sasfin Wealth

Sasfin Global Equity Model

Quarterly review - Q3 2022

30 June 2022 – 30 September 2022

S Securities

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PERFORMANCE

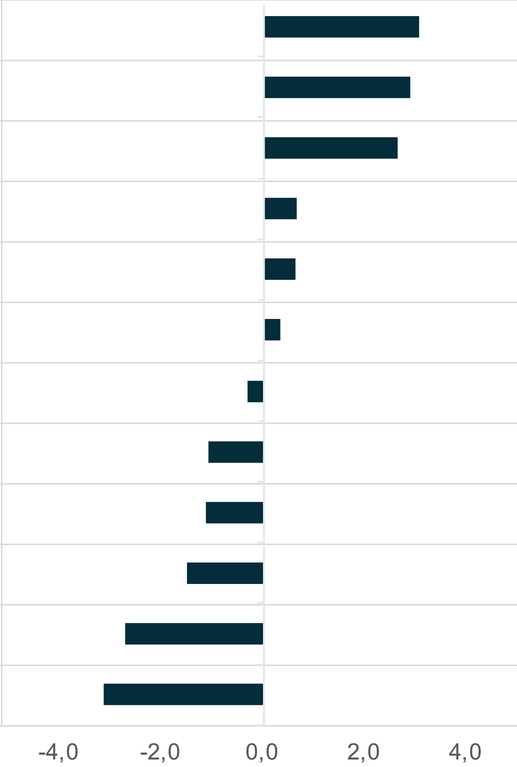
Total Return (%) - Period ended 30 September 2022

	3 Months	YTD	1 Year	3 Years[1]	5 Years[1]	Since Inception[1, 2]
SGEM	(6.6)	(24.3)	(21.6)	2.0	5.1	7.0
MSCI ACWI	(6.8)	(25.6)	(20.7)	3.8	4.4	5.7

Source: Morningstar
Note:
1 – Annualised
2 – Inception date: 31 December 2014

Portfolio Positioning (% Weight)

Sector	SGEM	MSCI ACWI	Under/Over (%)
Consumer Staples	10.5	7.5	
Cash	2.9	-	
Consumer Discretionary	14.2	11.6	
Financials	14.9	14.3	
Health Care	13.1	12.5	
Industrials	9.8	9.5	
Communication Services	7.3	7.6	
Materials	3.5	4.6	
Information Technology	20.3	21.5	
Energy	3.5	5.0	
Real Estate	-	2.8	
Utilities	-	3.2	



Source: Morningstar

MARKET COMMENTARY

Global equity markets fell for the third straight quarter as the MSCI All Country World Index, a broad measure of global equity markets, declined 6.8%. Central banks around the globe continue to increase interest rates in an attempt to tackle soaring levels of inflation. The trajectory of stock prices and interest rates are typically inversely related. Rising interest rates tend to lead to lower stock prices as the value of future profits generated by the companies are reduced owing to higher interest (discount) rates.

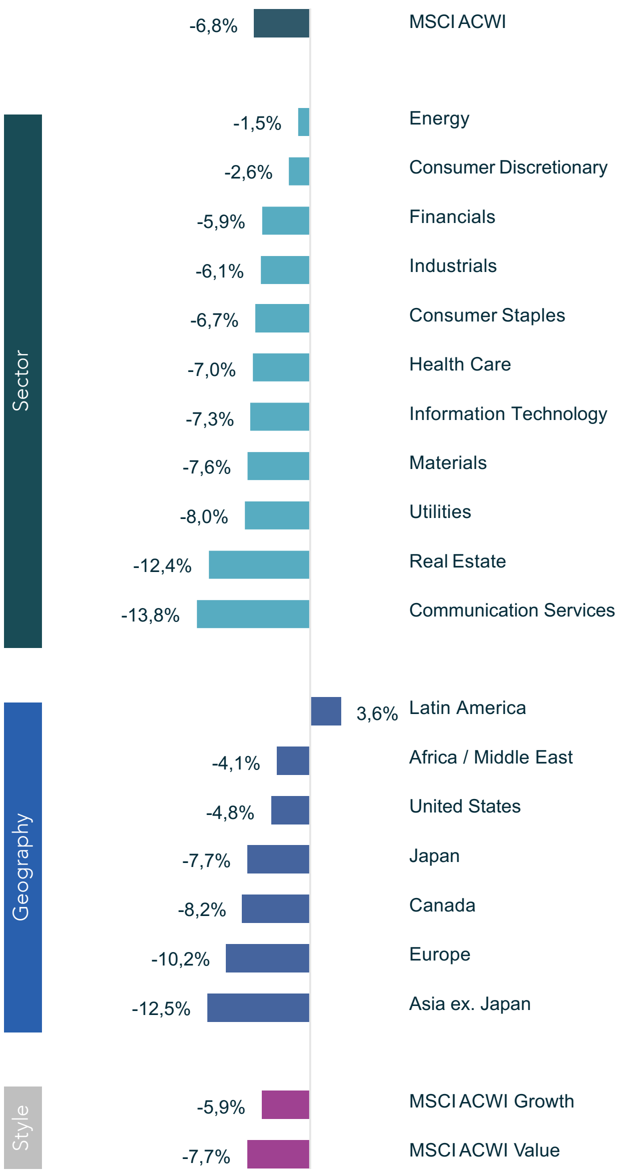
The US Federal Reserve ("Fed") has raised its benchmark rate by a cumulative 300 basis points year-to-date, with half of that increase coming through in the third quarter but we are yet to see a meaningful decline in the rate of US inflation. While this remains the case and unemployment levels remain low, there is a high likelihood that the Fed will maintain its aggressive hawkish policy and uncertainty will persist as to when the US has reached the end of its rate hiking cycle. Comments by Fed chairman Jerome Powell stating that monetary policy needs to be "more restrictive for longer" further underpins this possibility.

Inflation is running even hotter in Europe which has forced the European Central Bank (ECB") to raise its benchmark rate above zero for the first time in a decade. ECB president Christine Lagarde has signalled that there would be more interest rate hikes over the coming months in a bid to bring inflation back down to the central bank's target level of 2%. A tall order with inflation in the region hovering around 10%, spurred on by the ongoing energy crisis which may likely worsen as Winter draws nearer.

The third quarter has been particularly challenging for Chinese equities. Stock price falls were broad-based fuelled by the property sector crisis that the country is currently experiencing. Homebuyers are refusing to pay mortgages on unfinished homes which has sent the stock prices for property developers tumbling but stocks in other sectors have also been dragged into the negative spiral. Negative sentiment has also been exacerbated due to large parts of the country being placed into stringent lockdowns under China's zero-COVID policy. Even reassurances from Beijing that the crackdown on big tech companies would be relaxed did little to help.

The rapid rise in rates during the quarter meant that there were few places to hide, Bonds endured a negative period with the Bloomberg Global Aggregate Index, a broad measure of global bonds, declining 7%. Commodity prices were also weaker during the third quarter with the S&P GSCI, a broad measure of global commodity markets, falling 14%. The slump in the price of oil during the quarter was certainly noteworthy as the prices of Brent Crude and WTI fell by more than 25% as expectations for oil demand softened owing to lockdowns in China and the increasing likelihood of a recession in Europe as well as the US.

MSCI Index performance (USD%)



Source: FactSet

The one area where investors could find safety was the US dollar. During times of distress and uncertainty, as we are seeing now with rapidly rising interest rates and the possibility of recessions hitting many major economies, investors and traders alike seek protection in safe haven assets. During the quarter and for most of the year in fact, the US dollar has been the preferred choice with the US dollar index increasing 7% during the quarter and year-to-date it is up close to 17%.

PERFORMANCE AND ATTRIBUTION

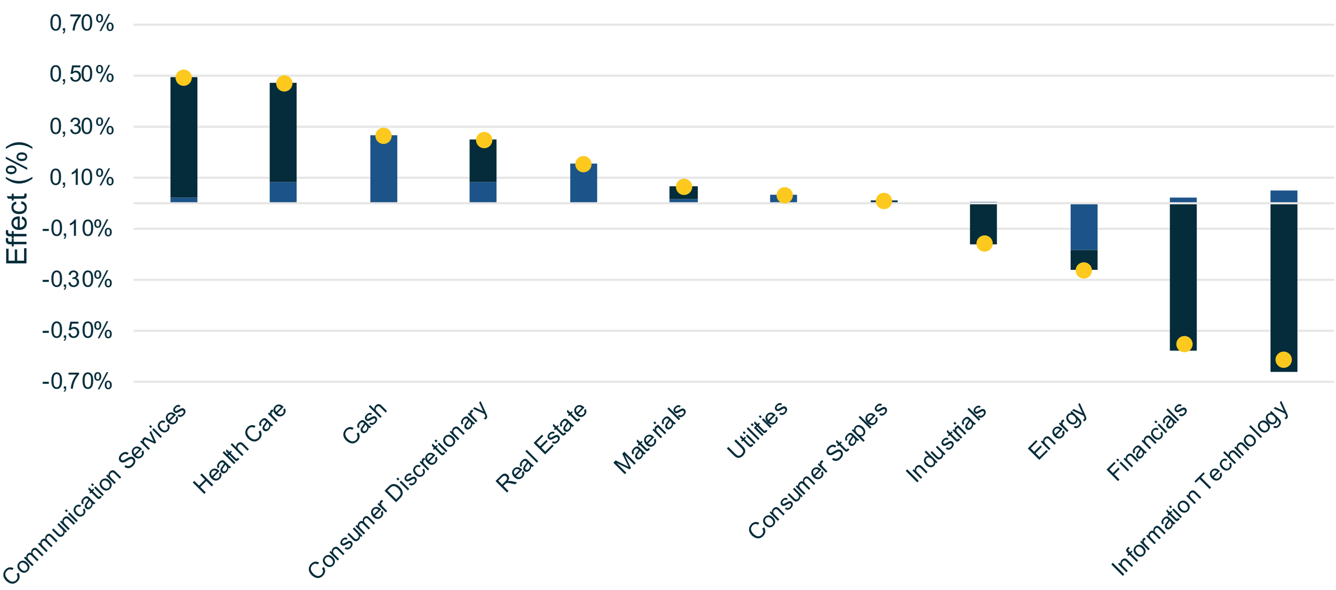
In similar fashion to most global equity markets, it was another negative quarter for the SGEM having declined 6.6%, slightly better than the 6.8% decline in the benchmark MSCI ACWI.

The Allocation Effect, which attributes performance based on the SGEM's weighting towards a sector relative to MSCI ACWI, was positive for the quarter and the main factor behind the SGEM's relative outperformance against its benchmark. In this regard, the allocation effect was positive across all but one sector, namely Energy, and the biggest contribution in terms of allocation came from the SGEM's small weighting in cash.

The Selection Effect, which refers to specific stock selection, was the biggest detractor in performance. In particular, stock selection within the Information Technology, Financials and Industrials sectors contributed to a drag in quarterly performance. Slightly offsetting the negative stock selections in these sectors were positive selection effects within the Communication Services, Health Care and Consumer Discretionary sectors.

For most stocks within the SGEM portfolio it was a negative quarter. In the Financials sector, the largest detractor was Asian insurance giant, **AIA**. As mentioned, this quarter was particularly difficult for Chinese stocks, both mainland as well as those listed in Hong Kong. AIA was not immune to the broad negative sentiment and fell sharply as a result. The fundamentals of AIA do not necessarily justify the extent of negative sentiment experienced by its stock price. Operating metrics for the insurer have been weaker owing to the stringent COVID lockdowns in the region and there was a minor decline in the company's embedded value.

Performance Attribution by Sector:



Total Effect: 0.2
Selection Effect: -0.4
Allocation Effect 0.6

Allocation Effect   Selection Effect   Total Effect

Source: Morningstar

It is also likely that as long as China continues to aggressively enforce its zero-COVID policy, the company will remain constrained. That said, the current price of AIA reflects a scenario of meagre growth, a far cry from what it was able to achieve pre-covid. We continue to believe that the intrinsic value of AIA – in an environment where covid restrictions are eventually relaxed, possibly removed, and AIA is able to return somewhere close to its previous growth levels – is above its current price.

Stocks within the Information Technology sector experienced some of the largest falls during the quarter and those in the semiconductor space were hit hardest. In this regard, chip designer **Nvidia** was the biggest faller. The company which is best known for producing graphics cards for computer gaming reported a disappointing set of results during the quarter. Sales growth has slowed owing to weaker demand on the gaming side as well as a fall in cryptocurrency prices. Graphic Processing Units ("GPUs") produced by the likes of Nvidia are also used to mine certain cryptocurrencies and a fall in the price of the digital assets has reduced the demand for GPUs. Results were also dampened by certain once-off expenditures as Nvidia had to write-off a portion of its inventory as average selling prices for GPUs fell on the back of weaker demand.

This isn't the first bad quarter that Nvidia has experienced in its near three-decade history and probably won't be its last. The semiconductor industry is cyclical in nature and is prone to large swings during the cycle as selling prices for semiconductors fluctuate owing to supply and demand dynamics. As with Nvidia, we saw a similar scenario with **Samsung**, the world's largest manufacturer of semiconductor memory chips, as average selling prices for these chips fell during the period. Even **ASML** has not been spared. The Dutch-based company does not make semiconductors but rather designs and builds the machines used in their manufacturing process.

While it might sound like all doom and gloom it is important to highlight that the prospects for semiconductors remain incredibly bright. We are currently experiencing a downturn in the semiconductor cycle, a natural event in a cyclical industry of this nature, but the longer-term structural demand for semiconductors remains incredibly strong. Beyond gaming, Nvidia's GPUs and its related CUDA platform are the market leader in terms of their use for artificial intelligence and are highly sought after by cloud computing giants for use in areas such as machine learning, computer vision, natural language processing and conversional AI.

None of this would be possible unless we had machines capable of producing chips small enough to perform such intense high-end calculations. That is where ASML comes in. It is the only company in the world capable of building machines that are able to produce leading edge semiconductor chips at scale using extreme ultraviolet (EUV) lithography. While Samsung remains a market leader in the manufacture of certain types of semiconductor chips, we have opted to exit our position in the company, the reasons of which we describe in detail below.

Other stocks that detracted from performance during the quarter included Alphabet and Raytheon. The stock price of aerospace and defence contractor **Raytheon** fell on news that it was reducing its cash flow forecast for the remainder of the year due to the enactment of a new tax rule by the Internal Revenue Service

("IRS") which no longer allowed for the immediate expensing of R&D. Forecast earnings for the company remained unaffected. A potential economic slowdown, or worse, a recession, is likely to lead many corporates to curb their advertising spend. As a result, advertisers such as **Alphabet**, parent company of Google, have suffered relatively larger falls in their share prices.

While it was a negative quarter for most stocks there were a few bright spots and the most surprising of all was **Amazon**. One might have expected the e-commerce giant to be dragged down with its peers but a better than feared set of results underpinned a boost in its share price. One the face of it, Amazon's results appeared to be rather disappointing. The company actually reported a loss for the quarter but the numbers included a significant non-cash accounting revaluation adjustment to its investment in electric vehicle company Rivian. Adding back this accounting nuance transforms Amazon's earnings back to profitability.

As an aside, Warren Buffet has often bemoaned these accounting revaluation adjustments as they create volatility in the results reported by his own company, Berkshire Hathaway, and they do not reflect the operational performance of the underlying business. Returning to Amazon, on an operational basis, the business was certainly profitable during the quarter but the sharp rise in inflation and fuel prices has led to a consequential increase in operating costs with operating margin compression the net result.
It was also a positive quarter for **Apple** and **Home Depot.** The stock price of the iPhone maker was also boosted as it reported better-than-expected quarterly results. Sales growth, while still positive, did decelerate sharply. Supply chain constraints as well as a strong US dollar (which detracts from non-US sales when converted into US dollars) were key factors in the deceleration along with strong pandemic-fuelled growth in prior periods which creates a strong base effect. In the case of Home Depot, the home improvement retailer surprised many with a better-than-expected set of results reporting healthy sales growth and record earnings despite the impact of supply chain disruptions.

LEADING CONTRIBUTORS*			LEADING DETRACTORS*		
COMPANY	**GICS SECTOR**	**CONTRIBUTION (USD %)**	**COMPANY**	**GICS SECTOR**	**CONTRIBUTION (USD %)**
Amazon	Consumer Discretionary	0.2	AIA	Financials	(0.9)
Home Depot	Consumer Discretionary	0.1	Raytheon	Industrials	(0.6)
Apple	Information Technology	0.0	Alphabet	Communication Services	(0.6)
Disney	Communication Services	0.0	Nvidia	Information Technology	(0.5)
Diageo	Consumer Staples	0.0	Visa	Information Technology	(0.5)

Source: Morningstar
Note: * Only includes performance of stocks held for more than three months

CHANGES IN HOLDINGS

During the quarter we made a decision to exit our position in **Samsung**. As mentioned, we remain positive on the sector as a whole but there were a number of factors that drove us to exit the position. Samsung is considered the "number two" foundry in the world, ranking behind Taiwan Semiconductor Manufacturing Company ("TSMC"). While this in of itself is not a bad thing, Samsung has lofty ambitions to challenge TSMC for its crown. Semiconductor manufacturing is highly capital intensive and Samsung will be investing a significant amount of capital to build new semiconductor fabrication plants ("fabs") in its bid to become the world's preferred leading edge chip manufacturer. Given the quantum of capital required as well as the time and skill necessary to achieve this objective, it remains too uncertain as to whether Samsung will be successful in its pursuit. In general, the return on capital generated by Samsung has been acceptable but it has experienced periods where returns fall below its cost capital. We would prefer to invest in businesses that provide more stability on returns generated from capital deployed. Given that we could quite possibly move into an environment of structurally higher inflation, we would also prefer that the companies we are invested in generate high returns on capital as they will be better positioned to absorb the higher costs associated with inflation.

We have spent a considerable amount of time and effort in our pursuit to identify a health care stock that we could add to the portfolio. In this regard, our rigorous process has identified **Thermo Fisher** as a suitable candidate. It may not be a household name but Thermo Fisher is a powerhouse in the life sciences space. The company provides a range of products and services used in diagnostic testing, biological and medical research as well as the manufacture of therapies and vaccines. The company has steadily grown its market share over the past few years and strengthened its already sizable economic moat through strategic acquisitions. A large portion of the revenue generated by the business is considered recurring meaning it is ideally positioned to deal with challenging slow/no growth economic environments.

POSITIONS ESTABLISHED		POSITIONS SOLD	
COMPANY	**GICS SECTOR**	**COMPANY**	**GICS SECTOR**
Thermo Fisher	Healthcare	Samsung	Information Technology

Source: FactSet

OUTLOOK AND WAY FORWARD

The increasingly aggressive rate hiking policies of central banks have led to significant headwinds for stock valuations. It is quite likely that while inflation continues to run well above central bank target levels, markets will remain volatile owing to uncertainty as to when the rate hiking cycle will reach its peak. Until we have more clarity in this regard, the market remains vulnerable to a further down leg.

That said, it is important to note that we are long-term investors. It is also worth pointing out that when taking a long-term view, it becomes far more difficult to say with any certainty as to what the interest rate level might be. One can certainly evaluate a variety of scenarios on a probabilistic basis but at best you are left with an educated guess. One could possibly argue with a bit more certainty that we may find ourselves in an environment of structurally higher inflation, at least higher than the levels we experienced over the past decade or so and this could imply slightly higher interest rates than we saw over the same period. What one could say with an even higher degree of certainty is that we are likely to experience an increase in the volatility of macroeconomic variables (with the exception of the COVID period between 2020/21) compared to a more subdued period that followed the global financial crisis.

To weather a more volatile macroeconomic environment we are of the view that it is best to hold companies that are better positioned to manage challenging economic headwinds. In our opinion, stocks that best fit this mould are quality growth businesses. In this regard, we focus on companies with strong fundamentals such as high returns on capital, competitive advantages, solid balance sheets and management teams that are able to deploy capital effectively, be it in attractive growth opportunities or via shareholder distributions. In a volatile macroeconomic environment, a strong management team will be of particular importance.

We spend a significant portion of our time and energy trying to find as well as monitor companies that fit our quality and growth criteria. Many of these companies have historically traded at too great a premium to what we deem to be their intrinsic worth which has ultimately kept us from taking a position. However, the third consecutive quarterly drop in markets has led to prices for many of these companies to fall close to price levels that we would deem reasonable. Importantly, the price that we pay for these businesses is of critical importance and would need to be at such a level that it offers a margin of safety for us to account for errors in our analysis as well as bad luck.

Despite the fall in prices and valuations for quality growth companies, there could be an argument for us to rather focus on lower quality companies as their valuations (still) appear to be relatively more attractive. We are however of the view that the benefit of owning superior quality may become more apparent as economic conditions worsen – a scenario which we could experience in the not-too-distant future as economic growth slows and the possibility of recession looms. At this point it is important to once again reiterate that we are long-term investors. While we could opt to invest in these lower quality businesses at lower valuations, we believe that the fundamentals that underpin their relatively more attractive valuations are at greater risk of deterioration than their more expensive quality growth counterparts.

To clarify and help you better understand our thinking consider the following. The value of a financial asset is the present value of its future cash flows. The rise in interest rates has reset the value of these assets as higher interest rates have lowered the present value of their respective future cash flows. It is still possible that we could see interest rates climb even higher which would lead to further decreases in the present value of future cash flows. While rising interest rates has been the key driver behind falling valuations, we believe that too little attention has been spent on the actual future cash flows. The future cash flows generated by a company are function of drivers such as sales growth (or lack thereof), profit margins and reinvestment rates back into the business. All of which filters through into the return on capital that a business generates. While it is not a foregone conclusion, it is quite likely that Europe and possibly the US, are heading for an economic recession. In this scenario, value drivers such as sales growth and profit margins would come under pressure. Even reinvestment back into the business may be at risk as available cash becomes scarce.

We would prefer to hold companies that are better positioned to protect these cash flows during challenging circumstances. In addition, estimates of future cash flows for lower quality companies may not reflect the extent to which their value drivers could deteriorate in a challenging economic environment which implies that their valuations do not either. On the other side of the coin, valuations for higher quality companies may include a premium, relative to lower quality companies, that reflects their ability to protect future cash flows as their value drivers hold up far better and are less likely to deteriorate. This premium had previously reached extreme levels but as mentioned, it is has subsequently fallen to a more reasonable level. Our philosophy has been and remains that as long as these companies maintain their quality growth standard as well as a sufficient margin of safety, we will continue to invest in them. In the long run, quality will out.

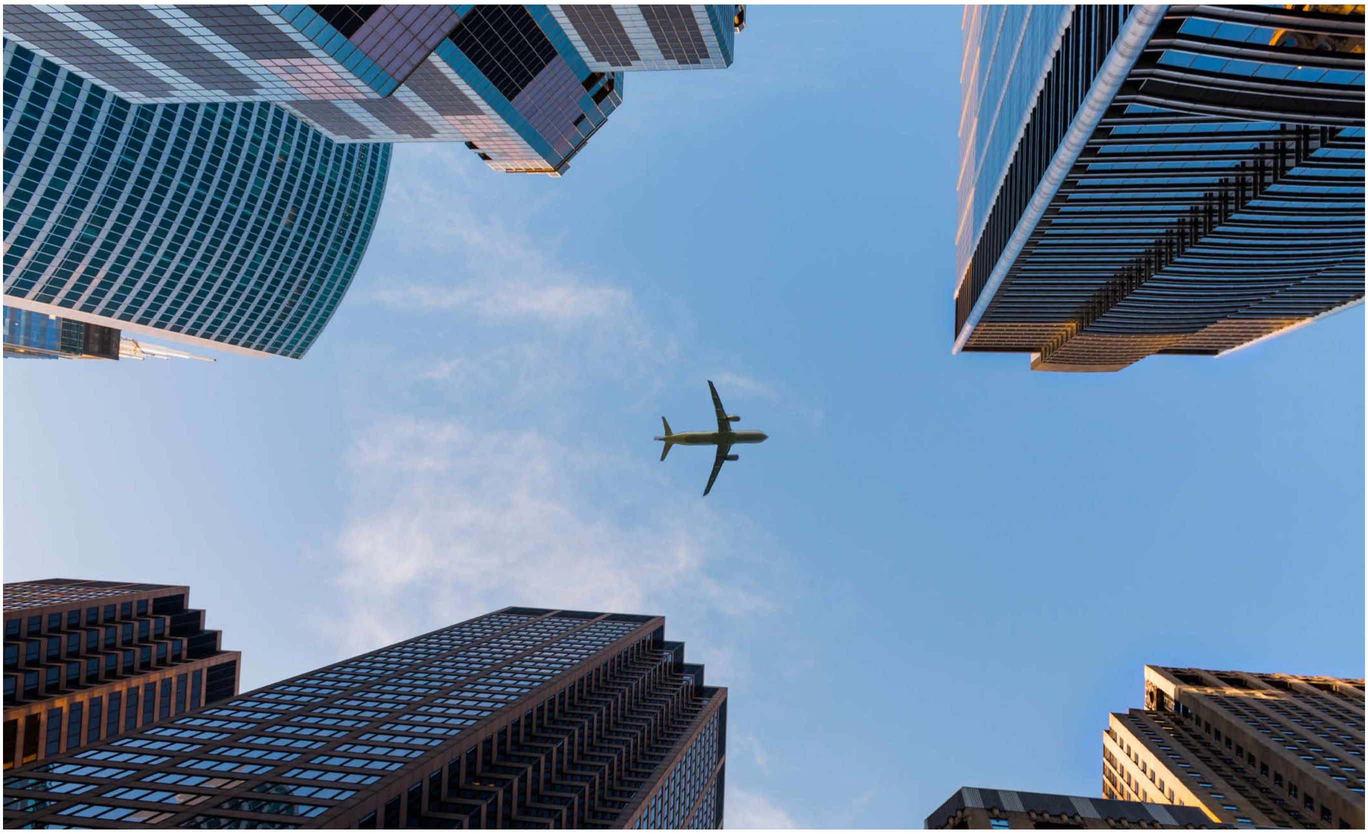
PORTFOLIO CHARACTERISTICS					
	SGEM	MSCI ACWI		SGEM	MSCI ACWI
Quality			**Valuation**		
ROE	39.7%	16.3%	P/Earnings	20.7x	13.3x
ROIC	22.3%	8.2%	P/Book	6.3x	2.1x
EBIT	25.6%	14.4%	P/Sales	4.2x	1.6x
Gross Profit	49.8%	34.9%	FCF Yield	5.2%	6.0%
Growth			**Risk/Volatility[2]**		
Sales growth[1]	8.6%	4.2%	Beta	0.9	1.0
Earnings growth[1]	19.5%	6.8%	Std Deviation	14.2	15.1
Size & Turnover			Sharpe Ratio	0.5	0.4
Market cap	USD462bn	USD306bn	Sortino Ratio	0.7	0.5

Source: FactSet

Notes:

1 - Trailing twelve months 3-yr annualised growth rate

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



TOP ADVICE BROKER

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