sasfin Wealth

Sasfin Global Equity Model (SGEM)

Quarterly Review – Q3 2024:
1 July 2024 – 30 September 2024

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Performance

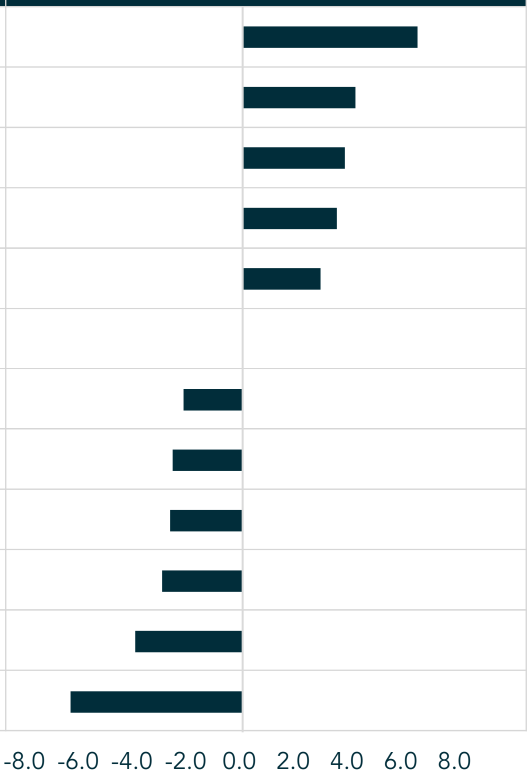
Total Return (%) - Period ended 30 September 2024

	Quarter	YTD	1 Year	3 Years[1]	5 Years[1]	Since Inception[1, 2]
SGEM	3.4	20.2	34.4	8.6	11.6	10.9
MSCI ACWI[3]	6.6	18.7	31.8	8.1	12.2	9.6

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 (%)
Health Care	17.4	10.9	
Consumer Discretionary	14.8	10.6	
Information Technology	28.4	24.5	
Cash	3.5	-	
Communication Services	10.7	7.8	
Materials	4.1	4.1	
Real Estate	-	2.2	
Financials	13.6	16.2	
Utilities	-	2.7	
Industrials	7.7	10.6	
Energy	-	4.0	
Consumer Staples	-	6.4	



Source: FactSet

Market Commentary

Global equity markets experienced another positive quarter as the MSCI All Country World Index gained 6.6% during the period. The gain came in spite of the unwinding of the Japanese yen carry trade which briefly threatened to derail markets. Years of ultra-low interest rates in Japan allowed traders to borrow in Japanese yen and invest in a currency that offers a higher return. For many such traders, US technology stocks became a favoured destination. The trade appeared to be working quite nicely until the recent surge in the yen after the Bank of Japan raised interest rates for the first time in 17 years.

The unwinding of the carry trade partly accounts for the relative underperformance of the Information Technology sector during the quarter. An additional headwind during the quarter has been the growing concern around the enormous spend on capex by large cap technology firms related to artificial intelligence ("AI"). In stark contrast to more recent quarters, technology stocks associated with the AI theme had led markets higher but now some have begun to question the potential return to be had from such a sizable investment. As such, Big Tech and semiconductor firms which are at the epicentre of this AI capex wave, were notable laggards during the quarter.

The buildout of AI infrastructure (data centers), is likely to lead to a sizable increase in electricity demand as AI compute is incredibly power intensive. Market participants are clearly expecting utility companies to profit from increased electricity usage, as reflected by the strong performance of the Utilities sector.

An additional tailwind for the Utilities sector was the decline in interest rates. The US Federal Reserve ("Fed") finally cut interest rates, signalling that further cuts lay ahead. Utilities as well as the Real Estate and Consumer Staples sectors are considered bond proxies as they provide steady, predictable income through dividends. Market participants tend to view stocks within these sectors favourably in an environment of falling interest rates as they offer bond-like returns. Other beneficiaries of falling rates were the insurance companies within the Financials sector. Many insurers continue to report improvements in the claims environment as well as sizeable premium increases passed onto consumers.

The US 2-year and 10-Year bond yields ended the quarter lower at 3.79% and 3.64% respectively. For the first time in over two years, the longer-term yield rose above its shorter-term counterpart.

While most major economies around the world have embarked on a cycle of rate cutting, US bond yields have fallen at a relatively sharper pace. As a result, the US dollar has come under pressure, weakening against other major currencies, as evidenced by the 4.8% decline in the US Dollar index.

Falling interest rates boosted the price of gold as the yellow metal rose 12.8% during the quarter, closing out the period at $2,630/ozt.

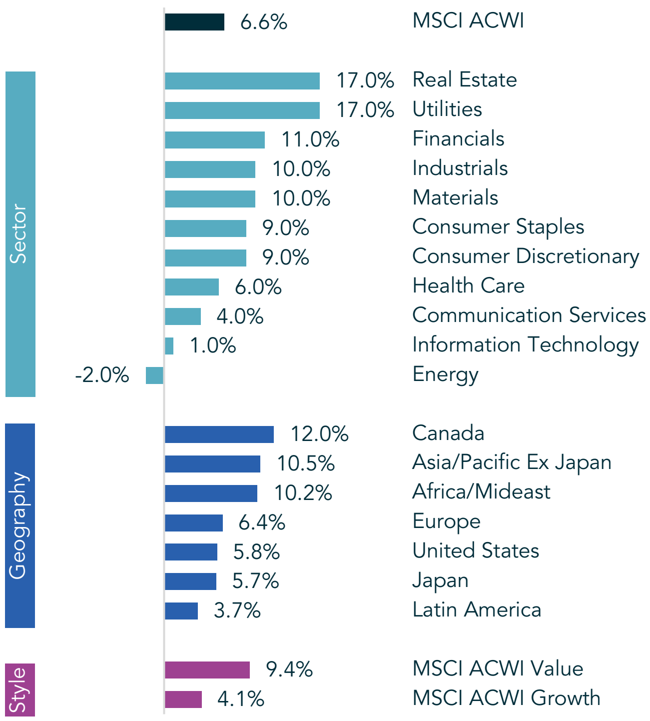
From a regional perspective, the tech-heavy Nasdaq index (+2.8%) underperformed during the quarter. The broader S&P 500 Index (+5.8%) delivered a higher return but the impact of a weaker US dollar was readily apparent when comparing the performance of the US against European equity markets.

In their respective local currencies, the returns of the Dutch AEX (-0.7%), the UK FTSE 100 (+2.4%), the French CAC (+3.7%) and German DAX (+5.5%) were all below the US. However, in USD terms, the returns for the European indices were notably higher, as the UK (+8.0%,) French (+6.5%) and German (+10.4%) indices outperformed their US counterpart.

Chinese authorities announced a slew of stimulus measures in an effort to reinvigorate their stumbling economy and debt-burdened property sector. Chinese equities reacted positively to the news leading to sharp gains across the board with the Hong Kong Hang Seng Index and the mainland CSI Index returning 14.8% and 17.7% respectively for the quarter.

The Energy sector was the worst performing sector during the quarter. The price of oil fell over 18% during the period as Brent crude and WTI closed out the quarter at $72 and $68 a barrel respectively. The decline, owing to increased output from the US and weak demand out of China, may be short-lived. Tensions in the Middle East continue to rise and the recent stimulus injected into the Chinese economy may serve as an additional catalyst.

MSCI Index performance (USD %)



Source: FactSet

Performance and Attribution

While the **SGEM** delivered a positive return for the quarter, our three quarters streak of outperforming the benchmark came to an end. The SGEM returned **3.4%** during the period compared to the benchmark's (MSCI ACWI) gain of 6.6%.

The relative underperformance can be ascribed to a combination of sector allocation and specific stock selection. From an allocation perspective, the SGEM's underweighting towards the Utilities sector, the best performing sector during the quarter as well as its large overweighting towards the underperforming Information Technology sector, were notable detractors from relative performance.

Zooming in to the specific stocks held within the various sectors, much of the relative underperformance can be ascribed to stocks closely tied to the "AI theme" which came under pressure during the quarter. **Adobe, Alphabet, Amazon, ASML and Nvidia** were all relative underperformers during the quarter despite having reported better-than-expected quarterly earnings.

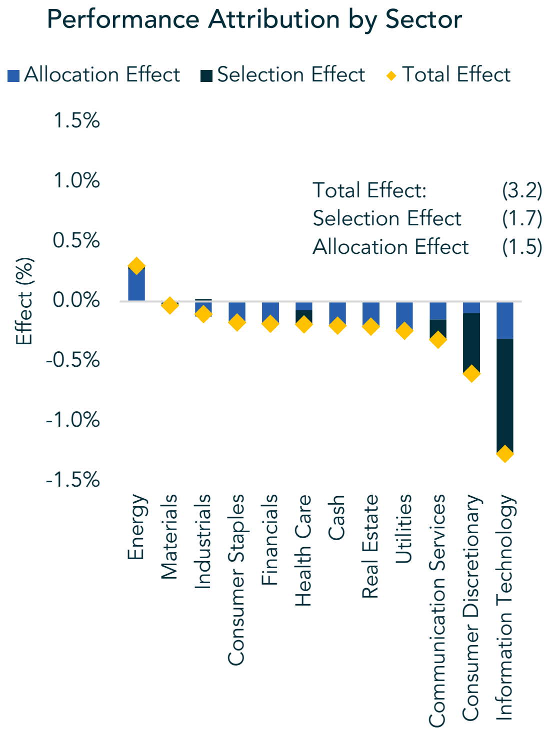
Forward-looking guidance provided by these firms was lower than expected and this only served to exacerbate the growing concern that significant spend on AI would fail to deliver a favourable outcome.

It is also worth noting that heading into the third quarter of this year, these stocks had performed exceptionally well since the launch of ChatGPT in late 2022 and despite the recent pullback, have still outperformed the benchmark MSCI ACWI.

Prior to the stimulus measures introduced by Chinese authorities, luxury goods conglomerate **LVMH** came under pressure as luxury goods counters sold off sharply around concerns surrounding the Chinese consumer. China has served as the growth engine for the luxury sector and despite the measures introduced to support the struggling consumers, concerns continue to linger around the health of consumers as well as the Chinese economy in general.

Relative underperformance aside, there were still many positives to be taken out of this quarter. The rate reduction by the Fed, as well as the prospect of future cuts, provided much needed confidence for the struggling housing market in the US. This in turn served to boost the stock price of home improvement retailer **Home Depot**.

UnitedHealth was another strong performer during the quarter. The Managed Care Organisation reported better-than-expected results and has also benefitted from the rotation into more defensive areas such as healthcare. Not all of our healthcare names enjoyed a positive quarter with **Novo Nordisk** a standout underperformer.



Source: Morningstar

After AI, the second hottest area in the market, at least prior to this quarter, has been weight-loss drugs. Denmark-based Novo Nordisk has been the leader in this segment, enjoying a tremendous surge in its stock price. The high prices in the US of their flagship drugs, Ozempic and Wegovy, which are also used to treat diabetes and various Cardiovascular risks, has led to calls for the sky-high prices to be significantly reduced, leading to a steep decline in the firm's stock price.

Not all of our technology stocks endured a challenging quarter. **Meta**, the owner of Facebook, Instagram and WhatsApp, reported a really strong set of results as well as a better-than-expected outlook. The firm also showcased where the billions in R&D are going in relation to its augmented / virtual reality (AR/VR) segment. The firm's AR glasses, named Orion, are not yet available for the consumer but Apple would certainly have been put on high alert as many questions and doubts linger over the iPhone maker's VisionPro headset and whether we have just witnessed the first device that could potentially challenge the iPhone.

Constellation Software, a serial acquirer of vertical market software companies was another technology stock that performed well during the quarter. The firm continues to deliver strong growth for shareholders as it lives up to its reputation as a compounding machine.

Top Performing Stocks			Bottom Performing Stocks		
Company	GICS Sector	Contribution (USD %)	Company	GICS Sector	Contribution (USD %)
Meta	Communication Services	0.7	ASML	Information Technology	(1.1)
UnitedHealth	Health Care	0.7	Novo Nordisk	Health Care	(0.6)
S&P Global	Financials	0.6	Alphabet	Communication Services	(0.5)
Home Depot	Consumer Discretionary	0.6	Microsoft	Information Technology	(0.2)
Constellation Software	Information Technology	0.4	Amazon	Consumer Discretionary	(0.2)

Source: Morningstar

Changes in Holdings

During the third quarter we did not add any new names to the portfolio, but we did exit our long-standing positions in **Johnson & Johnson** and **Shell**.

In more recent years, the **Johnson & Johnson** has faced strong lawsuits, primarily stemming from allegations that its talc-based products, such as Baby Powder, contained asbestos that was linked to ovarian cancer and mesothelioma. The costs associated with these lawsuits can be tallied up into the billions and there are still cases that are yet to be resolved.

In addition, Johnson & Johnson is still involved in the ongoing investigation into the role it has played in America's opioid crisis. One could argue that lawsuits of this nature come with the territory and even cynically put them down to the "cost of doing business".

What is however more concerning for us, from an investment standpoint, is the lack of innovation from the firm. Perhaps the lawsuits have distracted the firm from focusing on revinvestment back into the business. Regardless, when compared to its peers in the pharmaceutical and medical device spaces, Johnson & Johnson appears to be in a somewhat inferior position as competitors have released, or are about to release, newly innovative products whereas as Johnson & Johnson is staring at a somewhat ominous patent cliff and a pipeline that appears to be rather dry.

Added to this was the recent spinoff of the firm's consumer products business, which added an element of stability to the firm's earnings. This only served to add to the increasing unattractiveness of our holding in Johnson and Johnson, resulting in our exit of this position.

Fossil fuels are certainly not going to disappear. They are too integrated into the manufacturing and production of core materials such as steel, cement, plastic and ammonia. However, we are currently in the midst of an energy transition whereby governments are shifting, slowly, towards using "cleaner" alternatives that produce lower or no CO_2 emissions.

This type of transition does not bode well for oil majors such as **Shell**. One could very well argue that during this transition phase, natural gas may serve as a "bridge" owing to its lower emissions relative to coal. Shell is a major player in the natural gas market, and this would serve to bolster its investment case.

What is of greater importance to us is investing in companies that offer both stable and high returns on capital. The energy sector in general but specifically Shell's track record in this regard, has been quite poor. Returns on investment have been low and the volatility in commodity prices such as oil and gas does not offer the stability that we seek.

While the company has realigned management incentives to focus on generating higher returns on capital, the fact remains that they will still be subject to fluctuations in the oil price. We believe that your capital can be better deployed in companies that offer both higher and more stable returns that will enable the consistent compounding of your wealth. As such, we have opted to exit our position in Shell.

Outlook and Way Forward

The long journey is best made without noise

In the buildup to Nvidia's release of their quarterly results, the excitement was palpable, at least for those that closely follow the markets. For some, the excitement bubbled over into "watch parties" as superfans gathered in bars to view the latest from Nvidia's CEO, Jensen Huang.

The firm reported that sales had grown over 100% and profits had increased by over 150%. Ordinarily, this kind of performance would send the market into a frenzy. But Nvidia is no ordinary stock. The mood of the partygoers turned more sombre as the reality set in that the level of growth reported was well below that of the previous quarter. Management's guidance for the next quarter did not help either as it remained fairly similar to what was expected – not the beat-and-raise that Wall Street bankers and the like were hoping for. Nvidia's stock price fell 7% overnight.

One could take a number of insights away from the entire event. The fact that people are holding watch parties for quarterly result announcements highlights the hype around this stock and more broadly AI. As is often the case, when stocks are accompanied by this level of hype, any signs that might indicate a slowdown in growth – often leads to a sharp fall in the company's stock price – that is just the way that Wall Street operates.

What we would like you, the reader, to take away from this synopsis is that we do not follow Nvidia, nor any stock for that matter, with this kind of short-term focused, fever-pitched excitement. Nor do we react to quarterly pronouncements, one way or the other, with a knee-jerk reaction as so often seen by the market.

Our approach to analysing and investing in companies, has and remains that of a long-term mindset. Rather than obsessing over quarterly updates, our approach includes a detailed understanding of the long-term track record of a firm as well as how it might perform over the next decade or so, rather than just the next quarter.

Taking a long-term view forces us to focus on what will be core to the firm's (stock price) performance over a period of many years rather than the next quarter. Over a short period, stock prices are often swayed, be it up or down, by information that we would regard as noise. Monthly data points around the latest economic indicator or news stories about whether the Fed will cut interest rates at this month's meeting or the next – both items that we would categorise as noise. That is not to say we are not cognisant of the macro environment. Interest rates in particular serve as the foundation of the financial system. In a sense they serve as gravity to financial assets such as stock prices.

Over the longer-term, a firm's stock price is largely influenced by its ability to earn a return on its investments. The outcome of which is often established by the growth in the firm's earnings or cash flows.

To assess a firm's ability to earn a return on its investments requires us to have a good understanding of a few core areas. These include future growth opportunities available to a firm, if any at all. Management's ability to deploy capital into these opportunities. The structure of a firm's industry and whether the firm possesses any type of competitive advantage relative to its competitors. Last but not least, the strength of the firm's balance sheet.

There is also a strong connection between the above areas of assessment and taking a long-term view. Often investments take time to generate a return, especially in new or evolving markets. One could argue that seeking a return from an investment after just one year might be short-sighted. That is certainly what is taking place in the markets right now and the concern around spend taking place for AI.

Is the AI wave over?

Sentiment towards some of our companies exposed to the AI theme soured somewhat during the quarter. Hyperscalers (Alphabet, Amazon, Microsoft, Meta) and semiconductor firms (ASML, Nvidia) bore the brunt of the negativity. The unwind of the yen carry trade certainly played its part as a large portion of the "cheap" funding was likely deployed into the above categories. What has also begun to bubble to the surface are growing concerns around the return on investment from AI infrastructure spend by the hyperscalers.

Combined, over the next few years hyperscalers are expected to deploy over half a trillion dollars into AI, be it semiconductor chips, data center equipment and other costs associated with building AI models. It is certainly reasonable to raise concerns around any investment that reaches this scale but perhaps a little perspective is needed.

True to form, Wall Street has become impatient as it has been "nearly" two years since the launch of ChatGPT and the lucrative returns expected from AI are yet to emerge. This is a perfect example of where taking a longer-term view is useful. It is worth restating that it has only been two years since ChatGPT introduced itself to the broader public.
Given that generative AI is still in a fairly nascent phase of its lifecycle, and that it likely represents a technological paradigm shift, we would caution against dismissing the investment into this technology.

Outlook and Way Forward (Cont.)

Consumer use cases are still very much in the works but we have already begun to see glimpses of what may be coming. Apple recently showcased how it will integrate AI into your iPhone, serving as a digital assistant, by accessing your private data, as only Apple can, to provide useful insights for the user, such as retrieving your flight details through a simple voice prompt.

Apple would have certainly taken notice of Meta's recent Connect event where it introduced the world to its prototype augmented reality glasses dubbed Orion. Meta has combined both AI and augmented reality into one product that again can provide the person wearing them with useful abilities, be it multiple "virtual" work displays or even the ability to look at a set of ingredients on a kitchen counter and suggest a recipe. Apple is certainly working on its own pair of glasses, but we could be witnessing the birth of the first device that could potentially replace the smartphone.

While we wait for these consumer products and services to evolve, it is the enterprise space where AI is likely to make the biggest impact in this early phase of its evolution. Consider the introduction of the computer into the workplace or even the simple spreadsheet. One cannot overstate the impact on productivity from these products or tools. Employees became more efficient, or replaced in certain instances, and management was able to garner much greater insight into the business. We are witnessing a similar scenario playing out right now.

AI tools are already leading to productivity gains within organisations and management is once again able to gain greater insight as well as reap the rewards for productivity gains. The incentives are certainly there for the decision-makers but encouraging adoption by the employees actually using the AI tools may take time given that they have gone without for so long. Of course, as younger generations enter the workplace, adoption is likely to accelerate given that they have grown up using AI.

The proliferation of AI, and the return on the investment for the technology is therefore going to take time, similar to what took place with the internet and other technological shifts from earlier generations. How AI will be monetised is still a question that continues to evolve as is that of who will emerge as the AI champions.

This brings us back to the hyperscalers and semiconductors. Given that it will take time for AI to proliferate, both from a consumer and enterprise standpoint, we believe that it is too early to conclude that the spend by these firms will lead to poor returns.

It is quite likely that as long as AI spend continues to lead to scaling benefits, that is improvements in AI models, the firms will continue to invest. This would of course be viewed in a positive light for the likes of ASML and Nvidia. Hyperscalers will continue to invest in Nvidia's latest and greatest chips which of course will require ASML's machinery for them to be made. Furthermore, as long as the supply of Nivida's chips remains constrained, the firm can continue to sell them at premium prices.

Another important link between taking a long-term view and a firm's balance sheet strength is whether it can withstand periods of financial difficulty. From our perspective, it is important that a firm be able to weather a challenging environment, be it a slowing economy, rising interest rates or spiking commodity prices.

In this vein, we are about to head into a period that is likely to lead to an increased amount of volatility and garner much of the headlines for the remainder of the year. The US presidential election is around the corner and the race between former president Trump and Vice president Harris appears to be neck and neck.

Given that the election is likely to be closely contested, at least according to current polls, it is difficult to position a portfolio aligned with the interests of a specific candidate. We would also argue that positioning a portfolio around the agenda of someone that sits in the Oval Office will not make that big of a difference. History will show that regardless of which party holds office, US equity markets have generally tended to go up. This might suggest that the market is influenced by forces far greater than the US president. Your time, and certainly ours, is far better spent studying the structural forces or "Mega Trends" at play that are likely to influence the long-term performance of companies.

These could include:

- Technological innovations
- The global energy transition
- Changes in the geopolitical order
- Evolving societal trends

Our long-term outlook is far-better informed when considering the possibilities of AI, the global shift away from fossil fuels towards "cleaner" alternatives, the return to industrial policy by the US (both Democrats and Republicans have shifted in this direction) and the potential impact of a society exhibiting much greater longevity and declining birth rates.

Portfolio Characteristics					
	SGEM	MSCI ACWI		SGEM	MSCI ACWI
Quality[3]			**Valuation[3]**		
Return on Equity (ROE)	41.8%	15.5%	P/Earnings	28.5x	18.0x
Return on Invested Capital (ROIC)	26.5%	7.7%	P/Book	10.6x	2.9x
Earnings Before Interest and Tax (EBIT)	29.6%	13.5%	P/Sales	7.8x	2.2x
Gross Profit	56.1%	35.0%	FCF Yield	3.5%	4.3%
Growth[3]			**Risk/Volatility[2]**		
Sales growth[1]	14.2%	9.2%	Beta	0.9	0.9
Earnings growth[1]	23.3%	13.9%	Std Deviation	14.3	14.9
Size[3]			Sharpe Ratio	0.7	0.6
Market cap	USD1,017bn	USD640bn	Sortino Ratio	1.1	0.9

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 market cap weighted averages, SGEM Growth characteristics reflect median values

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