

## GLOBAL EQUITIES



### Nestlé

Nestlé, the world's largest food company, reported full-year results underpinned by strong pricing and resilient demand within a highly inflationary environment. Reflecting the end of the post-pandemic normalisation, reported sales declined by 1.5%. Despite passing through price increases (+7.5%), sales were negatively impacted by currency headwinds (-7.8%), the net impact of mergers and acquisitions (M&A, -0.9%), and marginally negative volume/mix effects (-0.3%). From an organic growth perspective (like-for-like, excluding currency and net M&A), sales growth was strong at 7.2%.

Sales growth was broad-based across the four largest geographic operating segments, with continued strong pricing in Europe, Latin America and North America offset by low single-digit volume/mix declines in Europe. Emerging markets outgrew developed markets (8.4% vs. 6.4%) on an organic basis, with both markets showing strong pricing power but emerging markets doing better from a volume/mix perspective (+0.8%). Gross margin expansion and more efficient distribution offset higher advertising and marketing, and other expenses to lift the underlying trading profit margin higher by 20 bps to 17.3%, not far off management's 17.5% - 18.5% target range. Earnings per share (on a constant currency basis) increased 8.4% to CHF 4.80. Reported earnings per share increased by 23.7% to CHF 4.23.



### Accenture

Global consulting firm, Accenture reported a weak second quarter and interim 2024 result with revenue growing 1.5% relative to the comparable period. The group continued to be impacted by weaker discretionary and capital expenditure from the North American (-1%) and EMEA (0%) regions. As previously communicated, Consulting revenue, which is more sensitive to clients' discretionary spend, was down 1.5% to US\$16.5bn. Managed Services (previously Outsourcing) was more resilient and grew 4.8% to US\$15.5bn.

From an industry perspective, spending from Health & Public Services as well as Resources drove revenue growth, up 11% and 5%, respectively. Communications, Media & Technology continued to decelerate, with revenue down 9%. Financial Services slowed materially and reported revenue was down 3%, while Products were largely unchanged with revenue growth of 1%.

Management remained optimistic about the work in progress related to generative AI, with related bookings of US\$1.1bn during the first half of the financial year. However, they expect general discretionary expenditure to remain constrained for FY 2024. As such, they have guided for weaker growth than initially

anticipated. Revenue growth is expected to be between 1% - 3% (down from 2% - 5%) and adjusted earnings per share is expected to grow between 3% - 5% (down from 3% - 6%). The group remains committed to returning excess cash to shareholders in the form of dividends and share buybacks and has maintained its US\$7.7bn target for FY 2024.

## LOCAL EQUITIES



### Mondi

Global leading paper and packaging company Mondi reported weak full-year results as lower prices and softer demand impacted the business. Group revenue declined 18%, with volume and price pressures across Corrugated Packaging and Uncoated Fine Paper offsetting resilience from Flexible Packaging. On a positive note, input costs were well managed and showed signs of stabilisation, ultimately limiting gross margin contraction from 38.5% to 37.4%. Earnings before interest, tax, depreciation and amortisation (EBITDA) declined 35%, with the EBITDA margin contracting to 16.4% from 20.8%. Taken together, earnings per share fell 58% to 103.5 euro cents per share. Despite the weak earnings result, cash generation was resilient, with cash generated from operations up 1.6% to €1.3bn.

Management highlighted positive demand dynamics towards year-end. Noting price increases across 70% of the portfolio, revenue growth has meaningful support factors, which together with continued cost management, should drive margin expansion and earnings growth for FY24.



### FirstRand

FirstRand (consisting of FNB, Wesbank, RMB and the UK's Aldermore and MotoNovo) reported fair half-year results, with normalised earnings up by 6%. In line with guidance, both consumer and corporate credit health deteriorated during the period, evidenced by a 28% increase in credit impairment charges and deterioration in the credit loss ratio. Despite this, the deterioration was not as bad as initially expected, allowing the group to continue to advance credit (+11%) to low-medium risk customers. Net interest income (+14%) grew strongly, supported by sustained growth in deposits (+11%).

The group expects consumers to remain under pressure until the end of June 2024. Thereafter, interest rates are forecast to be cut, supporting a recovery in the credit environment. An interim dividend of 200 cents per share was proposed, representing a 6% increase, which is in line with the group's dividend cover policy.



## Shoprite

Shoprite delivered a strong set of half-year results, with group sales up 13.9% driven by performance in the core RSA supermarkets business. The SA segment saw sales growth of 14.6%, with Checkers and Checkers Hyper (+13.7%) and Sixty60 (+63.1%) achieving double-digit sales growth. Checkers continues to be the fastest-growing grocer in the SA premium food segment. Shoprite and USave remained focused on keeping prices low and saw sales growth of 13.1%. Over the period, the group managed to contain internal retail selling price inflation to 7.7% in the Supermarkets RSA segment. Liquorshop continued to deliver, growing sales 25.2%. Group market share was also up, representing 58 consecutive months of market share gains.

Group gross margins were marginally higher at 23.6% (vs 23.5% in HY 2023), while trading profit increased by 10.7%. Trading margins declined to 5.5% due to higher expenses driven by diesel costs in the SA segment. Continued, but easing, loadshedding cost the group R500m over the period. The board declared an interim dividend of 267 cents per share, which represents year-on-year dividend per share growth of 7.7%



## Sanlam

Building on solid interim results in September, Sanlam reported a strong 2023 full-year result with performance across all operating segments rebounding. New business volumes across the group rose 18% to R397m in 2023. Life insurance new business volumes were up 14% during the period, with both SA and Asia showing positive trends. Asia's growth was driven by India, where sales increased 43% due to Shriram (Sanlam's Indian subsidiary) and growth in sales from third-party channels. The investment management segment also reported strong new business volumes growth of 22%. This growth was supported by the inclusion of Absa's asset management business and flows into the Pan-African operations. The short-term insurance segment reported the slowest new business growth of 4%, as risk management and margins were prioritised. Overall, net results from financial services were R12.4bn, 18% higher than the prior year. Including the volatile impact of unrealised investment returns, net operating earnings were up 25% to R13.9bn.

During the period, Sanlam continued to allocate capital in line with its strategy of building a strong SA and rest of Africa business. Locally, the group finalised the acquisitions of Capital Legacy (wills and estate solutions), Afrocentric (health insurance), and Bright Rock (risk products). In aggregate, Sanlam invested R3.2bn in strengthening its local business by acquisitions. Outside SA, the most material transaction in our view was Sanlam's joint venture with global insurer, Allianz to form an Africa-wide partnership. The partnership was concluded in October 2023 and so there has

been limited time to make any meaningful comparison to the prior period. This partnership, which combines both companies' African operations into one entity, will be 60% owned by Sanlam and provides Sanlam with scale in several African markets. We expect growth across the continent to be an important driver of group earnings over the coming years.



## Standard Bank

Africa's largest financial services provider, Standard Bank reported a strong full-year 2023 performance as headline earnings grew 27% to R43bn. The performance was driven by continued growth momentum across Africa Regions, where headline earnings rose 70% in constant currency. Growth slowed in the second half of the year, particularly in SA, as customer affordability constraints placed pressure on growth in both advances and deposits. Furthermore, the group guided for a slowdown in net interest income and non-interest revenue in FY 2024 as rate cuts are expected in key markets and trading revenue is projected to normalise off a high base.

Management remains committed to their FY 2025 targets, aiming for a return on equity of 17% - 20% (FY 2023: 18.8%) and a cost to income ratio of 50% (FY 2023: 51.4%). The group's dividend was up 18% to 1 423 cents per share, representing a 55% pay-out ratio.



## OUTsurance

OUTsurance Holdings reported a muted set of half-year results as the company was hit by natural disaster claims in Australia following storms within the region. Compared with the benign weather experienced in the prior period, the losses from the increased claims resulted in group earnings increasing by just 0.5% to R1.4bn. Excluding the Australian natural disaster claims, the group's claims ratio (a key driver of profitability) improved, with the Australian operation performing at a similar level to the SA businesses. Despite the muted earnings, OUTsurance's gross written premiums were strong. In aggregate, the SA and Australian property and casualty businesses reported a 22.5% increase in gross written premiums with annualised new business premiums increasing by 38.8% to R4.8bn. Growth was aided by disciplined pricing, good organic growth and a 4.6% weakening in the rand versus the Australian dollar.

The group declared a dividend of 61.2c per share, 7.7% higher than the prior year and ahead of the increase in normalised earnings. This increase in the dividend was enabled by the higher payout ratio from the Australian operations as well as the resumption in dividends from OUTsurance Life. Management expects the uncertainty within the reinsurance market to abate over the next few months, giving them confidence in the group's future capital needs. Regarding OUTsurance's foray into Ireland, the group's Irish operations reported a loss of R59m. This was expected, as

the business gears up for a market launch in the next quarter. We view OUTsurance's entry into the Irish market as an opportunity for the group to further diversify its operations from the slower growing SA market into attractive insurance markets that have the potential to be as successful and significant as Australia has been for the group.



Remgro

Diversified financials and industrials investment holding company, Remgro delivered weak half-year results following a period of heightened corporate activity and a challenging SA business and consumer backdrop. Headline earnings per share declined 39.1% to R3.81 while the disclosed Intrinsic Net Asset Value (INAV) was down 5% to R236.95 per share. The Group completed significant corporate actions, which distorted the comparability of headline earnings to the prior period. Removing the impact of these corporate actions would have seen headline earnings decrease by 13.1%, reflecting a mixed underlying performance across key portfolio investments. Net cash at the centre was roughly unchanged, following significant investments and loans related to both Mediclinic and Distell being taken private, and a large preference share redemption meaningfully reducing outstanding debt. Despite the weak result, management declared an interim gross dividend of 80 cents per share, unchanged from last year's distribution.

Looking at key segment-level earnings performance, Healthcare's contribution was slightly weaker following stability across South Africa and strong growth in the Middle East, offset by continued challenging conditions in Switzerland. Consumer Products was mixed, with RCL Foods and Siqalo recovering, supported by easing input costs and a defensive consumer, while Heineken struggled at the other end of the consumer spectrum as downtrading negatively impacted their higher priced, more premium portfolio. Financial Services, mostly OUTsurance, showed strong operational execution, however, earnings growth was offset by higher claims and investment in growth opportunities. Infrastructure's earnings were down significantly on higher finance costs however operational growth was healthy with CIVH revenue up 11%. The Industrials segment's performance was mixed, with Air Products reporting pleasing revenue growth driven by packaged gas, despite the lack of large project development in the mining, chemical and metal extractions industries, which are the typical heavy users. TotalEnergies was a meaningful detractor in Industrials, with earnings impaired by a negative adjustment to TotalEnergies Natref stock, following Natref being classified as held for sale.



MTN

Consistent with a tough macroeconomic backdrop in some of the group's key markets, MTN reported weak full-year 2023 results. While group revenue for the period was up 6.8% to R221bn, this was below the blended rate of inflation (16.7%) across the markets MTN operates in. Service revenue, which excludes device and SIM card revenue, drove revenue growth, increasing by 6.9% during the period. Earnings before interest tax and depreciation (EBITDA) for the group fell 0.5% to R90.4bn. This was despite MTN's expense efficiency programme, which delivered R2.6bn in savings for the year, ahead of the targeted R1.5bn. Consequently, the group's EBITDA margin fell 3% to 40.9%, with reported headline earnings decreasing to R3.10 (-72%). The significant weakness in the Nigerian Naira during the period was a key contributor to MTN's weak performance. In constant currency, the group's results were commendable, with service revenue up 13.0% and adjusted headline earnings falling 9.5% to R12.03. Furthermore, MTN managed to increase total and active data subscribers by 2% and 9.3%, respectively, highlighting the group's continued operational resilience despite a tough macro environment.

During the period, MTN announced the signing of definitive agreements with Mastercard for a minority investment of US\$200m in MTN's Fintech segment at a valuation of US\$5.2bn. This segment includes the group's mobile money, insurance, airtime lending and e-commerce businesses. Over the medium term, this segment is expected to grow by approximately 30% per annum, highlighting the opportunity for this to become a meaningful contributor to group profit. At the transaction valuation of US\$5.2bn, the fintech segment makes up almost 60% of MTN's current market capitalisation, which suggests that the market has yet to fully account for this future opportunity. Given MTN's recent share price weakness, the company is trading below our estimate of fair value.

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