sasfin Wealth

Sasfin Innovation Portfolio

Quarterly Review – Q1 2024

The Macroeconomic Summary

Global equities continued their positive momentum from last year as evidenced by the MSCI All Country World Index, a broad measure of global equity markets, which gained 8.2% for the first quarter of 2024. Gains, for the most part, could be attributed to the same factors that drove equity markets higher last year, namely artificial intelligence ("AI") and the prospect of interest rate cuts.

While these remain the key drivers behind equity markets, they do continue to evolve. Despite inflation levels maintaining their downward trajectory, many central banks, in particular the US Federal Reserve ("Fed"), have resisted the urge to pull the trigger and commence cutting interest rates. This may have something to do with US inflation edging slightly higher during February to 3.2%, up from 3.1% in the previous month. The outlook for the number of rate cuts by the Fed during the year has also reduced from six to three as the yield on the US 10 Year increased 38 basis points during the quarter to close at 4.20%.

An additional nuance is the makeup of the companies driving markets higher. Gains derived during 2023 were somewhat narrow with a small group of companies, namely the Magnificent 7 (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla) accounting for an outsized portion thereof. In contrast, the performance of some of the "gang" during this quarter has left many wondering whether the moniker still applies and perhaps some may even start referring to them as the Good: Nvidia (+83%), Meta (+37%), Amazon (+19%) and Microsoft (+12%), the (not so) Bad: Alphabet (+8%), and the Ugly: Apple (-11%) and Tesla (-29%).

As opposed to a handful of stocks driving the market higher, gains have begun to broaden out and we saw strong performances by cyclical stocks within the Energy, Financial and Industrial sectors. The Fed may have dampened the macro picture after reducing its projections for interest rate cuts but it did upgrade its forecast around economic growth for the year. The combination of the two macro variables may be underpinning the positive performance seen within cyclicals.

Energy stocks have also been boosted by an increase in the price of oil during the quarter with Brent crude and WTI closing the quarter at $87 (+12%) and $83 (+16%) a barrel respectively. Tensions in the Middle East aside, other factors contributing to rising oil prices include an improved outlook for economic growth as well as Opec+ members, which include Saudi Arabia and Russia, extending voluntary production cuts in an attempt to lift prices higher.

As mentioned, the AI theme continues to influence market sentiment and it remains the primary reason behind the Information Technology and Communication Services sectors ending the period as the top performers. In particular, semiconductor and related hardware stocks, which fall under the Information Technology sector, remain the primary beneficiaries of the AI gold rush taking place. Nvidia, the poster child for the AI evolution, saw its market cap soar past the $2 trillion mark during the quarter, making it the third most valuable company in the world. AI heavyweights, Alphabet and Meta, were the primary contributors to the gain by the Communication Services sector.

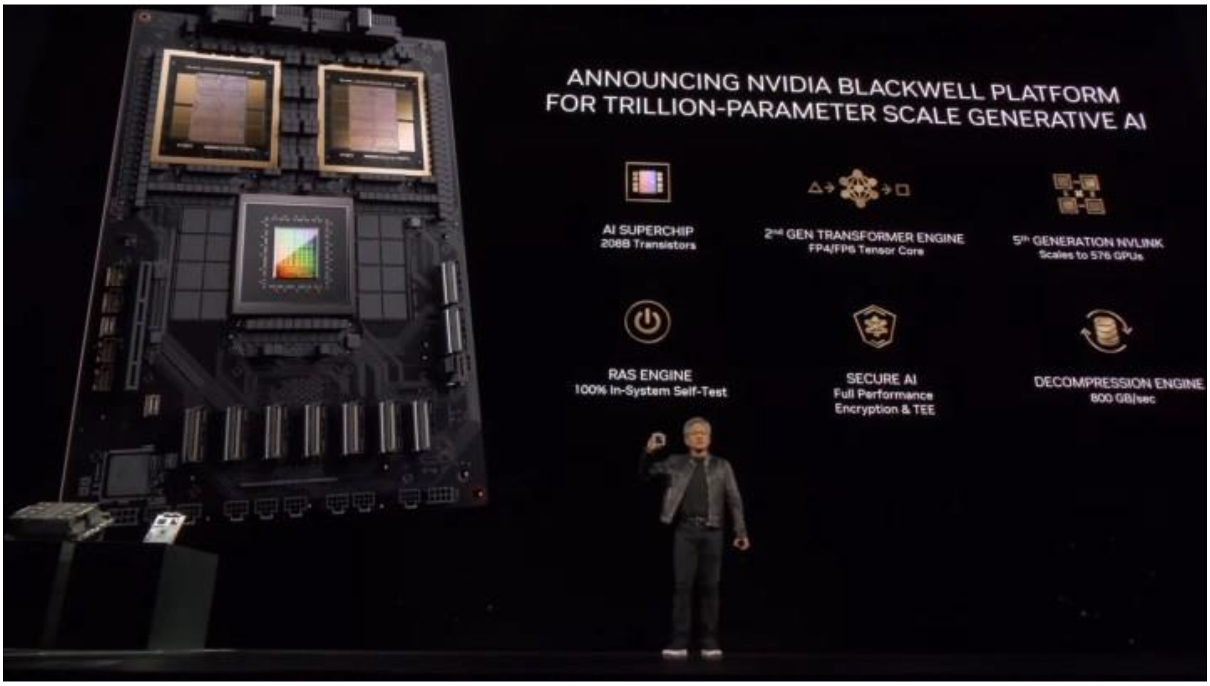
Regionally, the top performing major market during the quarter was Japan. In fact, Japanese equities have been relative outperformers for over a year and there are a host of factors driving their upward moves. These include initiatives by the Tokyo Stock Exchange to compel companies to invest in their businesses and improve shareholder returns, tax incentives that will encourage households to reallocate savings into equities and possibly the decline in investment appetite for China.

Chinese equities continue to underperform as a slowdown in growth and concerns over an indebted property sector linger. Elevated debt levels, be it Chinese real estate or even US government debt, have led many investors, as well as central banks, to continue to allocate funds to gold. The price of the yellow metal reached new highs during the quarter as it closed the period at $2,214/ozt. Adding to its allure are the anticipated rate cuts by the Fed as well as other central banks. Bullion does not provide a yield and as rates come down, so gold glows ever brighter.

The Innovation Portfolio | Q1 2024

The Innovation Portfolio delivered a positive return of 6.6% during the quarter. The result was slightly below the return of broader equity markets as well as the portfolio's benchmark, the Russell Small Cap Completeness Growth Index, which returned 8.6% during the period.

The largest contributors to the Innovation portfolio's positive gain during the period were its holdings in semiconductor and related hardware stocks. We saw strong gains from the likes of Nivida (+83%), Arista Networks (+23%), and KLA (+20%). Nvidia reported another exceptional set of results during the quarter. Both revenue and earnings continued their exponential growth trajectory and the company is well on track to reach an annual run rate of $100 billion. At its recent GTC conference, which felt more like a Taylor Swift concert than the usual sober affair, attendees cheered as Nvidia's charismatic CEO, Jensen Huang, announced a new range of products and solutions. Fanfare aside, the announcements during the event highlighted the strength of Nvidia's position within the AI market as the company seeks to entrench its already sizable competitive advantage in the space. Nvidia is still struggling to keep up with demand as data centers around the world are rapidly filling their server racks with Nvidia's various AI components, be it GPUs, CPUs or network switches.



Nvidia CEO Jensen Huang unveils Nvidia's latest accelerated computing platform at GTC 2024

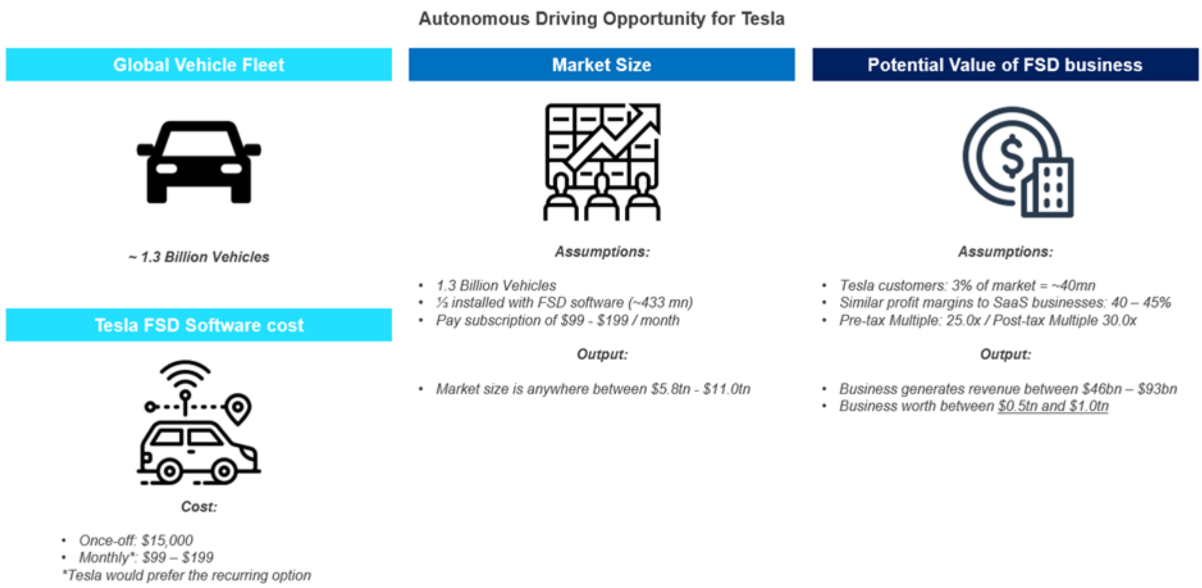
It is important to note the multiple products and solutions that Nvidia is offering. The misconception by many is that Nvidia only builds GPUs, the core chip used to train AI models. In fact, Nvidia effectively builds data centers as it offers the full stack of compute therein, including its growing software platform, CUDA. The range of compute and software is what distinguishes Nvidia from its counterparts. In the world of AI, the data center is effectively the computer and the operating system is CUDA. Roughly $250 billion a year is spent on data center infrastructure and Jensen Huang estimates that it is likely to grow to anywhere between $1.0 and $2.0 trillion, depending on your timeframe. While it is plain to see that this represents a sizable opportunity for Nvidia, what is less obvious is that the nature of data infrastructure capex is such that it tends to be very sticky. One could therefore infer that once a customer has purchased Nvidia's solutions, they may stick with the company's products for some time.

Detracting from the portfolio's positive performance this quarter were our holdings associated with the transition to cleaner energy solutions. Enphase (-8.5%) was a notable underperformer and we saw steep declines from our positions in Global X Lithium & Battery ETF (-20.4%) and Tesla (-29.3%).

The global transition towards electric vehicles (”EV”) appears to have hit a speed bump, following a slowdown in EV sales. One could ascribe the slowdown to a number of factors including higher interest rates, which impacts the affordability for a consumer that typically purchases a vehicle on credit in some form. Additionally, many consumers are opting to purchase a plug-in hybrid vehicle, as range anxiety fears persist, as well as concerns over the future resale value of EVs.

In the case of Tesla, one of the direct holdings in the Innovation portfolio, an additional headwind facing the EV maker has been the proliferation of Chinese alternatives, with BYD emerging as a noteworthy competitor, specifically with regards to Chinese consumers. The slowdown in growth by Tesla has led many a Tesla-bear to announce, as they have done so many times in the past, that this is the beginning of the end for Tesla as well as its CEO Elon Musk. During Tesla’s results presentation to the investment community this quarter, Elon Musk acknowledged Tesla’s current lack of growth but suggested that the company was currently between two waves of growth. As the current wave, driven by sales from the Model 3 and Y platforms ebbs, Tesla is currently gearing up for its next platform, a significantly more affordable vehicle that will either be produced in greater numbers or focused specifically on autonomous driving, possibly both.

It is worth noting that the majority of Tesla’s valuation is predicated on its ability to develop and monetise a fully autonomous driving system, in Tesla-speak Full Self-Driving (“FSD”). Compared to its competitors, at least those outside of China, Tesla is arguably the best positioned company in the world to develop an end-to-end solution for autonomous driving. It plans to achieve this objective through a combination of generative AI and the Tesla fleet of vehicles.



Note: Illustrative example of Tesla’s investment opportunity of autonomous driving

The opportunity that lies in wait for autonomous driving is not that well understood but the simplistic illustrative example above does provide some idea of the sizable potential. There are roughly 1.3 to 1.7 billion four-wheeled vehicles within the global fleet. One could assume that roughly one third could be installed with autonomous driving software which equates to roughly 433 million.

Currently, most Tesla owners that opt to purchase its FSD software do so through a once-off $15,000 cost. There is also the option to pay a monthly subscription of between $99 and $199 (on an annual basis this equates to somewhere between $1,188 and $2,388 per subscription). This would be the preferred option for Tesla as it offers much more value over the longer term. If this sounds like a software subscription or SaaS model, you are already going down the right path. Assuming the 400 million plus users are willing to pay the monthly subscription fee, then the total market could range between $6.0 and $11.0 trillion. In the case of Tesla, assuming it only makes up 3% of this market or roughly 40 million users, then its annual revenue from this business could fall somewhere between $50 and $100 billion. As we mentioned, this is similar to a SaaS business model. SaaS companies, on average, generate operating margins between 40-45% and are typically valued at a pre-tax multiple on earnings of 25.0x (or roughly 30.0x after tax). Applying these metrics to the annual revenue range calculated above, one can arrive at a value of somewhere between $0.5 trillion and $1.0 trillion. Again, we note this model quite is simplistic in nature but it does help one understand the potential of the autonomous driving opportunity and how much it could be worth to Tesla and its shareholders.

Despite the steep fall in the company's stock price during the quarter, a phenomenon not too unfamiliar for historically volatile Tesla stock, we remain convicted in our holding. We believe that the headwinds currently blowing Tesla's way are cyclical rather than structural. It is quite likely that battery technology will continue to improve, eventually reaching a stage where range anxiety fears are alleviated. In addition, we also expect the total cost of ownership for electric vehicles to continue to become more competitive than their internal combustion engine (ICE) counterparts, eventually reaching a point where it is no longer a debate. Our positive outlook for Tesla remains underpinned on the enormous opportunity ahead of the company and far outweighs the potential downside. Our conviction is best illustrated by our decision to increase our exposure during the recent price weakness.

While we remain positive on the broader theme regarding the clean energy transition, our approach as to how we gain exposure has evolved. Rather than owning a basket of companies that are dispersed across various sectors, we would prefer to gain exposure via more direct holdings. In this regard, we exited our remaining "indirect" position as we sold out of the Global X Lithium & Battery ETF (-20.4%). As mentioned, the ETF fell sharply during the quarter as many of the holdings within the basket are exposed to similar headwinds to that of Tesla.

In its place, we initiated a position in Nextracker, the world's leading provider of solar tracking and software solutions. Simplistically, the solution offered by Nextracker effectively turns solar panels into sunflowers as they are able to follow the sun's movement throughout the day. Tracking the movement of the sun increases the amount of energy the panels can produce by as much as 40%. Given the increase in solar deployments that are expected to take place around the globe and the productivity gains that can be realised from Nextracker's technology solutions, we are quite optimistic around the future potential of this company.

Note: Nextracker's software-enabled solar tracking solution

During the quarter, we also opted to exit our position in Iridium Communications (-33.3%), a global satellite communication services provider. The company operates a network of satellites that orbit the Earth, enabling voice and data transmission from anywhere on the planet. This is particularly useful in remote areas where traditional cell service is unavailable. While we remain positive on this niche of communication as part of our broader 5G, IoT & Big Data theme, we have soured on the company in question. Iridium has yet to transition to a more sustainable level of profitability. This provides an element of discomfort given the sizable debt quantum on the company's balance sheet, particularly in a higher interest rate environment.

Looking ahead, expectations surrounding the direction of interest rates will continue to play a significant role in the movement of stock prices over the short-term. In a short space of time, expectations regarding the number of rate cuts by the Fed have reduced significantly and some market commentators have even postulated that we could even see a rate increase! The nature of the holdings within the Innovation Portfolio is such that they are relatively more sensitive to interest rate movements, both up and down. This is due to our holdings being longer duration in nature as the majority of their expected future earnings lie further out into the future when compared to the average stock.
While we are highly cognisant of the current rate environment, particularly the impact on current valuations, we are more concerned around the long-term profitability of the companies within the portfolio. We remain confident that the companies that we hold are exposed to powerful, long-term secular trends that will serve as key drivers behind the growth in earnings over the long-term. Using a long enough timeline, one could easily see that most things in the investment world are cyclical. It is useful to take a step back and understand where we might be in terms of a particular cycle. In the case of clean energy, be it solar and even electric vehicles, it is our view that while sentiment may be waning at the current point in time, we are merely nearing the trough of a much larger cycle, that is still poised to continue its upward trajectory as the world transitions to cleaner forms of energy.

In a similar vein, it is our view, contrary to what some may think, that we are near the bottom of the AI cycle. Taking a short-term view, it could easily be argued that we are at a peak in this cycle given the spend taking place and the general "hype" associated with this technology over the past year or so. However, taking a view from a much longer-term perspective, it is quite likely that we are still in the very early stages of an exceedingly larger cycle that could likely rival the impact of the internet, if not exceed it.

USD Returns

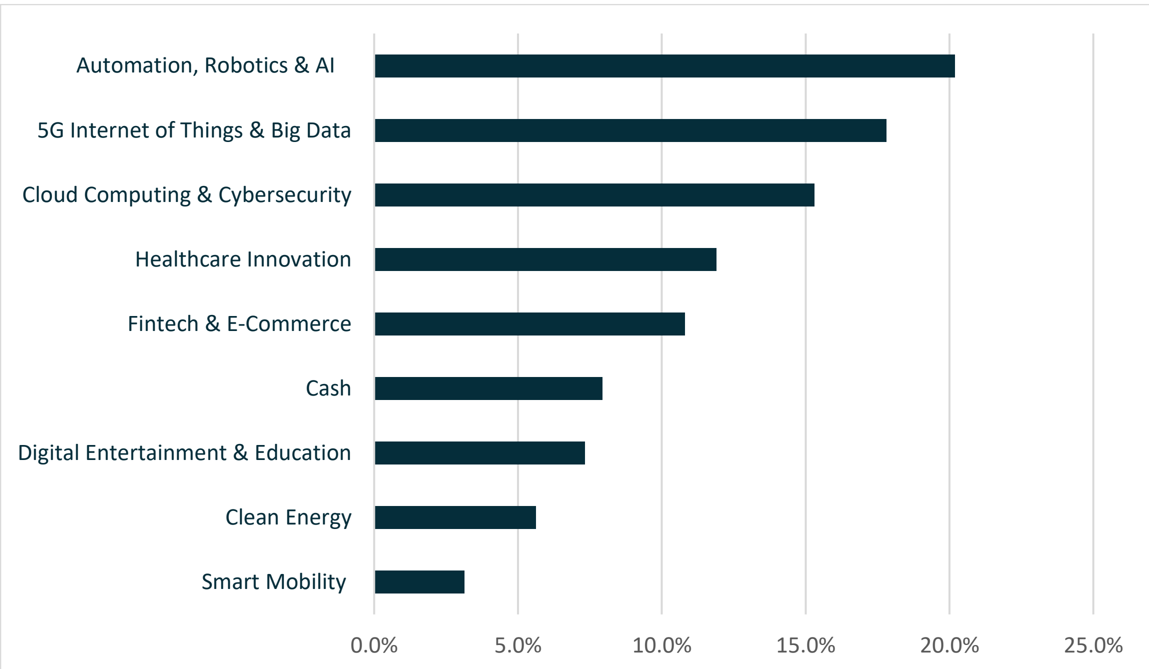
	3m	YTD	1yr	3yrs	5yrs	Inception
Innovation USD	**6.8**	**6.8**	**17.4**	**-3.0**	**10.8**	**18.6**
Russell Small Cap Growth	8.7	8.7	31.3	-1.0	12.0	12.9
All Share	-5.6	-5.6	-4.9	-0.5	3.9	5.8

ZAR Returns

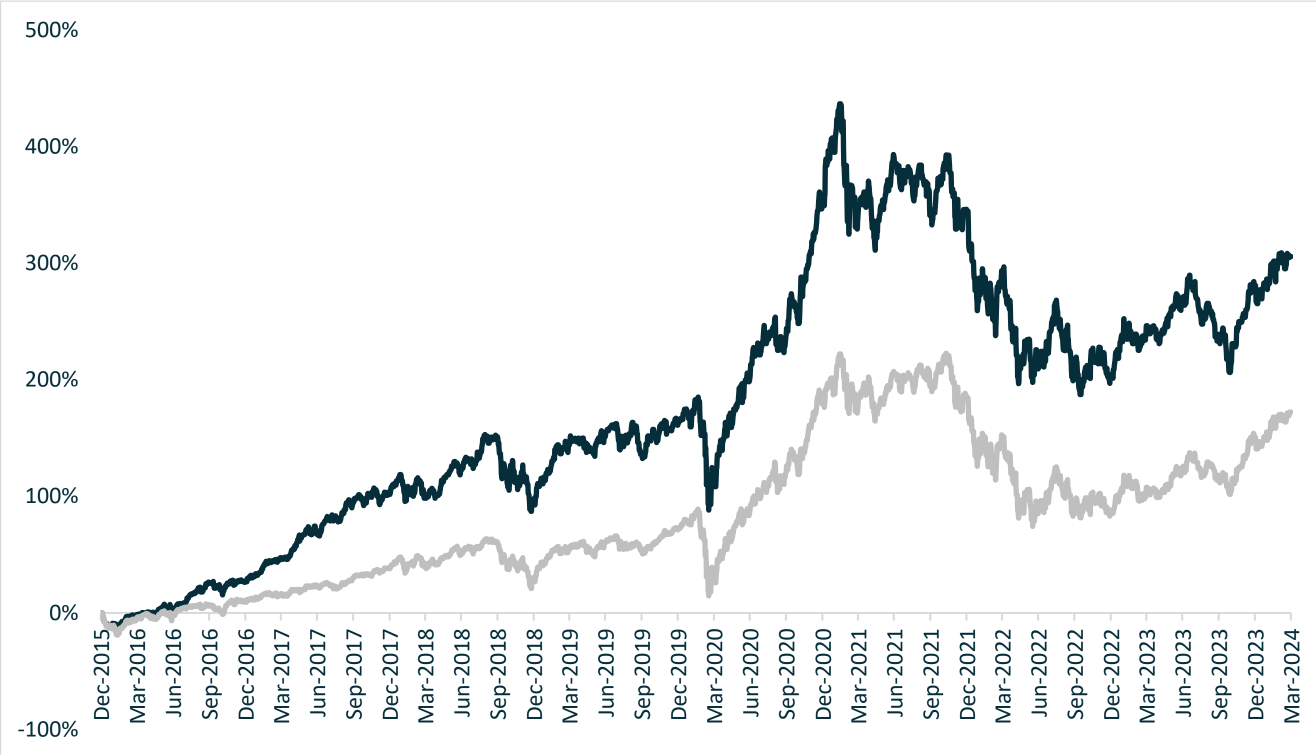
	3m	YTD	1yr	3yrs	5yrs	Inception
Innovation ZAR	**10.3**	**10.3**	**24.1**	**5.6**	**16.4**	**21.1**
Russell Small Cap Growth	12.5	12.5	39.9	7.6	18.2	15.7
All Share	-2.2	-2.2	1.5	8.1	9.7	8.4

Positioning

Investment Theme Weightings



Indexed Performance in USD since inception – USD Total Return (%)



APPENDIX

What is the Innovation Portfolio?

- Numerous disruptive thematic innovations are set to fuel world economic growth in the 2020s. The Innovation Portfolio seeks to capitalise on the themes driving this growth such as Smart Mobility, Healthcare Innovation, Internet-of-Things & 5G, Robotics & AI, Cloud Computing & Cybersecurity, e-Commerce & Digital entertainment, and Clean Energy.
- The Innovation Portfolio invests in innovative global companies, using a combination of **active and passive investment strategies**. The portfolio invests in exchange traded funds (ETFs) to provide diversified exposure to each of the investment themes. Thereafter, stocks are selected by the investment team to complement these ETFs within each theme.
- It is an **offshore share portfolio** (the client owns each of the underlying holdings), based in US dollars, and benchmarked against the Russell Small Cap Complete Growth Index.

Why should you consider investing in this portfolio?

- The Innovation Portfolio provides **exposure to innovative global companies** that are positioned to benefit from attractive long-term investment themes that are driving growth and changing the world.
- The portfolio is managed by a **dedicated and experienced investment team**, with a deep understanding of global markets, the investment themes, and underlying holdings.
- The portfolio contains a relatively **small number of holdings** to ensure that they are understood in detail. However, it is highly diversified across geographies, sectors, and investment themes.
- All proposed portfolio changes must be passed by the Sasfin Investment Committee thereby ensuring **good governance**.

INVESTMENT TEAM

Craig Pheiffer, CFA

Craig began his career as an investment professional in 1990 in the fixed income division of Frankel Kruger stockbrokers. He was involved with bond trading, institutional bond sales, primary dealing and market-making and has held various investment strategy roles since being appointed Chief Investment Strategist at Sasfin Frankel Pollak Securities in 2000. Craig is the chair of the Sasfin Securities Investment Committee and a CFA Charterholder and holds a BSc Computer Science (Wits), and a BCom, BCom Hons and an MCom in Economics (Unisa).

Nicholas Dakin

Nicholas is a Portfolio Manager based at Sasfin's Cape Town branch, with over seven years of industry experience. He manages bespoke portfolios for private clients. Nicholas is a member of the Sasfin Securities Investment Committee and holds a Bachelor of Business Science in Economics Honours and Mathematical Statistics Honours, and a Master of Commerce in Financial Markets from Rhodes University. He covers the following investment themes: Digital Entertainment & Education; Smart Mobility.

Nicholas Pittaway

Nicholas joined Sasfin Wealth at the start of 2021 as a Portfolio Manager with more than nine years of industry experience. With an investment universe that is constantly changing, Nicholas views change and thematic investing as an opportunity to create alpha / additional performance for clients. Nicholas holds a Bachelor of Commerce in Financial Planning and covers the following investment themes: Healthcare Innovation; Cloud computing & Cybersecurity.

Wouter van der Merwe, CFA

Wouter has worked as a Portfolio Manager at Sasfin Wealth for seven years. He is also a member of the Sasfin Securities Investment Committee and is particularly involved in looking at the technology sector. Wouter holds a Bachelor of Commerce in Financial Management, Honours in Financial Economics and Investment Management, and is a CFA Charterholder. Wouter covers the following investment themes: FinTech & E-Commerce; Automation, Robotics & Artificial Intelligence.

Samuel van Tonder, CFA

Sam has worked as a Portfolio Manager in David Shapiro's investment team for over five years. He is focused primarily on the management of offshore equity portfolios. Sam holds a Bachelor of Commerce in Investment Management, Honours in Economics and Financial Analysis, and is a CFA Charterholder. Sam covers the following investment themes: Healthcare Innovation; Clean Energy; Cloud Computing & Cybersecurity.

Muhammed Wagley

Muhammed Wagley is a Portfolio Manager at Sasfin Wealth. Prior to his employment as a portfolio manager, Muhammed had worked as a portfolio assistant in David Shapiro's investment team. Muhammed has an honours in Corporate Finance and Investment Management from Wits University and is currently a CFA Level 2 candidate. He has a methodical, bottom- line approach to the customer focused industry within which he operates and assists Nicholas Dakin with his coverage of the Digital Entertainment & Education Theme.

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