Sasfin Global Equity Model (SGEM)

Quarterly Review – Q2 2023:
1 April 2023 – 30 June 2023

sasfin.com

PERFORMANCE

Total Return (%) - Period ended 30 June 2023

	Quarter	YTD	1 Year	3 Years[1]	5 Years[1]	Since Inception[1, 2]
SGEM	6.9	16.2	20.4	9.5	8.3	9.6
MSCI ACWI[3]	6.2	13.9	16.5	11.0	8.1	8.0

Source: Morningstar

Note:

1 – Annualised

2 – Inception date: 31 December 2014

3 – MSCI All Country World Index

Portfolio Positioning (% Weight)

Sector	SGEM	MSCI ACWI	Under/Over (%)
Cash	5.1	-	
Consumer Discretionary	14.8	11.3	
Financials	17.2	15.4	
Consumer Staples	9.0	7.3	
Industrials	10.9	10.6	
Health Care	11.9	11.8	
Materials	4.1	4.6	
Communication Services	6.4	7.3	
Energy	3.0	4.6	
Real Estate	-	2.3	
Utilities	-	2.8	
Information Technology	17.6	22.1	

-6.0 -4.0 -2.0 0.0 2.0 4.0 6.0

Source: FactSet

MARKET COMMENTARY

Global equities enjoyed another positive quarter as the MSCI All Country World (MSCI ACWI) Index, a broad measure of global equity markets, gained over 6% during the period. The performance is however somewhat misleading in that over half the gain can be attributed to just seven stocks. The magnificent seven, as they are referred to in some circles, includes Alphabet, Apple, Amazon, Meta, Microsoft, Nvidia and Tesla. Given their large weightings, sectors that contain the seven outperformed as evidenced by strong gains from the Information Technology, Consumer Discretionary and Communication Services sectors.

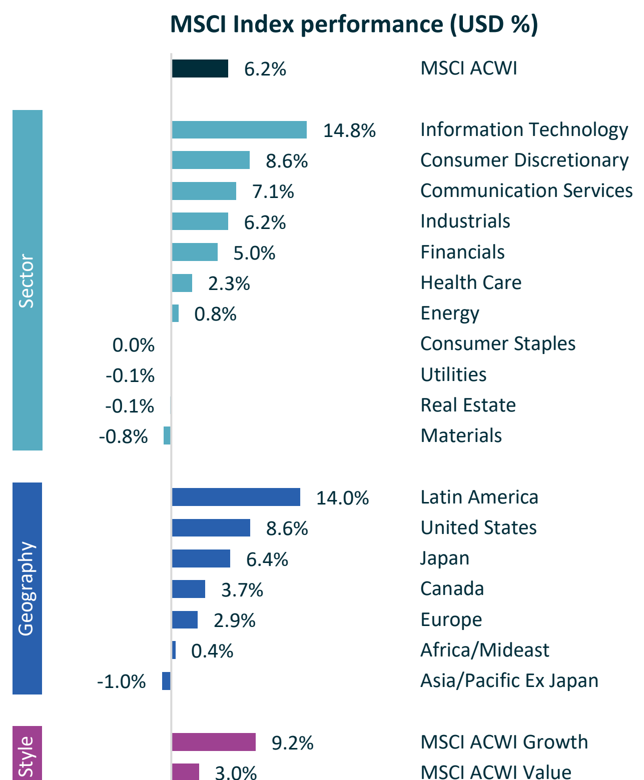
One factor that may be driving demand for these stocks is that markets are anticipating that they will be the "winners" of the artificial intelligence ("AI") mania that has taken the world by storm. The seven may account for an outsized portion of quarterly gains but there were actually a number of technology stocks that outperformed during the quarter. One could interpret these moves as AI mania spilling over into relatively smaller tech counters or perhaps the market continues to favour "risk-on" assets this year as opposed to 2022 where defensive or "risk-off" assets outperformed. Looking beyond the so-called AI winners, the general performance from the remainder of global stocks was far more muted. Risk-off or defensive sectors such as Consumer Staples, Utilities and Health Care underperformed the broader market as did the Energy and Materials sectors on the back of falling commodity prices.

Markets may be anticipating lower demand for commodities following a weak post-covid recovery in China as well as the possible negative impact of central bank rate hiking on economic growth. Even after Saudi Arabia implemented production cuts, the price of Brent crude still declined 6% during the quarter, closing at $74 a barrel . Industrial metal price declines ranged from high single digits to the high teens and even bullion, which briefly traded above the $2,000/ozt level, ended the quarter lower at $1,912/ozt (-3%).

From a regional perspective, the positive impact from the "seven" was even more pronounced in US markets given their relatively larger weightings in major US equity indices. This is evidenced by the above-average returns from the S&P500 (+9%) and the tech-heavy Nasdaq Composite (+13%). US bond yields edged higher during the quarter with the US 10-year climbing 30 basis points to 3.8% and its shorter-term counterpart, the US 2-year, increasing 90 basis points to 4.9%.

US inflation levels continue to cool from the 9% level in June last year but at 4%, inflation still remains relatively high, well above the US Federal Reserve's ("Fed") target rate of 2%. While the Fed opted to hold interest rates steady at its most recent meeting in June, commentary from Fed officials suggests that further rate hikes later in the year were still on the cards.

During the quarter, a number central banks in Europe raised their benchmark rates as well as signalled their intent to implement further rate hikes later in the year. In general, European bond yields were also higher at the end of the quarter with the German and UK 10-year benchmark rates closing at 2.4% and 4.4% respectively. While the Dutch AEX, French CAC 40 and German DAX stock indices each returned roughly 3% during the quarter, the same could not be said for the UK's FTSE 100 Index which ending the quarter roughly flat, weighed down by declines in global miners and oil majors. Japanese stocks maintained their positive momentum following a call from the Tokyo Stock Exchange earlier this year for companies to achieve sustainable growth and increase corporate value. However, it was a disappointing quarter for Chinese equities. Concerns over a stalling recovery post-covid restrictions, weaker-than-expected consumer spending and industrial production as well as record unemployment among the youth soured investor sentiment towards Chinese equities.



PERFORMANCE AND ATTRIBUTION

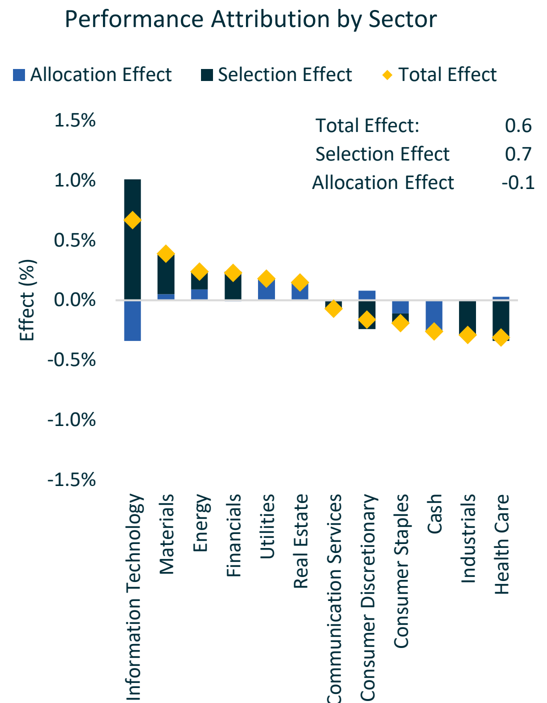
Similar to global equity markets, the SGEM registered another positive quarterly gain, having returned 6.9%, slightly ahead of its benchmark (MSCI ACWI) which returned 6.2% during the period.

The relative outperformance against the benchmark can largely be ascribed to the Selection Effect. This is the portion of the outperformance which is based on the returns of specific stocks selected to be included in the SGEM and their individual weightings in the SGEM relative to their weightings in the benchmark. The notable standout contributor to the Selection Effect was the Information Technology sector.

The Allocation Effect illustrates the portion of the SGEM's performance that can be attributed to the SGEM's over or under weighting of sectors relative to the benchmark. While the SGEM did benefit from its relative underweighting towards the Energy, Materials and Real Estate sectors, all underperformers during the quarter, the overall Allocation Effect detracted from the SGEM's performance this quarter. In somewhat of an odd reversal, the Information Technology sector was the largest contributor to this negative impact.

The contrasting contribution (Selection vs. Allocation) from the Information Technology sector can be explained by the SGEM's relative underweighting to the overall Information Technology sector, which outperformed the broader market during the quarter, as well as the SGEM's overweighting of specific Information Technology sector stocks that were also outperformers during the quarter. Simply put, the SGEM held the right stocks in the sector but our overall exposure to the sector was too low to benefit from its overall outperformance.

Within our Information Technology sector holdings, **Nvidia** was once again the top performer. The company recently reported a surge in demand for its semiconductor chips used to train AI models leading management to raise guidance on future earnings to substantially higher levels. The stock returned over 50% during the second quarter and with that Nvidia has now became the first semiconductor stock to reach $1 trillion in market capitalisation, continuing to increase in value on the back of the AI explosion that is currently captivating global markets. Our holdings in **Microsoft** (Information Technology), **Alphabet** (Communication Services) and **Amazon** (Consumer Discretionary) were also strong performers during the quarter, lifted higher as a result of the AI narrative driving markets.



Source: Morningstar

Even **S&P Global** (Financials) is regarded by some as a potential beneficiary from AI given its proprietary data set in terms of ratings and financial markets. Following a post-covid lull, momentum within corporate bond and debt issuance has begun to accelerate, an additional factor contributing to the firm's positive quarterly performance

Apple became the first company in history to reach $3 trillion in market capitalisation. The iPhone maker recently launched its latest innovation, the Apple Vision Pro headset. The device is designed to provide the user with an ultra-realistic augmented reality experience and at a retail price of $3,500, user expectations will be high. Whether this device will replace the iPhone as the primary consumer device remains to be seen but it could provide Apple with a new avenue of growth in the future.

While most of our holdings delivered a positive return during the quarter there were a few exceptions. The largest detractor during the quarter was **Thermo Fisher**. The healthcare firm was a key beneficiary during the pandemic as it supplied the vaccine manufacturers with the "picks and shovels" required for research and manufacturing purposes. As demand for the vaccines has begun to wind down, so has revenue growth for Thermo Fisher, leading to weaker sentiment towards the stock.

The near-term may contain lower sales growth for the instrumentation, consumables and diagnostics provider but the long-term outlook remains quite positive. There are a number of drugs in the pipeline waiting approval as well as new opportunities emerging from cell and gene therapies, all of which would require equipment and consumables from companies such as Thermo Fisher.

It was a disappointing quarter for **Nike** as it continues to work its way through excess levels of inventory. The world's largest shoe-maker has been forced to offer its goods at discounted prices to reduce inventory levels, negatively impacting its margins. Excess inventory levels can also be attributed to elevated levels of inflation which have begun to take their toll on the US consumer dampening demand for discretionary items.

Disney's stock price fell during the quarter after it reported a decline in its streaming subscriber base. The decline emanated from its streaming platform in India, Disney+ Hotstar, which recently lost exclusive rights to stream the IPL leading to roughly four million subscribers to leave the platform. Excluding India, Disney's core streaming base did grow slightly as did average revenue per core subscriber.

The lacklustre post-covid recovery in China as well as concerns over high youth unemployment has led many to shy away from Chinese equities, negatively impacting our holding in **AIA**.

TOP PERFORMING STOCKS			BOTTOM PERFORMING STOCKS		
COMPANY	**GICS SECTOR**	**CONTRIBUTION (USD %)**	**COMPANY**	**GICS SECTOR**	**CONTRIBUTION (USD %)**
Nvidia	Information Technology	1.6	Thermo Fisher	Health Care	(0.3)
Microsoft	Information Technology	0.9	Nike	Consumer Discretionary	(0.3)
Amazon	Consumer Discretionary	0.9	Disney	Communication Services	(0.2)
Alphabet	Communication Services	0.6	Diageo	Consumer Staples	(0.1)
S&P Global	Financials	0.6	AIA	Financials	(0.1)

Source: Morningstar

CHANGES IN HOLDINGS

During the quarter we reduced our weighting in Nvidia as the surge in its stock price saw its weighting reach a level that was above our maximum threshold for a stock of its nature.

OUTLOOK AND WAY FORWARD

As the macroeconomic background continues to evolve, so do the expectations around the possible scenarios that might unfold. Inflation levels continue to fall from their peak in 2022 but remain above central bank target levels. Central bankers remain committed to further reducing inflation with continued rate hiking signalled for later this year.

The impact of further rate hikes has created much speculation around how economic growth will be affected. There are those anticipating that economies will experience a hard landing as the burden of higher interest rates take their toll on the consumer and corporate profit margins. Others believe the landing may be softer with the consumer remaining resilient and corporates able to cope with higher interest rates. There are even some that believe there may be no landing at all and economies will continue to grow, albeit at a reduced growth trajectory.

The outlook for inflation remains difficult to predict. Looking ahead, the trend appears to be for lower inflation, though once again, there are some that believe that we will be living with higher levels of inflation when compared to the past decade or so, owing to structural changes surrounding wage growth, commodity prices. In what may seem unlikely given the high levels of inflation we are currently experiencing, there are also those that predict we could be heading towards a period of deflation, when the rate of inflation falls below zero, as opposed to the disinflation that we are currently experiencing.

The impact of the above on the performance of the companies that we own can certainly be meaningful, especially in the short-term, but our focus remains geared to the factors that will ultimately impact the earnings or cash flows of our holdings over the long-term.

Our analysis will be centred around whether or not a company can continue to generate high returns on capital and reinvest those returns back into the business on a sustainable basis. This means that we will continue to reassess the competitive advantages of our holding companies as well as the growth opportunities that lie ahead of them.

One particular trend that has garnered much press lately and that could very well impact the areas that we focus on, be it positively or negatively, is the recent explosion of AI. The technology is likely to bring both good and bad elements, but it is hard to ignore the potential of this technology to be highly transformative as well as disruptive. Those companies that enable the technology are likely to benefit from its proliferation and the recent surge in their stock prices have begun to reflect that possibility.

Alphabet, parent company of Google, Amazon and Microsoft have all seen their stock prices surge on the back of the so-called AI mania given that they are well positioned to distribute AI to the masses through their cloud computing platforms. The strength of an AI model is very much predicated on the amount data used to train the model as well as how proprietary the data might be. The above Big tech names possess large amounts of such data which again positions them attractively to benefit from AI. Of course, the largest beneficiary, thus far, from the AI boom has been semiconductor firm Nvidia, having become the latest company to join the trillion-dollar club in terms of market capitalisation.

The prodigious move in the prices of these AI stocks has however led some to question whether they may now be in bubble territory, and it will only be a matter of time before it bursts. In determining whether we should continue to hold a stock or sell it, we primarily consider two factors. Whether the fundamentals of the business have changed such that it can no longer generate a sustainable return on capital at a level that we would consider suitably high enough and whether there has been a material change in the growth outlook for the company that would reduce its opportunity set to reinvest incremental returns on capital.

Given the nature of the companies that we own, namely quality-growth businesses, they are often priced at levels that would make them appear seemingly expensive, especially on a relative basis. Our approach is to hold these companies on a long-term basis, enjoy the benefits of their compounding effect as they consistently reinvest high returns of capital into attractive areas of growth. We are therefore not inclined to sell these stocks when they appear expensive, which is often the case.

OUTLOOK AND WAY FORWARD (cont.)

In the case of our holdings in Alphabet, Amazon, Microsoft and even Apple we believe this to be the case and remain comfortable with our holdings despite their sizable appreciation in price this year.

Nvidia does however present somewhat of a conundrum and does leave us feeling slightly ambivalent. As mentioned above, we did reduce our weighting as the surge in its stock price saw it rise to a level above our maximum threshold for a stock of its nature. Despite reducing our weighting, Nvidia has continued with its positive momentum, especially after announcing a massive upgrade to its previous earnings guidance.

It is now priced at such a level that the company would need to maintain its sizeable growth projections for an extended period of time without experiencing any degradation in the returns that it generates on capital. It is still possible that the company could achieve these lofty targets, but the probability thereof has decreased. There is also the possibility that we fail to assign sufficient weighting to the probability of Nvidia meeting or even exceeding the higher end of our expectations given the potential opportunity that stands in front of the company.

It is worth framing this opportunity as it might help you explain our conundrum as well as help you gain a better understanding of the opportunity that stands before the company.

The market for AI semiconductor chips is expected to grow at around 30% per annum over the next few years and Nvidia is expected to be a major beneficiary of this growth given the preference of software developers to use Nvidia's chips to train their AI models. This is but one area of Nvidia's growth opportunity.

Historically, data centers such as those run by Microsoft and Amazon, are filled with CPU chips from Intel, another semiconductor company. We are currently going through a structural change in computing, whereby workloads are being shifted away from CPUs, towards "accelerator" chips, the kind which Nvidia is responsible for.

A "recycling" of the data center, provides a sizable opportunity for Nvidia given the scale of chips that are currently installed that could potentially be replaced.

Nvidia's competitive advantage over other chip companies lies in the low-level software that it provides for its chips that assist developers in writing code. The ecosystem that Nvidia has created around its chips and software, has grown rapidly over the past year, effectively strengthening Nvidia's competitive advantage. For years, Nvidia has invested in its software capabilities, and it is now in a position to start cashing-in as it offers software platforms and applications that can easily be used to develop AI models, as well as build digital twins, an offshoot of the metaverse. Having software become a bigger part of Nvidia's operations transforms the company into one that has more scalability as well as recurring revenue, given the nature of the software business model. That is to say, going forward, Nvidia's profit margins are well positioned to increase as well as become somewhat more stable, a differentiating feature given the cyclical nature of semiconductor firms.

The final opportunity that could lead Nvidia to achieve such sizable growth expectations is in the area of autonomous driving. Currently a small part of its operations, Nvidia has recently announced a notable increase in its automotive pipeline which includes the likes of BYD, now the world's largest EV company. Nvidia will assist its customers in developing their autonomous driving solutions through its AI capabilities and this has the potential to become a sizable portion of Nvidia's overall business.

It would be remiss of us not to mention that the growth opportunities mentioned above are almost certainly going to lead to an increase in competition for Nvidia, some of which is already at its doorstep. Even Big tech names such as Amazon, Microsoft and Meta are now embarking on a journey to design their own chips to compete with Nvidia. In the auto arena, a fierce competitor in the form of Tesla awaits. Interestingly, Tesla opted to stop using Nvidia's chips in 2019, instead going the route of designing its own AI chips that it believes will be superior to that of Nvidia.

OUTLOOK AND WAY FORWARD (cont.)

Beyond competition, Nvidia will also be faced with other risks that could impair its ability to grow in line with the market's lofty expectations. One notable area of concern is the growing tension between the US and China around semiconductors.

The US government has already restricted Nvidia from supplying China with its most advanced AI chips over concerns that said chips were being used for military purposes. Nvidia was however able to skirt the restrictions by offering Chinese customers a slightly downgraded version. It is quite likely that the US government will implement further export restrictions on Nvidia and this could be quite negative for the company given the sizable contribution from Chinese customers.

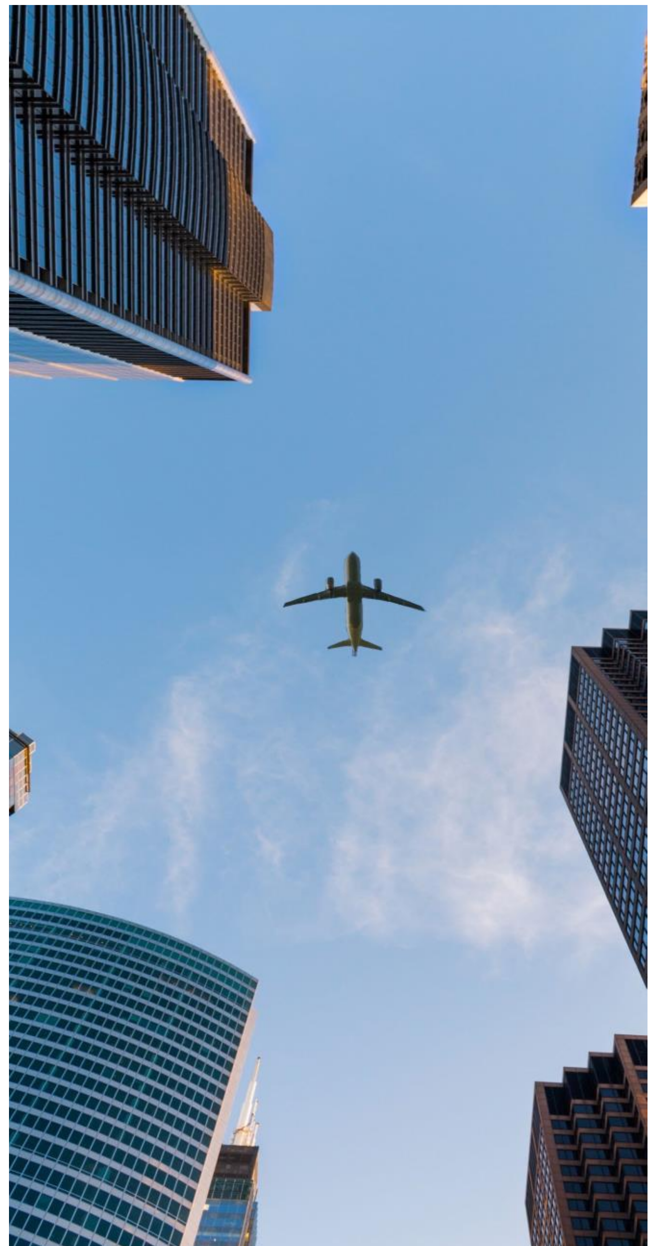
As for how AI might influence the rest of our holdings, we will remain vigilant as to the impact on their operations, be it good or bad, and react accordingly if so required.

For now, we remain content with our portfolio holdings. Given the higher quality and growth characteristics of our companies compared to our benchmark, we are not fazed by the higher relative valuation. That said, we do acknowledge that equity markets appear somewhat frothy at the moment.

On this point, the elevated price levels that markets are currently experiencing, specifically for quality growth names, do make it more challenging to deploy capital into new holdings. Our internal hurdle rate for new investments is set at a level that we believe will exceed the return of the broader equity market over the long-term. It is important that we maintain this minimum level of return as it provides us with a margin of safety for errors in judgement we may have made, and more likely will make, when assessing companies. By maintaining our hurdle rate, it will also ensure the we do not accept any seemingly attractive opportunities that ultimately result in sub-optimal returns.

The consequence of maintaining our hurdle rate during periods in which markets appear to be unattractively priced is that our investment opportunity set is reduced, at least for the time being.

However, one thing we are certain of is that there will be future market downturns or at least periods where the stocks in our quality growth universe are more attractively priced. It is in these periods that we will look to take advantage of attractive entry points into businesses that we believe offer both high quality and attractive growth opportunities.



PORTFOLIO CHARACTERISTICS					
	SGEM	MSCI ACWI		SGEM	MSCI ACWI
Quality[3]			**Valuation[3]**		
ROE	34.8%	15.7%	P/Earnings	25.6x	16.3x
ROIC	20.6%	7.9%	P/Book	9.3x	2.5x
EBIT	23.6%	13.6%	P/Sales	5.9x	1.9x
Gross Profit	48.6%	34.4%	FCF Yield	4.3%	4.7%
Growth[3]			**Risk/Volatility[2]**		
Sales growth[1]	10.2%	6.9%	Beta	0.9	0.9
Earnings growth[1]	10.1%	8.6%	Std Deviation	14.5	15.3
Size[3]			Sharpe Ratio	0.6	0.5
Market cap	USD630bn	USD440bn	Sortino Ratio	1.0	0.7

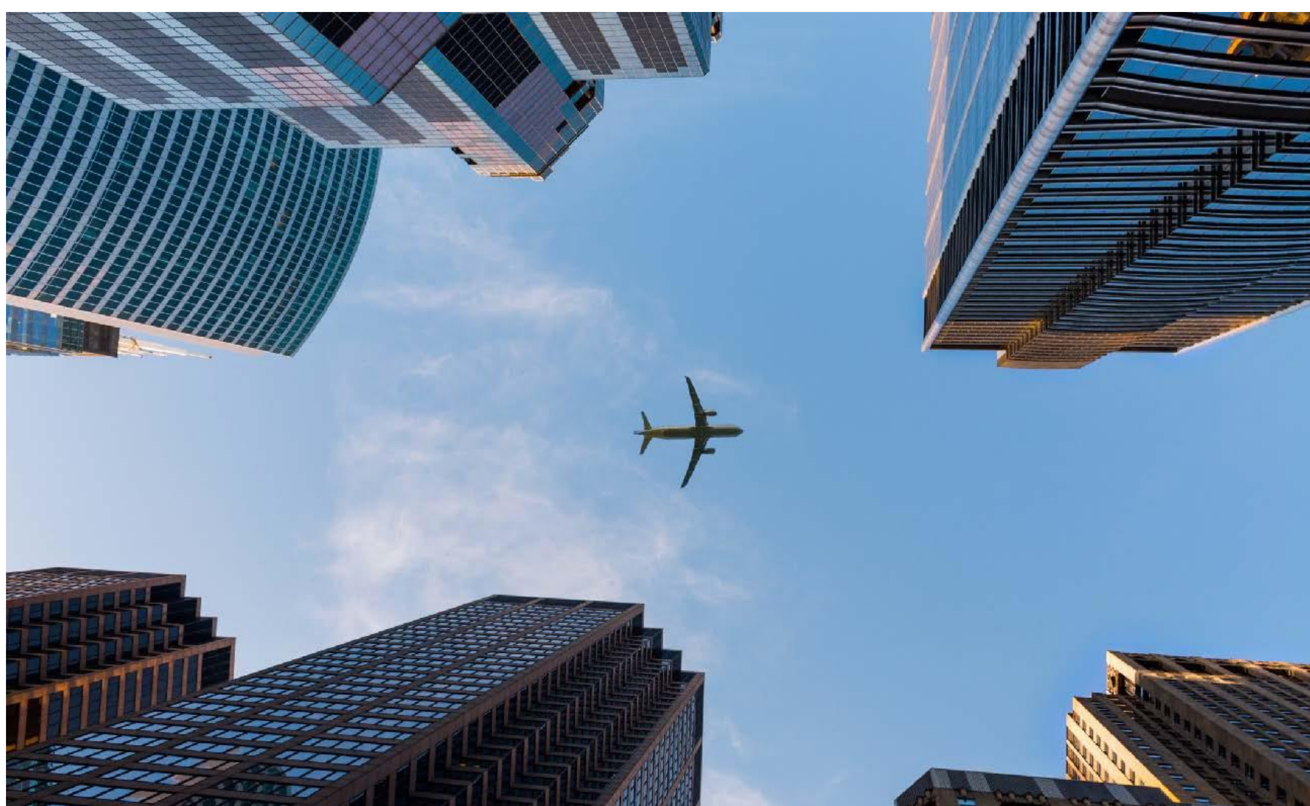
Source: FactSet, Morningstar

Notes:

1 – Trailing twelve months 3-yr annualised growth rate

2 – Risk statistics calculated since SGEM inception (31 December 2014)

3 – SGEM Quality, Valuation and Size characteristics calculated using weighted averages, SGEM Growth characteristics reflect median values



sasfin.com

Disclaimer

Collective Investment Schemes in securities are generally medium to long-term investments. The value of participatory interests may go up or down and past performance is not necessarily an indication of future performance. The Manager does not guarantee the capital or the return of a portfolio. Collective Investments are traded at ruling prices and can engage in borrowing and scrip lending. A schedule of fees, charges and maximum commissions is available on request. The Sasfin Wealth SICAV reserves the right to close the portfolio to new investors and reopen certain portfolios from time to time in order to manage them more efficiently. Investments in foreign securities may include additional risks such as potential constraints on liquidity and repatriation of funds, macroeconomic risk, political risk, foreign exchange risk, tax risk, settlement risk as well as potential limitations on the availability of market information.

The information contained in this communication is for information purposes only and does not constitute advice in any form, including but not limited to investment, accounting, tax, legal or regulatory advice. Terms, conditions and values contained herein are indicative only and subject to negotiation and change. This material does not constitute an offer, advertisement or solicitation for investment, financial or banking services. The material has no regard to the specific investment objectives, financial situation or particular needs of any specific person. The material is based upon information considered reliable, but the parties do not represent that it is accurate or complete or that it can be relied upon as such. All illustrations, forecasts or hypothetical data are for illustrative purposes only and are not guaranteed. The parties accept no liability whatsoever, whether direct, indirect or consequential for any loss or damage of any kind arising out of the use of all or any part of this material, and any reader or prospective investor is urged to be aware of all the risks involved in dealing with any financial product and the need to specifically consult with a professional adviser before making any decision or taking any action.

Sasfin Wealth, a division of the Sasfin Bank Group of Companies including Sasfin Securities (Pty) Ltd, Reg. No. 1996/005886/07, a member of the JSE and a registered Credit Provider NCRCP 2139, and Sasfin Asset Managers (Pty) Limited, Reg. No 2002/003307/07, an authorised financial services provider License No. 21664.