Prosperity

June 2024

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Private Clients
by Old Mutual Wealth

ECONOMIC UPDATE

South African economic growth (real GDP) dipped into negative territory in the first quarter of 2024 on a quarter-on-quarter basis. Measured on a year-on-year basis, the economy expanded by just 0.5%. StatsSA also reported a 67 000 decline in formal employment in the first quarter.

While this data is backward and not forward-looking, it does underscore the main challenge facing the seventh democratic administration. South Africa's economy is chronically underperforming, with real growth having averaged less than 1% over the past decade, less than annual population growth.

Unemployment remains among the highest in the world, above 30%. A weak economy over the past decade means tax revenues have persistently lagged spending and government borrowed a cumulative R5 trillion to plug recurring annual budget deficits. This in turn placed upward pressure on interest rates, as bond investors worried over government's creditworthiness and charged it a premium. This contrasts with the usual situation where countries experiencing weak growth see their interest rates declining.

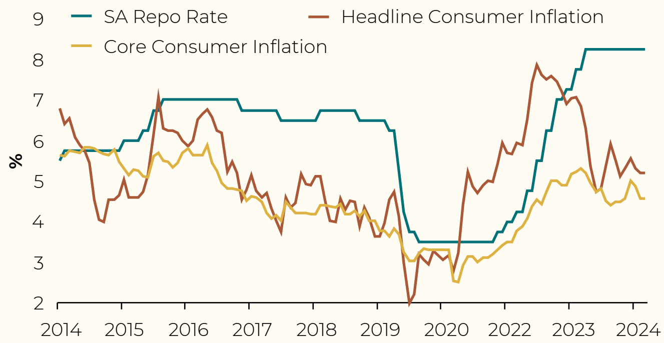
The formation of a centrist Government of National Unity (GNU) that includes the ANC and the DA, IFP and other smaller parties has given investors optimism that some of the key blockages that impede economic growth, specifically infrastructure challenges and excessive red tape, can be removed.

There need not be too much reinvention of the wheel. Many important reforms were already underway before the election and just need to be cemented. Notably, Operation Vulindlela, the joint initiative between Treasury and the Presidency set up in 2020 will continue its work of tackling a focused list of obstacles to foster growth. It has already achieved success, notably in deregulating the electricity sector, and it has been three months since the country experienced nationwide loadshedding. On this note, the reappointment of Kgosientsho Ramokgapa as Electricity Minister and the consolidation of all energy-related policy under his ministry (as opposed to three different departments previously) is positive.

Fiscal consolidation is also something that has been underway for some time and will continue, though the exact contours could shift somewhat under the new coalition. For instance, the aspiration of a slimmed down value-for-money Cabinet was shelved to accommodate ministers from several parties in sufficient numbers.

However, there was progress even before the formation of the GNU, with South Africa finally posting a small primary budget surplus in the fiscal year to end March, meaning that tax revenue exceeded non-interest spending for the first time in 15 years. This is a key step towards bending the trajectory of public debt, which stood at 75% of GDP at the end of the first quarter. The retention of Enoch Godongwana in the role of Finance Minister was also welcomed by the investor community.

The economy should also benefit from lower short-term interest rates over the medium term as the Reserve Bank responds to an improved inflation outlook. Consumer inflation was unchanged at 5.2% year-on-year in May. Core inflation, excluding food and energy prices, was also unchanged at 4.6%. Inflation is likely to return to the 4.5% midpoint of the target range early next year. Barring a global calamity that sends food or fuel prices skyrocketing, inflation should remain under control given soggy domestic demand and gradual easing of supply-side pressures on prices (such as businesses needing to run generators during loadshedding).



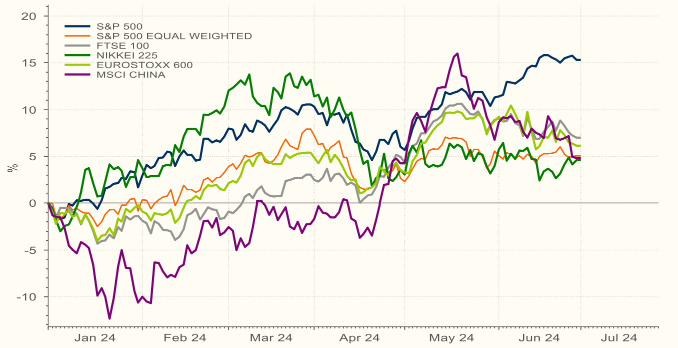
Source: LSEG Datastream

Of course, the Reserve Bank does not just focus on local inflation, but also takes the global interest rate environment into account. With US inflation having eased in May, the case is building for the Federal Reserve to start cutting rates, probably in September. The Bank of England is also on course to start cutting rates in the third quarter, while the European Central Bank has already reduced its policy rate.

MARKET UPDATE

The MSCI World Index was up 2.1% in June, with the Magnificent 7 (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla) contributing more than 90% to this return.

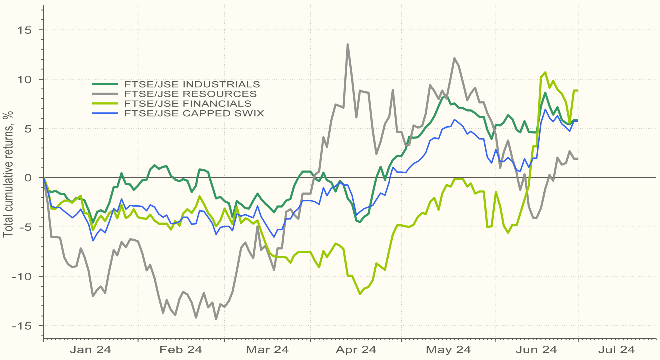
MAJOR EQUITY INDICES IN US$



Source: LSEG Datastream/ Old Mutual Multi-Managers

Major US indices ended the month higher, with the Dow Jones (+1.1%), S&P 500 (+3.5%) and the Nasdaq (+6%) all recording gains. In the UK, despite inflation falling to the Bank of England's 2% target for the first time in three years, the FTSE 100 ended June 1.3% lower.

China's equity market continued to struggle as the region's economic recovery remains uncertain. Measures to boost the struggling property market failed to lift market sentiment, with the Shanghai Composite (-3.9%) and Hang Seng (-2%) both recording losses. Over in Japan, the Nikkei ended June 2.8% higher.



Source: LSEG Datastream/ Old Mutual Multi-Managers

On the local front, the JSE experienced a particularly volatile period due to the GNU negotiations. On 19 June, the All Share Index hit an all-time high, breaking through the 81 000 level and eventually ended the month 3.9% higher. Resource stocks were the worst performers (-3.7%), while Financials rallied 14.5% in June. Industrials recorded a more muted monthly gain of 1.4%.

The rand recorded significant gains in June, firming to below R18/US$ earlier in June before closing the month 3.3% firmer against the greenback. The gold price ended the month unchanged at US$2 325/oz. Brent crude rose 5.9% in June, and platinum fell 4.1%.

GLOBAL EQUITIES

Nike

Nike released a lacklustre set of 2024 full year results that reflect slowing demand in its lifestyle brands and direct-to-consumer (DTC) channel, especially in North America. Despite this, the group was able to expand its gross margin by 110 basis points, which along with cost-saving measures, led to a 12% increase in net income to US$5.7 billion. This translated to diluted earnings per share of US$3.95, excluding restructuring costs. Nike maintained its 22-year streak of increasing dividends, distributing US$2.2 billion to shareholders, and executing US$4.3 billion in share repurchases.

Looking ahead, in the face of fierce competition and its business reset, Nike has guided for a mid-single-digit percentage decline in revenue for 2025. The company aims to drive growth through marketplace strategies, innovation and appealing to conscious consumers with affordable footwear. Furthermore, the upcoming Olympics presents an opportunity to regain lost market share. Nike's share price declined sharply following the release of its results, which is a function of both investor concern pertaining to the successful execution and duration of the turnaround as well as the revised full year 2025 guidance provided by management.

LOCAL EQUITIES

Ninety-One

Global asset manager Ninety-One reported full year results that were impacted by persistently elevated interest rates that swayed investors' decisions to delay allocations to risk assets. Over the period, the asset manager saw net outflows of £9.4bn as clients exited equity markets, where returns were driven by narrow sectoral performance. Outflows were higher in the second half of the financial year versus the first half, likely driven by continued uncertainty around interest rates globally. As a result, the group reported a 3% decrease in assets under management (AuM) to £126bn.

Adjusted operating revenue for the period declined 8%, with the adjusted operating profit margin down to 32% (vs 32.7% in 2023) following effective cost management, with employee remuneration and business expenses both declining over the year. Management fees declined on the back of lower AuM, while performance fees were up as a result of stable long-term performance across their funds. Adjusted earnings per share (EPS) decreased 8%, in line with the fall in adjusted operating profit. The board declared a final dividend of 6.4p per share, resulting in a full year dividend of 12.3p per share.

Mr Price

SA apparel retailer Mr Price reported a reasonable set of full year results in a period characterised by loadshedding (in the first half – the group reached 100% back up power by the end of the first quarter) and a constrained consumer environment where discretionary spend was under pressure. Despite this, the group reported revenue growth of 15.5%, which was supported by their acquisition of Studio88 (effective 4 October 2022). Growth in revenue included retail sales of R36.6bn (+16.2%). Group gross margin increased 20bps as they managed supply chain challenges over the festive period by anticipating delays and managing inventory accordingly. This resulted in lower markdown activity, which was supportive of margins in the second half.

Total expenses increased 20.1% (+7.7% ex. Studio88), driven by increased space from the Studio88 acquisition and a higher operating cost environment. As a result of expense growth exceeding sales growth, group operating margin declined 110bps to 14%. Basic and headline earnings per share rose 5.4% and 6.7%, respectively. The group remains highly cash generative and ended the period with a R2.8bn cash balance. A final dividend of 526.8 cents per share (+17.8%) was declared. Management remains confident in the group's value proposition, noting that despite the local economy contracting between January and March 2024, group retail sales increased 5.9%. While supply chain pressure is likely to have an effect in the short term, developments around port infrastructure are encouraging. Pressure on consumers is expected to abate as the year progresses, which will drive growth through the second half.

Stor-Age

Property REIT, Stor-Age reported a mixed set of full year 2024 results. While the group's SA operations continued to show strong operating metrics, the UK operations experienced muted growth following strong growth over the last three years. The current macro environment that is characterised by high interest rates and a slowdown in housing activity has had a negative impact on property companies, including the self-storage sector. Overall, rental income and net property operating income were up 13.5% and 14.4%, respectively. Across both regions, the group reported growth in net operating income, with SA increasing by 14.7% while the UK grew by 1.1%. However, occupancies across the two geographies diverged. The group's SA operations reported a 2.9% increase in occupancies while the UK reported a 1.6% decline. Dividends for the period were unchanged from the prior year at 118.17 cents. This was lower than the 15.3% growth in earnings before interest tax depreciation and amortisation (EBITDA). An increase in the UK corporate tax rate and a 46% increase in interest costs were largely responsible for the difference in the dividend and operating income growth.

While Stor-Age has hedged over 80% of its debt from higher interest rates, this has not fully insulated the business from higher rates as the hedges have expired. There are indications that the current interest rate hiking cycle may have reached its peak and we will likely see interest rate cuts in the second half of the year, which will assist in reducing Stor-Age's interest burden. A small, but fast-growing part of Stor-Age's business is the additional fees that the group generates from non-property related activities. These include the management fees received for the group's services in managing properties for their joint partners and third-party digital advertising for strategic self-storage operators. This business line is attractive due to its capital-light nature and its ability to improve Stor-Age's digital capabilities. Over the reported period, fees from this segment rose by 75.4% to R63.1m. More than half of this revenue is recurring in nature, which adds to its attractiveness. We expect this to continue to grow over time and to provide an acquisition pipeline for the group across regions.

prosus

Prosus

Prosus released an encouraging set of 2024 full year results marked by significant milestones and strategic moves. Over the period, the company continued to streamline its organisational structure, achieving improvements across core performance metrics. Revenue grew by 11%, free cash flow tripled year-on-year to US$524 million and core headline earnings per share rose by 96%. This was driven by strong performance in Ecommerce, Tencent and the ongoing buyback programme. Notably, Ecommerce revenue surged by 19% and the segment was able to achieve profitability ahead of schedule, with trading profit improving by US$451 million. Loss making segments narrowed losses, testament to management delivering on their targets, while the ongoing buyback programme consistently rewarded shareholders. The programme, which has created US$32 billion in value, remains a consistent performer, resulting in an 8% Net Asset Value (NAV) per share accretion in FY24. With a strong balance sheet and prudent capital allocation, Prosus continues to deliver value to shareholders while positioning itself at the forefront of technological innovation.

Looking ahead, Prosus has embraced cutting-edge AI technologies, positioning itself at the forefront of value creation. The recent appointment of Fabricio Bloisi as CEO adds further momentum as he brings significant entrepreneurial experience in scaling technology companies and a drive for innovation.

NASPERS

Naspers

Naspers' robust full year 2024 results reflect the business' resilience and strategic focus on profitability growth, and commitment to driving shareholder value. Notably, revenue increased by 17% to US$6.4 billion, core headline earnings increased by 110% and free cash flow doubled to US$477 million. This was achieved as Ecommerce reached profitability six months ahead of target, with an US$460 million improvement in profit as revenue surged by 18%. It was also supported by strong performance in Tencent and the ongoing share buyback programme. The programme, which has created US$32 billion in value, remains a consistent performer, resulting in a 9% Net Asset Value (NAV) per share accretion in FY24. With a strong balance sheet and prudent capital allocation, Naspers continues to deliver value to shareholders while positioning itself at the forefront of technological innovation.

Looking ahead, Naspers has embraced cutting-edge AI technologies, positioning itself at the forefront of value creation. The recent appointment of Fabricio Bloisi as CEO adds further momentum as he brings significant entrepreneurial experience in scaling technology companies and a drive for innovation.

CONTACT US

CAPE TOWN

PINELANDS

TEL: 021 524 4678
ADDRESS: 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: 97 La Gratitude, Dorp Street, Stellenbosch, 7600
EMAIL: privateclients@omwealth.co.za

NEWLANDS

TEL: 021 524 4678
ADDRESS: 22 Kildare Street, Newlands, 7700
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

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