

Prosperity

June 2023

- Economic and Market Overview
- Global Equities
- Local Equities

Private Clients
by  Old Mutual Wealth

ECONOMIC UPDATE

We have recently witnessed the most synchronised rate hiking cycle on record, with an average of 27 central banks raising rates every month over the last year. The full impact of all this monetary tightening is yet to be felt. Across the developed world, unemployment is still low, while solid growth in household incomes and excess savings support spending. While there are areas of weakness – with the global manufacturing sector under severe pressure – the larger services sector is still doing well.

With just 12 central banks raising rates in June and the major monetary authorities taking divergent paths, we are perhaps beginning to see the start of a break in the synchronised nature of the global rate hiking cycle. This is likely to lead to interesting market developments in the months ahead.



In June, the US Federal Reserve (Fed) left its policy rate unchanged. However, it pointed to the likelihood of further hikes, unless incoming data indicate a noticeable softening in inflation and the economic outlook. Despite a 500 basis point cumulative rate increase over the past 18 months, the US economy remains resilient. While inflation is coming down, this does not mean that the Fed's mission is accomplished. Headline inflation declined to 4% in May from a 40-year high of 9.1% in October last year. This is a big improvement and raises real incomes. However, having more than halved, it would need to halve again to reach the Fed's 2% target. This "last mile" is likely to be tougher and the Fed's pause is therefore not necessarily a pivot.

The European Central Bank (ECB) hiked rates by 25 basis points in June, taking its deposit rate to 3.5%. This is the highest level in 22 years, with rates increasing by 400 basis points over this cycle. Recent economic data in the Eurozone has been disappointing, and the ECB has cut its growth forecast for the next three years. However, inflation remains elevated and is only expected to return to target by 2025. Further hikes are therefore very likely.

Across the English Channel, the pace of rate hikes intensified following the release of higher-than-expected UK inflation numbers. With core inflation rising to 7% (in contrast to modest declines in the US and Eurozone), the Bank of England (BoE) raised its policy interest rate by 50 basis points to 5%. This

marks the 12th consecutive increase since December 2022. And while the BoE's rate is now at its highest level since 2008, it is still deeply negative in real terms.

In Asia, Japan's policy interest rate has been unchanged since 2016, while China has cut rates. While the rest of the world is worried that inflation might not fall fast enough, above-target inflation in Japan (core inflation was at 3.4% in April vs the 2% target) is welcome after many years of very low to negative price increases. The question is whether inflation will persist in this region and effectively boost this long-considered moribund economy.

China is the only major economy where consumer inflation, in the aftermath of COVID, has not risen and remains low. Headline and core inflation were a mere 0.2% and 0.6%, respectively in May. The post-lockdown rebound has disappointed across a broad range of economic variables, from retail sales to fixed investment and credit growth.

Locally, there were two silver linings in June – a reduced intensity of load shedding and lower inflation. This reduces the likelihood of further rate hikes. Consumer inflation fell to 6.3% year-on-year in May from 6.8% in April. Food inflation has finally turned the corner, falling from 14% to 12% year-on-year. Petrol inflation declined to 3.5% in May, but is expected to turn negative on a year-on-year basis in June, pulling headline inflation lower.

SA HOUSEHOLD DEBT

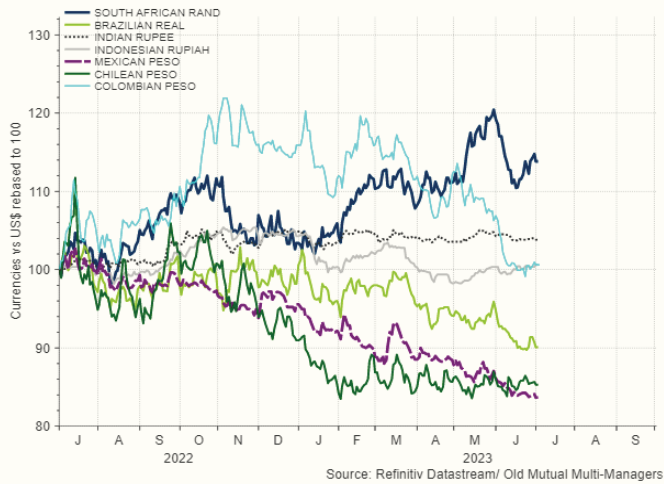


Overall, South African consumers are not overburdened with debt, and have some capacity to absorb the interest rate increases. According to SA Reserve Bank data, household debt increased in the first quarter, but only marginally higher than disposable income, which also rose. The ratio of household debt to disposable income was 62.1% in the first quarter, still well below the all-time high of 80% in 2008. This long period of deleveraging means households spent 8.4% of after-tax income on debt service costs in the first quarter. This is up from 6.7% in early 2022 before interest rates started rising but is in line with the 2010 to 2019 average. The historic peaks in the ratio were 13% in 2008, when debt levels were high, and 12.9% in 1998, when the prime rate spiked to 25%. These sharp increases in debt servicing costs presaged a steep decline in consumer spending. The current situation is not as bad.

MARKET UPDATE

Most major global markets ended June on a solid footing, with the MSCI World closing the month 6.1% higher. With an upbeat US earnings season currently underway, US equity markets performed well. The S&P recorded its best monthly performance (+6.5%) since October last year. The NASDAQ (+6.6%) and the Dow (+4.6%) ended June in positive territory. In the UK, the FTSE-100 rose 1.1% over the month.

With China experiencing slower-than-expected spending, markets ended the month mixed. While the Hang Seng was 3.7% higher in June, the Shanghai Composite Index fell by 0.1%. In Japan, the Nikkei rallied and ended the month 7.5% higher.



Locally, the JSE All Share Index rose 1.3% in June. The financial sector was the best performer, rising by 11.4% over the month. Industrials followed with a 3.5% monthly gain, while resources fell 8.2% following a broad sell-off in commodity markets. The rand firmed by 4.7%, ending June at R18.85 to the US dollar. Brent crude oil (+3.1%) achieved its first monthly gain for 2023. With lower commodity prices and a stronger US dollar, gold declined by 2.2%, closing the month at US\$1 919. The platinum price also declined (-9.2%) in June.

GLOBAL EQUITIES



Nike

With a backdrop of supply chain disruptions, adverse currency movements and hard lockdowns in large parts of China during the financial year, Nike reported a mixed set of results for the full year 2023 reporting period. Revenue increased 10% on a reported basis and 16% in constant currency. Revenue from Nike Direct, which includes the group's digital sales and Nike-owned stores, was the key revenue driver, growing by 20% on a comparable basis. Despite the strong revenue growth, group margins were negatively impacted by a myriad of events, most notably supply chain disruptions and currency movements. Geographically, all regions reported double-digit revenue growth, except for Greater China which reported 4% revenue growth for the full year. However, in the final quarter of the financial year, revenues in China rose 16% following the country's reopening from pandemic-enforced lockdowns. Overall, Nike's diluted earnings per share fell 14% to US\$3.23 as a result of a decline in the gross margin as well as an increase in the group's tax rate.

Digital revenue growth, a metric that we monitor closely given Nike's stated strategy of generating a larger proportion of sales through the channel, rose 24% during the financial year. Impressively, Nike currently generates 26% of total revenue from its digital platforms, which is up from 10% in 2019. For the reporting period, Nike generated 43% from direct sales to consumers, highlighting the acceleration in the group's intention to engage more closely with its end customers. We believe that this will drive higher margins and profitability in the future. Dividends declared for the period were up 10% from the prior year, a continuation of the group's history of growing dividends for each of the last twenty-one years. Furthermore, the group bought back US\$5.5bn worth of shares during the period, up from US\$4bn in the prior year.

LOCAL EQUITIES



Stor-Age

Property REIT, Stor-Age, reported a mixed set of results for full year 2023. While the group's South African operations continued to benefit from the positive trends experienced since the onset of COVID, the UK operations experienced a slowdown in the second half of the reporting period. Overall, rental income and net property operating income were up 17.3% and 15.3%, respectively. Across both regions, the group reported strong growth in average rental rates (+8%); however, occupancies across the two geographies diverged. The group's SA operations reported an increase in occupancies from 90.1% in the prior year to a record high of 92.2%.

The UK operations experienced a decline in occupancies from 90.4% in the prior year to 85.4% as the region's property market is increasingly being impacted by persistent inflation and rising interest rates. The group reported an increase in dividends per share of 3.6%, lower than the 8.3% increase in distributable earnings. The increase in the number of shares in issue, post the capital raise in 2022, accounted for the difference in dividend and distributable income growth.

Over the period, Stor-Age continued to make progress with its development pipeline. A growing part of its pipeline has been via joint ventures in both the UK and SA. In the local market, the group operates a joint venture with Nedbank where Stor-Age is developing four new properties. Stor-Age will earn fees from developing and managing the properties until an acceptable occupancy level is reached. This arrangement is similar to the one in the UK with Moorfield, where Stor-Age has a 24.9% interest as well as a recent partnership with US investment manager, Nuveen. Management views joint ventures as a way to increase scale and generate revenue from managing properties the group does not fully own, while simultaneously mitigating the risk of delays in reaching favourable occupancies at new properties.



Mr Price

SA apparel retailer, Mr Price reported 2023 full year results that, although below expectations, were still strong considering the challenging environment. Characterised by loadshedding, high interest rates, and increased inventory levels which puts pressure on margins, the current environment is a very testing one for the management team. Management estimate that 318 000 trading hours – or R1bn in sales – were lost over the period due to loadshedding. To this end, the group's back-up power installation plans remain on track, with 70% of stores already being able to operate with back-up power. Persistently elevated food and public transport inflation, as well as higher interest rates are placing significant pressure on Mr Price consumers, as reflected in the 30% rise in credit demand over the period.

Overall, revenue was supported by recent acquisitions – Studio88, Power Fashion and YuppieChef. Retail sales rose 18%, with the Apparel, Home, Financial Services and Telecoms segments all improving over the period. Operating costs excluding Studio88 grew 6.7%, slightly ahead of organic sales growth of 2.1%. As a result, operating profit margin declined by 260bps. Group headline earnings per share fell 6%. The group is working on building its cash position after settling the R3.6bn acquisition of Studio88. They ended the period with a cash balance of R1.4bn and declared a dividend of R4.47 per share. Management maintains that the outlook remains tough, with consumers expected to remain under pressure for the remainder of this year.



Prosus

Prosus delivered full year 2023 results that were better than expected, showing sustained revenue growth and clear signs of improving profitability. Prosus' e-commerce portfolio (all operations excluding Tencent) maintained double-digit revenue growth, albeit slower than last year, up 20% to US\$9bn (+27% in local currency). All segments, with the exception of Etail, showed strong growth, with Food Delivery and Payments & Fintech standing out (+44% and +51% respectively in local currency). Etail struggled against a high base while also contending with the impact of the war in Ukraine, and the deteriorating economic environment. Despite the disappointing performance in Etail, Prosus remains in a healthy financial position with US\$14.9bn in cash and an undrawn US\$2.5bn revolving credit facility against US\$15.4bn in interest-bearing debt. Management announced a structure simplification to remove the current cross-holding structure and allow both Naspers and Prosus to continue buying back their own shares. This is expected to be completed within the current financial year.

CONTACT US

CAPE TOWN

PINELANDS

TEL: 021 524 4678

ADDRESS: 4th Floor, Block A, Old Mutual Wealth, Mutualpark, Jan Smuts Drive, Pinelands, 7405 | PO Box 207, Cape Town, 8000

EMAIL: privateclients@omwealth.co.za

STELLENBOSCH

TEL: 021 861 5300

ADDRESS: The Vineyard, Building B, Corner Adam Tas and Devon Valley Road, Stellenbosch, 7600

EMAIL: privateclients@omwealth.co.za

JOHANNESBURG

TEL: 011 245 3805

ADDRESS: 1 Mutual Place, 107 Rivonia Road, Sandton, Johannesburg, 2196

EMAIL: privateclients@omwealth.co.za

PRETORIA

TEL: 012 369 7236

ADDRESS: 43 Ingersol Road, 3rd Floor, Podium at Menlyn, Lynnwood Glen, 0081

EMAIL: privateclients@omwealth.co.za

KWAZULU NATAL

KLOOF

TEL: 031 767 7300

ADDRESS: 74 Old Main Road, Unit 7, Kloof, KwaZulu-Natal

EMAIL: privateclients@omwealth.co.za

Private Clients
by  Old Mutual Wealth

Old Mutual Wealth Private Clients (Private Clients) is a division of Old Mutual Wealth Trust Company (Pty) Ltd ("OMWTC"), a licensed Financial Services Provider, Reg No: 1925/002721/07. Private Clients is authorised to provide financial services on the OMWTC licence.

To report unethical behaviour, call the Anonymous Reporting line 0800 222 117, email toahotline@tip-offs.com or visit www.tip-offs.com

4th Floor, Block A, Old Mutual Wealth, Mutualpark, Jan Smuts Drive, Pinelands, 7405 | Tel: +27 (0)21 524 4678 | Email: privateclients@omwealth.co.za

This document is for information purposes only and does not constitute financial advice in any way or form. It is important to consult a financial planner to receive financial advice before acting on any information contained herein. Old Mutual Wealth and its directors, officers and employees shall not be responsible and disclaims all liability for any loss, damage (whether direct, indirect, special or consequential) and/or expense of any nature whatsoever, which may be suffered as a result of or which may be attributable, directly or indirectly, to the use of, or reliance upon any information contained in this document.