

Prosperity

August 2023

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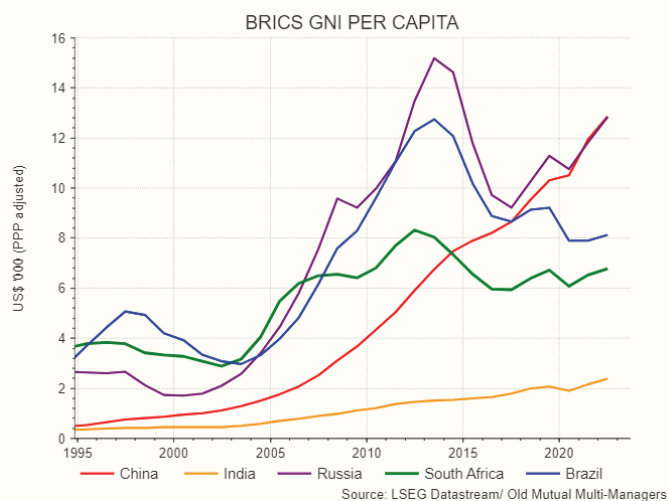
Private Clients
by  Old Mutual Wealth

ECONOMIC UPDATE

Towards the end of August, South Africa hosted the annual BRICS summit. Russia's growing global isolation and escalating tensions between China and the US meant that the summit received a great deal of media attention. While many commentators now paint BRICS as a solid alternative to the G7 and Nato, BRICS remains a loose alliance of very different countries with very different interests. In fact, BRICS has more clarity on what it stands against – Western dominance – than what it stands for.

It is worth remembering that this grouping of countries started in a Goldman Sachs research paper 22 years ago, when then chief economist, Jim O'Neil, argued that the ongoing economic rise of Brazil, Russia, India and China would necessitate a reordering of global governance institutions. He was not wrong, but coming soon after the dotcom crash, the BRIC concept quickly became a marketing fad as the "hot new thing" in investments. This idea gathered further momentum when these countries emerged from the 2008 Global Financial Crisis in better shape than the West.

In 2009, the leaders of the four countries met to turn the acronym into a political club and in the following year, South Africa was invited to join. Today, however, BRICS is still more form than substance. It remains an informal arrangement for now, lacking a founding charter, and importantly, any kind of free-trade arrangement. The one tangible creation of BRICS is the New Development Bank, set up as an alternative to the World Bank and other Western-led development institutions, but it remains small in comparison. Ironically, given the growing talk of de-dollarisation, it largely lends US dollars.



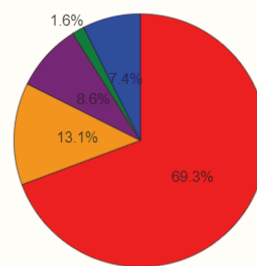
Far from collectively being the countries of the future, the BRICS have had divergent performances since 2009. China has enjoyed spectacular gains in real per capita income, but as we now know, serious imbalances built up over this period. These include a property bubble and associated rapid rise in private debt that is likely to create an overhang, constraining growth in the years ahead. China's declining population, like Russia's, is also a structural headwind.

India has also managed sustained improvements in living standards from very low levels of per capita income. With its large and relatively young population and high savings rate, India can continue to grow rapidly in the years ahead, with the right government policies. Russian national wealth rises and falls with energy prices, and on the surface, currently appears strong. However, being cut off from the rest of world will do serious long-term economic damage.

Finally, South Africa and Brazil have followed very similar patterns, given that they have similar unequal, unbalanced and commodity-intensive economies. While both nations enjoyed rapid growth in per capita incomes during the pre-2008 commodity boom, they have stagnated since. In the absence of politically difficult structural economic reforms, history suggests that we will have to wait for the next commodity boom to see another spike in living standards in these two countries.

South Africa is a tiny economy compared to the other four, since its population of 60 million is half that of Russia's and slightly more than a quarter of Brazil's, with China and India being billion-plus behemoths. In terms of GDP, China is the largest economy by far - larger than the other members combined.

BRICS GDP (Current US\$)



- China
- India
- Russia
- South Africa
- Brazil

Source: LSEG Datastream/ Old Mutual Multi-Managers

One of the outcomes of the summit was that the BRICS invited Argentina, Egypt, Ethiopia, Iran, Saudi Arabia and the United Arab Emirates to join in an attempt to act as a geopolitical counterweight to the G7 group of Western democracies. While this garnered much media attention, the summit has little by way of immediate economic or financial market consequence for South Africa. A few trade concessions were announced, as were a few investment initiatives. Nevertheless, BRICS is still a long way from being a free-trade area (which would benefit South Africa greatly) and is even further away from the far-fetched idea of a common currency.

While there is widespread unhappiness among developing economies around the West's dominance of global institutions and the dollar's primacy in the global financial system, there are also many areas of disagreement between these countries.

For instance, perhaps the oddest feature of BRICS is that India and China have fought wars over disputed border areas, most recently coming to blows in 2021. Among the new members, Iran and Saudi Arabia share centuries of enmity, while conflict is brewing between Egypt and Ethiopia over managing the Nile's precious water resource.

It is also notable that none of the new BRICS members are from China's backyard. There is considerable unhappiness over Chinese expansionism in Southeast Asia, so much so that Vietnam banned the *Barbie* movie for showing a map with the "nine dash line" of China's territorial claims in the South China Sea.

Far from signalling the emergence of a powerful united bloc as a counter to the West, we are instead seeing continued drift towards a more fractured, multipolar world.

From a South African point of view, the economic benefits of BRICS membership have so far been questionable. While the potential for growing and diversifying exports into these large markets, particularly China and India, is undeniable, there are still many obstacles in place. The enlarged BRICS grouping means potentially more markets we can sell into, but it also dilutes our influence and exposure. We are now a smaller fish in a bigger pond.

MARKET UPDATE

Growing concerns about the global economy, specifically disappointing economic data in China and the likelihood of US interest rates remaining higher for longer, led to major global markets declining in August, with the MSCI down 2.3%.

In the US, the Nasdaq Composite Index (-2.2%) recorded its worst monthly performance of 2023, and the S&P 500 (-1.8%) and the Dow Jones (-2.4%) also recorded losses during the month. Despite positive inflation data in the UK, the FTSE 100 declined by 3.4% in August.

During the month, foreign funds exited the Chinese equity market following a downturn in manufacturing activity. The Hang Seng declined by 8.5% and the Shanghai Composite Index slid 5.2%. Japan's Nikkei ended the month 1.7% lower.

On the local front, the All Share Index declined by 5.1% in August, with Resources (-10.3%), Industrials (-5.1%) and Financials (-2.0%) all recording losses. The rand fell by 5.8% against the greenback, closing at R18.88 for the month – its second weakest close for 2023. Brent crude oil (+1.5%) recorded its third consecutive monthly gain and ended the month at US\$86.86/bbl. Iron ore and gold prices both declined by 1.2%, while platinum rose by 1.9% for the month.

GLOBAL EQUITIES

DIAGEO

Diageo

Global spirits producer, Diageo, reported mixed full year results, with organic sales growth (+6%) driven entirely by pricing/mix, which more than offset lower volumes (-0.8%). Reported net sales grew 11% with pricing accounting for two-thirds of growth, and favourable currency movements the remainder. Regionally, Asia Pacific (+13%), Europe (+11%), and Latin America and Caribbean (+9%) grew most on an organic basis. Volume growth was less widespread, with Asia Pacific the sole source of growth (+5%), followed by Europe with flat volumes, while North America saw volumes decline by 5%. Following two years of strong COVID recovery-related growth, increased advertising and promotion (A&P) as well as innovation strategies will be required to revitalise momentum.

Higher input costs (most significantly energy costs) together with lower volumes (most notably beer in Africa) led Diageo's gross margin 1% lower. Following the lower gross margin, negative currency effects and impairments to assets (most significantly the McDowell's brand in India) drove reported operating margin contraction of 147bps to 27.1%. On an organic basis, the operating margin was slightly better from strong operational delivery in Asia Pacific, and Latin America offsetting declines in North America and Europe. Full year earnings per share before exceptional items grew 7.6%.

In July, the group changed its functional and presentation currency from GBP to USD. The change speaks to Diageo's large share of net sales and expenses in the US and other countries whose currencies correlate closely with the US dollar. There will be no change to the UK listing. Owners of London-listed shares will now have the option of receiving dividends in either GBP or USD.



Berkshire Hathaway

Berkshire Hathaway reported a strong first half result for 2023. Earnings for the six months to June were US\$71.4bn versus a loss of US\$38bn for the same period last year. Results are heavily impacted by returns generated from the investment portfolio due to the unrealised gains and losses being included in earnings. Removing the impact of the investment portfolio, the underlying operating businesses grew earnings by 9.2% over the first six months relative to the first six months of the 2022 financial year. This result was largely driven by a strong recovery in the insurance businesses. Berkshire's investment portfolio recorded gains of US\$53.3bn, given the strong performance of the US equity market year to date.

A further key feature of the results was the interest income generated from the company's investments in short-dated US treasury bills. Interest income rose to US\$2.5bn year to date, up from US\$392m for the first six months of 2022. Berkshire's cash pile is currently at US\$147bn, with the vast majority being invested in short-dated US treasury bills. Share buybacks also slowed in the second quarter to US\$1.4bn, down from US\$4.4bn in the first three months of the year.



Amazon

Amazon reported strong second quarter performance, with a commendable recovery in e-commerce profitability. Operating profit more than doubled to US\$7.7bn while the group's operating margin improved by 300bps to 5.7%. Positively, the e-commerce giant has started to reap benefits from the expansion of its fulfilment network as it recorded the fastest delivery speeds on record for Prime members. Amazon Web Services' sales and profitability continued to slow in line with management's guidance as clients scale down and save costs. However, demand for the platform's new suite of generative Artificial Intelligence (AI) solutions has driven new contract wins and will likely drive growth going forward.

Reduced capital expenditure, improved productivity and lower working capital investment supported free cash flow generation. While a slowdown in global economic growth and consumption makes for a challenging outlook, earnings should be supported by sustained improvement in e-commerce profitability.

LOCAL EQUITIES



BHP Group

BHP Group reported full year results that were impacted by significantly lower commodity prices and inflationary pressures in the form of higher labour, diesel and electricity costs. Group revenue declined by 17%, while underlying earnings before interest, tax, depreciation and amortisation (EBITDA) declined by 31% over the period. Despite this disappointing result, the group managed to keep production stable and demonstrated good cost discipline with a strategic focus on growth. Highlighting disciplined cost control, the contraction in the underlying EBITDA margin was limited to 54%, which remains relatively attractive.

Free cash flow of US\$5.6bn was generated over the period, which is a notable achievement, especially following investments totalling US\$13.1bn towards acquisitions (OZ Minerals) and capital

expenditure. Although BHP has taken on more debt following the acquisition and dividend payments, debt remains within the US\$5bn-US\$15bn target range and is expected to stay at the upper end as growth spend ramps up. The group reported underlying earnings per share of 265 US cents.



Mondi

Global leading paper and packaging company, Mondi, reported half year results that were meaningfully weaker than the prior year yet still slightly ahead of consensus expectations. Operating conditions were challenging when compared to the first half of 2022. A slowdown in demand, declining prices, inventory destocking and still high (although moderating) input prices affected the result. Group revenue declined 14%, with volume and price pressures across Corrugated Packaging and Uncoated Fine Paper offsetting resilience from Flexible Packaging. Higher input costs, particularly energy and wood prices (both related to lingering effects from the European energy crisis), undermined the gross margin, which contracted to 37% from 39.4%. Although well-managed, the fixed-cost nature of the group's operating expenses combined with a higher cost of goods led to earnings before interest, tax, depreciation and amortisation (EBITDA) 44% lower with the EBITDA margin contracting to 17% from 26.3%. Taken together earnings per share decreased 57% to 63.7 euro cents per share.



Quilter

UK-focused wealth management group, Quilter Plc, reported half year results that were significantly better than analyst expectations. The group's adjusted operating profit of £76 million was 36% higher than consensus analyst expectations, which resulted in a 13% increase in the group's share price on the day results were announced. The better-than-expected profit was driven largely by good cost control, with revenue performing marginally better than expected. The one area of weakness was net inflows from independent channels, which are yet to recover to satisfactory levels despite positive market returns for the year-to-date. Overall, adjusted earnings per share was up 34% to 4.3 pence, with operating margins higher at 24%.

Assets under Management and Administration (AuMA) rose 2% to £101.7bn at the end of June 2023. This increase was mainly driven by the positive market moves over the period (£2bn). Gross flows over the period were £5.5bn, 5% lower than the prior year. Outflows were 14% higher at £4.4bn reflecting increased withdrawals from clients that were impacted by a higher cost of living in the UK and higher debt obligations given higher interest rates. The group announced a 25% increase in the interim dividend to 1.5 pence per share. This translates into a 35% pay-out ratio, which is lower

than the group's target range of between 40% - 60%. Given the highly cash generative nature of the business, we expect a significantly larger dividend in the second half of the year, which will bring the full year dividend within the target range.



MTN

Despite a challenging macroeconomic backdrop, MTN reported resilient half year results; with service revenue increasing by 17% to R107.7bn. Reported service revenue growth was marginally below the blended inflation rate of the group's operating regions, which grew at 17.8%. In aggregate, revenue and earnings before interest, tax and depreciation (EBITDA) for the period rose 16.1% and 12%, respectively. Despite MTN's expense efficiency programme delivering savings of R703m over the reporting period, margins declined by 1.5% due to elevated inflation and forex volatility in key geographies. The Data and Fintech segments were once again the standouts, reporting revenue growth of 23.6% and 21.7%, respectively. The number of subscribers across the group increased by 3.6% to 291.7m. Active data subscribers increased by 7.4% to 139.5m, making up less than 50% of MTN's total subscribers.

Along with the results, MTN announced the signing of a memorandum of understanding to sell a minority stake of its Fintech segment to Mastercard. While MTN did not disclose the size of Mastercard's potential stake in the segment, the group disclosed the implied valuation of the transaction at US\$5.2bn. At a valuation of approximately R100bn, this means that about 35% of MTN's market value can be ascribed to its fast-growing Fintech segment, which management have previously pointed to as a key growth driver across the continent. News of this transaction was well received, with MTN's share price at one point trading 10% higher than its previous close.



Standard Bank

Standard Bank reported a strong set of first half results, with headline earnings up 35%. The African region (contributing 44% to group headline earnings) was the star performer, with headline earnings growth in the banking division up 65% and achieving a 28.4% return on equity. Overall, the group's ROE of 18.9% was up an impressive 320bps and is now comfortably within management's target range of 17% - 20%. The group's interim dividend of 1308.4 cents per share is up 34% from the comparable period, driven by the increase in headline earnings.

Management cautioned that the outlook remains challenging, with higher interest rates now translating into increased credit impairment charges, decreased loan approval rates due to affordability constraints and declining credit appetite. Management

therefore expects a moderation in both net interest income and non-interest revenue, and consequently, lower earnings growth in the second half of the year. ROE is expected to remain within the target range for 2023.



Sibanye Stillwater

Sibanye Stillwater reported weak half year results that were hampered by lower PGM basket prices in both SA and the US, rising production costs, and production disruptions caused by weather and socio-economic events. Revenue declined by 14% over the period, while adjusted earnings before interest, tax, depreciation and amortisation (EBITDA) fell 37%. Despite the weak result, Sibanye's balance sheet remained conservatively positioned with a marginal net debt position and cash of R22.1bn. The board declared an interim dividend of 53 cents per share, in line with the upper-end of the dividend policy range between 25% - 35% of normalised earnings.

Over the period, the US PGM operations experienced a shaft incident at the Stillwater West mine, which led to lower production and higher production costs. Furthermore, this has delayed the implementation of the previously announced operational optimisation plans, which aimed to right-size production and costs over a three-year timeline. Sibanye's SA Gold segment benefitted from stabilised operations and a strong contribution from DRDGOLD. Production was materially higher with lower unit costs compared to last year, which, together with 22% higher rand gold prices, drove adjusted EBITDA from a R3.1bn loss to a R2.4bn gain over the period. However, post the reporting period, the SA Gold operations suffered two significant incidents, which will affect performance significantly during the second half.

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