

# Prosperity

April 2023

- Economic and Market Overview
- Global Equities
- Local Equities

Private Clients  
by  Old Mutual Wealth

## ECONOMIC UPDATE

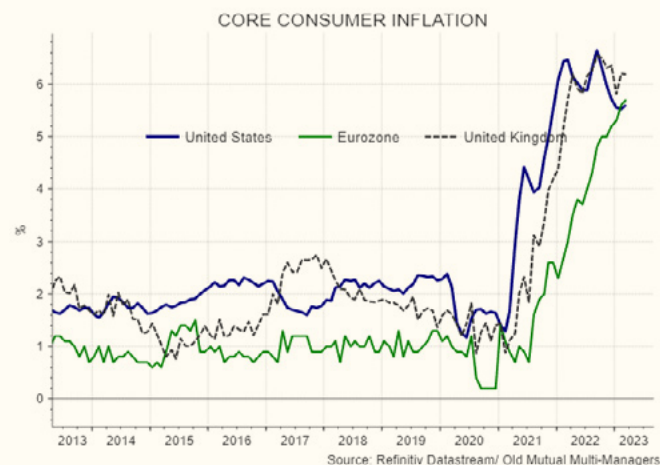
Following the banking sector turmoil in the previous month, April was relatively quieter –though not uneventful. First Republic Bank was sold to JPMorgan under the guidance of US authorities, becoming the third US bank to fail. Nonetheless, economic data has generally been resilient, inflation continues to recede (albeit unevenly), and none of the major central banks had policy meetings.



While US economic growth slowed during the first quarter, it remained positive at 1.6% year-on-year in real terms. In nominal terms (before removing inflation), growth was still 7% year-on-year. Importantly, consumer spending, which accounts for more than two-thirds of economic activity, grew at a steady rate.

The Eurozone economy grew by 1.3% year-on-year in real terms in the first quarter. Like the US, it represents a slightly slower pace of expansion, but is positive and much better than expected six months ago when the global energy crisis was at its worst.

China's economy rebounded strongly in the first quarter following the lifting of COVID restrictions towards the end of last year. Chinese GDP growth increased to 4.5% year-on-year, exceeding economist expectations. Beijing has set a growth target of 5% for the year, which seems achievable. Longer term, the Chinese economy still faces headwinds that will make it difficult to sustain this pace.



While global growth has been resilient at the start of 2023, the outlook is not rosy. The lagged impact of rapid rate increases over the past 14 months is starting to show, and central banks are not done hiking yet. In fact, the growth resilience to date will give central banks comfort that they can focus on fighting inflation, which, despite recent improvements, remains well above target in all major economies except China. The US Fed has probably reached the end of the hiking cycle, but the European Central Bank still has some way to go.

Moreover, with most US banks reporting first quarter earnings during the month, it is clear that the smaller banks are forced to pay higher deposit rates and accordingly, have a reduced appetite for lending into the real economy. This is likely to contribute to economic weakness, though the full extent will only become apparent with time. Fortunately, the larger banks still seem rock solid and there is no reason to expect a repeat of the 2008 Financial Crisis.

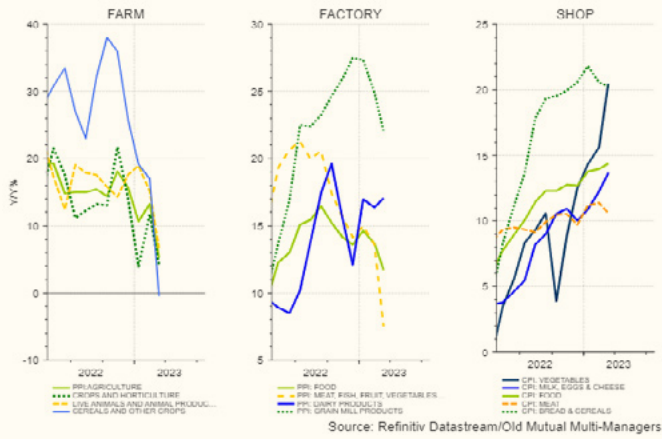
In summary, it is a tricky macro environment for investors. Good news is still not quite good news in the sense that the more resilient economic activity is now, the less likely inflationary pressures fade by themselves and therefore, the more central banks need to raise rates. If history is a guide, this could ultimately cause a sharp slowdown.

On the local front, South Africa's biggest economic challenge this year has been power cuts, and this remains the case. Stage 6 loadshedding was a regular feature during the month, and this naturally weighs on economic activity. However, we still do not have a precise estimate of the actual impact as businesses are constantly trying to adapt and adjust as best they can. We will only know the true impact with hindsight. Growth forecasts for this year from the likes of the Reserve Bank and International Monetary Fund point to virtual stagnation, but these rely on very pessimistic assumptions of how loadshedding affects businesses.

Similarly, the Reserve Bank assumes that businesses pass on 90% of spending on diesel generators to customers, and therefore loadshedding adds as much as a full percentage point to inflation. This might be overstating things since the ability of firms to pass on cost increases is constrained in the tough economic environment.

Nonetheless, the latest inflation data surprised to the upside again. The Consumer Price Index rose 7.1% year-on-year in March, up from 7% in February. The main culprit was persistently high food inflation, which increased to 14%. However, core inflation, which excludes volatile food and fuel prices, remains elevated at 5.2%, above the Reserve Bank's 4.5% target.

## FOOD INFLATION VALUE CHAIN

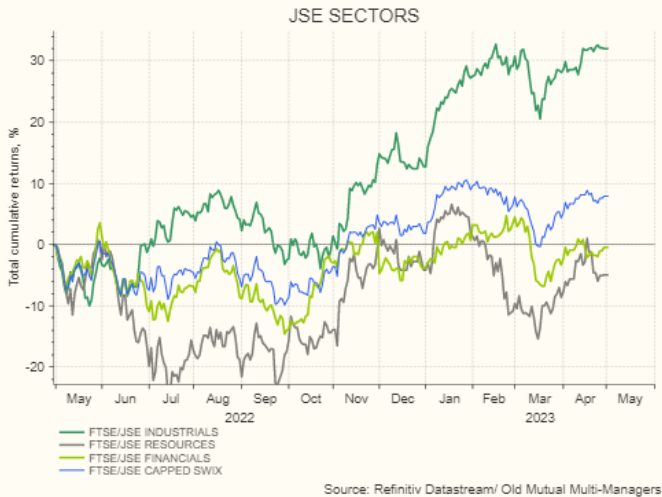


Regardless of what the Reserve Bank does with interest rates, inflation is likely to decline in the coming months. The rand oil price has already turned negative on a year-on-year basis and will start pulling headline inflation lower. Food inflation should also moderate at the retail level given that it is declining materially at farm and factory levels across most categories.

## MARKET UPDATE

Most major global markets ended April in positive territory, with the MSCI World Index closing 1.8% higher.

In the US, the Dow Jones (+2.5%), S&P 500 (+1.5%) and the Nasdaq Composite (+0.4%) all recorded gains during the month. The UK's FTSE-100 also performed well, returning 3.1% in April. Asian markets ended the month mixed. While the Shanghai Composite (+1.5%) and Nikkei (+2.9%) recorded gains, the Hang Seng slid 2.5%.



The JSE All Share Index gained 2.8% in April, with Resources (+4.2%), Industrials (+3%) and Financials (+1.3%) all ending the month higher. The rand weakened by 2.7% against the US dollar to close the month at R18.30/\$. With a weaker dollar and higher commodity prices, the gold price recorded its second consecutive monthly gain (+1.1%), while iron ore slid 12.4% in April. Brent crude was 0.3% lower.

## GLOBAL EQUITIES



### Apple

Given Apple's status as a bellwether for the state of consumers, the group's latest quarterly earnings update was among the most highly anticipated of the last few weeks. Despite investor concerns leading up to the results, the company managed to beat revenue and earnings expectations for the second quarter, which saw the share price rise in reaction to the results. However, in absolute terms, revenue for the period was 3% lower at US\$94.8bn, while earnings per share remained unchanged at US\$1.52. Average analyst expectations were for revenue and earnings of US\$93.1bn and US\$1.44, respectively.

Apple's active installed base (i.e. the total number of devices it has in the market) exceeded two billion, reaching all-time highs. Management has increasingly prioritised this metric as the group has shifted focus to its services business, which grew revenue 5% during the quarter. While service growth was impacted by a slowdown in digital advertising and mobile gaming, it still represented a record quarter for the group. Related to the group's service growth was the disclosure of over 975 million current paid subscribers across Apple's various services. This was an increase of 150 million from a year ago and nearly double the paid subscriptions from three years back. Apple ended the quarter with a net cash position of US\$57bn, paid dividends of US\$3.7bn, and carried out US\$23bn of share repurchases. This continues a trend of utilising excess cash on its balance sheet to reduce share count, which has been supportive of earnings growth.



### Visa

Visa, the world's largest payments technology company, reported strong second quarter 2023 results that showed that despite well-documented macro concerns, the business continues to enjoy a strong recovery across key geographies. Payment volumes for the second quarter rose 10% year-on-year, ahead of the 7% increase in the first quarter. Cross-border volumes, which drive the higher-margin international transaction revenues, increased 24% year-on-year. While this was slower than the 38% increase reported for full year 2022, cross-border volumes are still growing at an impressive rate. The trend of faster-growing international transactions highlights how Visa continues to benefit from increased travel post the pandemic. During the second quarter, rebounding Asian travel was the primary driver of international transaction volumes. Excluding the group's European operations, which have been affected by the exclusion of its Russian operations, cross-border volumes rose 32% year-on-year.

Group revenue for the quarter was up 11% to US\$8bn, driven by the growth in payment volumes, cross-border volumes and processed transactions. Excluding currency movements, revenues rose at a faster pace, up 13% over the quarter. Net income for the quarter was US\$4.3bn or US\$2.03 per share, an increase of 17% and 20%, respectively. Growth in earnings was in line with management's previous guidance of approximately 20% over the quarter. The group's expenses were well managed, which resulted in higher margins. During the quarter, the group repurchased US\$2.2bn worth of shares at an average price of US\$222 per share.

## LOCAL EQUITIES



### Capitec

Capitec reported a mixed set of full year results, with headline earnings up 15% to R9.7bn within a low economic growth and challenging consumer environment. Confirming the latter point, the bank grew loans and advances by 16% to R98bn while deposit growth (+9% to R147bn) was more in line with growth in the client base. Two million active clients were added over the year, bringing the total client base to 20 million. This effectively means that a third of the SA population have a Capitec account. Earnings from the credit life insurance and funeral plan offerings were also up strongly - 23% and 58%, respectively. Profits in Capitec's Business Bank offering, which has yet to be formally launched, more than doubled to R389m. Despite the strong growth in income across the business, signs of a strained consumer were evident, with the bank's net credit impairment charge growing by 80% to R6.1bn over the period. While this increase is significant, two factors should be considered. Firstly, the inputs inherent in the 2022 charge were prepared prior to the Ukraine/Russia conflict, an event that introduced material volatility and uncertainty into global markets, prompting downward economic growth forecasts and results. Secondly, the current credit loss ratio at 8% is not far from the pre-COVID level of 7.2%, highlighting a normalisation following the 11.4% reported in 2021 and 4.9% reported in 2022. Further evidence of this normalisation can be seen in the moderation in the Expected Credit Loss coverage ratio, which improved to 22.9% from 26.9% in 2021. Nonetheless, evidence of a constrained consumer is clear.

Over the period, despite technology-related expenses rising by 47%, Capitec's operating costs declined by 5%, largely as a result of fewer staff incentives. This saw the bank's cost-to-income ratio declining to a more normalised level of 39% from 47% in the prior period. Furthermore, Capitec maintained an industry-leading return on equity (ROE) ratio of 26%, which is not far off pre-COVID levels of 28%. With the bank remaining well capitalised, the board declared a final dividend of 2 800 cents per share, taking the full year dividend to 4 200 cents per share, up 15% year-on-year.

## Clicks

South Africa's largest retail pharmacy chain, Clicks reported strong interim results despite the tough operating environment characterised by loadshedding and a constrained consumer. Excluding vaccinations, group turnover was up 6.8% over the period. The increase in turnover was driven by the retail segment (+11.9%). On the other hand, performance in the distribution segment was muted with turnover down 1.8%, impacted by the lower increase in the regulated single exit price (SEP) of medicines granted by the Department of Health (DoH). Retail sales growth was driven by a recovery in the beauty and personal care segment and supported by loyalty card members (+300 000 to 10m). Adjusted diluted headline earnings per share were up 10.2% and operating margins saw a 40bp increase to 8.2%.

Over the period, the Constitutional Court found that Clicks had contravened regulations of the Pharmacy Act and ruled in favour of the Independent Community Pharmacy Association (ICPA) after a seven-year long battle against the group's ownership of both dispensing and manufacturing pharmacies. This ruling means that the DoH now has the power to revoke Clicks' pharmacy license. However, the court suggested that Clicks be given the opportunity to divest itself of Unicorn Pharmaceutical – Clicks' manufacturing subsidiary. Although Unicorn Pharmaceutical is fully owned by New Clicks and not Clicks, it is a 100% subsidiary of the JSE-listed entity Clicks Holdings. Unicorn-manufactured drugs contributed 10.2% of Pharmacy revenues and 2% of Retail turnover, according to Clicks, making up about 215 generics. Management stated that they are engaging with the DoH to come to a resolution but in the interim no restrictions were placed on the sale of private label products through their dispensaries.

Looking ahead, the outlook remains challenging due to increased inflationary pressures, loadshedding and higher interest rates. Management is confident that their locational advantage will result in continued performance across segments and have committed to their store rollout plan.

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