

# Portfolio Watch

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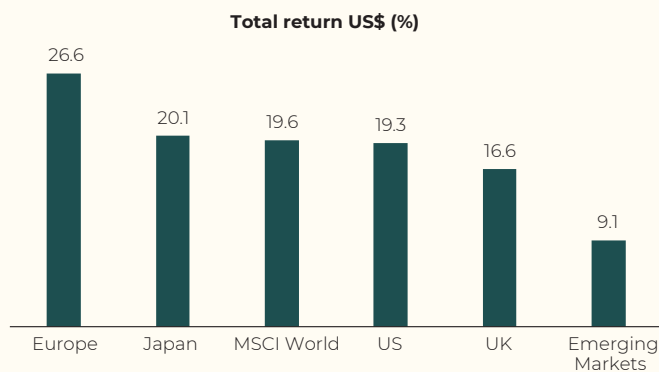
## STICKING TO OUR KNITTING

Following a strong rally during the first half of this year, the past few months have been characterised by global equity markets retreating from their recent highs. In fact, the MSCI World Index ended October 10.4% lower than its July peak, technically placing the index in correction territory. Yet, despite the recent declines, returns across equity markets since October last year, when the market bottomed, remain impressive. This is perhaps surprising, given all that has transpired over the ensuing period.

### THE LEADERS AND LAGGARDS

From 12 October 2022 to 31 October 2023, the MSCI World Index returned around 20% in US dollars and slightly more in rands. Interestingly, Europe (+27%) and Japan (+20%) were the standout regional performers over the period, while the US marginally underperformed the broader index, despite the Magnificent Seven's (i.e. Apple, Microsoft, Alphabet, Amazon, Nvidia, Meta and Tesla) stellar performance.

Graph 1: Geographic returns (12 Oct 2022 – 31 Oct 2023)



Source: LSEG Workspace/Private Clients Research

You may recall that in October last year, Europe's supposed recession – on the back of surging energy prices following Russia's invasion of Ukraine – was imminent and dominated news headlines. At the time, the UK was embroiled in a messy political circus that led to the shortest-serving Prime Minister in the country's history. And yet, just one year later, most regions have produced strong returns in US dollars, with Europe leading the rally. This serves as another reminder of the risk (and folly) of being too focused on and swayed by news headlines.

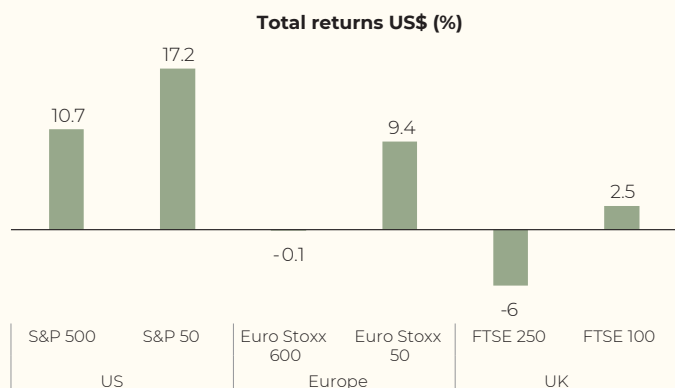
While last year's concerns around Europe and the UK have largely vanished, other concerns persist, and new ones have emerged. Interest rate increases by global central banks remain front and centre of investors' minds, along with sticky inflation, high oil prices and geopolitical uncertainty. On the ever-present market wall of worry, investors have since added the US' deteriorating fiscal position amid higher interest rates along with China's slow pace of recovery. And as is the case with the wall of worry, the list of concerns seems to grow longer with each passing month. Legendary investor Peter Lynch once remarked that "far more money has been lost by investors in preparing for corrections, or anticipating corrections, than has been lost in the corrections themselves." Over the last year, this has certainly rung true.

### MARKET CAP DIVERGENCE

One notable trend we have seen in markets this year has been that of a few large shares leading the market. The Magnificent Seven's strong performance is well-known, with these companies largely driving US equity market returns this year. For the year to date, the S&P 500 (which includes all seven companies) is up 10.7%, with the Magnificent Seven contributing around 90% of this return. Over the same period, the equally weighted S&P 500 declined by 4.1%. In other words, despite the respectable year-to-date return in the S&P 500 Index, the average S&P 500 company has produced a negative return for the year-to-date.

This trend is not entirely unique to the US. In both the UK and the broader European equity markets, large-cap indices (Euro Stoxx 50 and FTSE 100) have outperformed their mid-sized peers, as shown in graph 2. Perhaps this explains why, despite the strong returns over the last 12 months, there is no overwhelming sense of optimism among most investors.

Graph 2: Select Index performance: Jan 2023 – October 2023



Source: LSEG Workspace/Private Clients Research

## A CONSISTENT INVESTMENT PHILOSOPHY

Despite the current headlines and prevailing concerns, we continue to manage our clients' portfolios in the same manner that we have always done. This entails finding and remaining invested in quality companies that we believe are best positioned to withstand ever-changing macroeconomic cycles. Below is a short summary of three such businesses we have recently added to our global equity portfolio.

- LVMH, known for its flagship brands Louis Vuitton and Christian Dior, is the leading luxury products group globally and the only company present across all luxury sectors. The group is well diversified from a brand, product, and geographic perspective, which allows the company to better weather business cycles compared to its peers. Furthermore, the group maintains a very strong balance sheet and generates strong free cash flow, which we regard as key quality attributes.

- Stryker is a leading global medical technology company. The group has accumulated an attractive portfolio of innovative orthopaedic devices and maintains strong market shares in other medical and surgical equipment. The group's portfolio benefits from long-term themes of ageing populations, earlier intervention, and higher healthcare expenditure in both developed and emerging markets. In some key regions, the group sells its products directly to doctors and hospitals, which results in very high switching costs.

- While Atlas Copco may be a lesser-known company, the group has a long illustrious history. The company was established 150 years ago in 1873 and is a globally diversified industrial group operating in 180 countries. Over time, the group's industrial equipment and services have evolved such that today they provide tools that are essential in manufacturing and production facilities across every industry. While essential, the group's equipment and services are a fraction of the capital cost of operating and maintaining production facilities and as such provide the group with pricing power that is evidenced by stable gross and operating margins.

## STICKING TO OUR KNITTING

With just a few weeks left of this year, equity markets in 2023 seem set to deliver higher returns than those achieved in 2022. Few would have anticipated this outcome at the start of the year. Given that news headlines will shortly be dominated by forecasts of what will happen in markets in 2024, it is worth remembering that most of what was predicted this year did not occur. At Private Clients, our focus will remain unchanged – investing in high quality companies, not overpaying for these companies, and remaining invested for the long-term. This is an approach that continues to serve our clients well.

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