sasfin Wealth

Sasfin Global Equity Model (SGEM)

Quarterly Review – Q2 2024:
1 April 2024 – 30 June 2024

sasfin.com

PERFORMANCE

Total Return (%) - Period ended 30 June 2024

	Quarter	YTD	1 Year	3 Years[1]	5 Years[1]	Since Inception[1, 2]
SGEM	4.5	16.2	22.3	6.4	10.7	10.8
MSCI ACWI[3]	2.9	11.3	19.4	5.4	10.8	9.0

Source: Morningstar

Note:

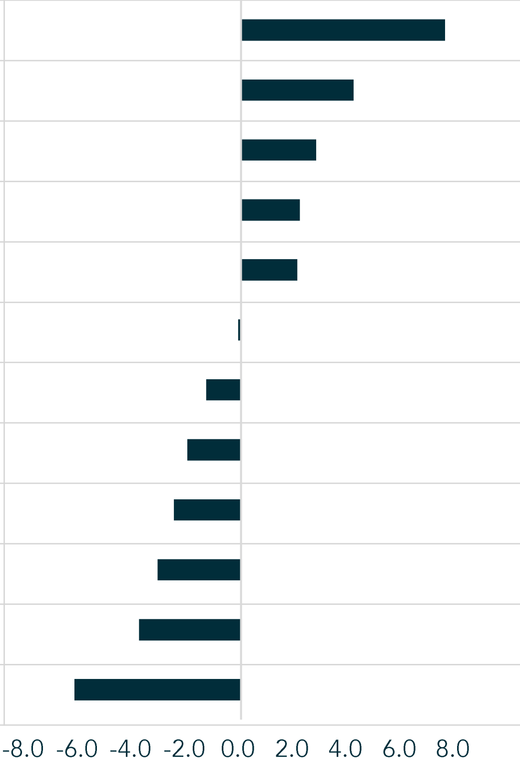
1 – Annualised

2 – Inception date: 31 December 2014

3 – MSCI All Country World Index

Portfolio Positioning (% Weight)

Sector	SGEM	MSCI ACWI	Under/Over (%)
Health Care	18.5	10.9	
Consumer Discretionary	14.6	10.4	
Communication Services	10.7	7.9	
Cash	2.2	-	
Information Technology	28.0	25.9	
Materials	3.9	4.0	
Energy	3.1	4.4	
Real Estate	-	2.0	
Utilities	-	2.5	
Industrials	7.2	10.3	
Financials	11.8	15.6	
Consumer Staples	-	6.2	



Source: FactSet

MARKET COMMENTARY

Despite a rocky start to the quarter, global equities were able to regain their positive momentum as **the MSCI ACWI Index** ended the period 2.9% higher.

The positive result was largely driven by stocks within the **Information Technology** and **Communication Services** sectors, specifically those perceived to be the early–on "winners" of the Artificial Intelligence ("AI") mega-trend that continues to encapsulate the minds of market participants. The winners, as the market perceives them today, are those within the hardware and infrastructure segment. Key beneficiaries include semiconductors, networking equipment for data centers as well as edge devices expected to be equipped with AI capabilities such as personal computers and smartphones.

AI computing consumes a significant amount of electricity. Stocks within the **Utilities sector**, especially those with nuclear power capabilities, experienced sharp rises in their stock prices as markets anticipate a surge in demand for electricity.

The debate continues to rage on as to when the US Federal Reserve ("Fed") will begin to cut interest rates. The May inflation print of 2.6% maintained the overarching trend of falling price levels and will only serve to further pressure the Fed to pull the trigger. US Bond yields ended the quarter relatively unchanged from the start as **US 2-year** and **10-year** yields ended June at 4.7% and 4.3% respectively.

High levels of interest rates continue to place strain on consumers, as spend, particularly for discretionary items, has begun to slow. Stocks within the **Consumer Discretionary** sector were notable underperformers during the quarter as belt tightening has begun to take its toll. Unlike the US, a number of central banks in Europe have not been shy to cut interest rates. The Swiss National Bank cut rates for the second time this year, and the European Central Bank cut its deposit rate for the first time in five years.

Falling rates would ordinarily be viewed as a positive for equity markets but performance by European equities was mixed during the quarter. The industrial-heavy **German Dax Index (-1.4%)** underperformed as German automakers continued to suffer at the hands of EV imports from China. The parliamentary election in France, which could see the business-friendly centrist president Emmanual Macron lose power, spooked market participants, leading to sharp declines in French stocks and leaving the **French CAC Index (-7.1%)** in negative territory at the end of the period. On a more positive note, the **Netherlands AEX Index (+6.0%)** outperformed during the period, owing to sizable contributions from local semiconductor stocks.

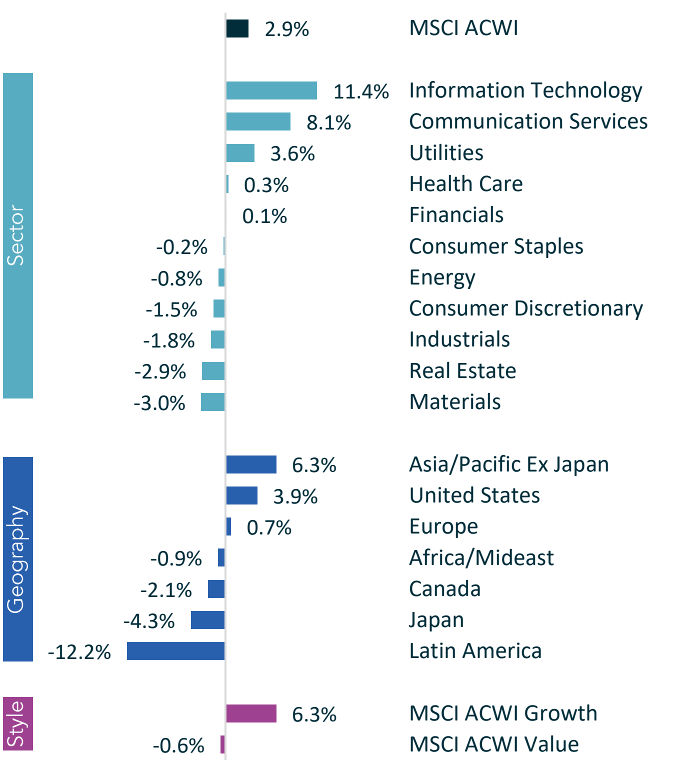
Despite the Bank of England resisting the urge to cut rates, the **FTSE 100 Index (+3.7%)** was a relative outperformer. Investors continued to bargain hunt within the region, weighing up the impact of a regime change as the Labour Party looked set to come into power for the first time in 14 years.

Asian markets (ex. Japan) were the standout performers during the quarter with Taiwanese semiconductor stocks notable contributors. Hong Kong-listed Chinese equities also rebounded which led the **Hang Seng Index (+9.2%)** higher. Cyclicals, such as financial and energy stocks, were boosted by the news of the Politburo outlining new measures to address the faltering property sector. The release of better-than-expected economic data points, economic growth and industrial production, served to boost positive sentiment. Chinese tech giant Tencent was also a notable contributor after reporting better-than-expected earnings.

China aside, cyclicals were relative underperformers during the quarter. The **Materials sector** was weighed down by disappointing results from industrial gas counters as well as a sizable drop in steel prices which negatively impacted counters within the segment. Energy counters were pegged back as a combination of weak economic data points, rising inventories and a strong US dollar, saw the prices of **Brent crude** and **WTI** slip by 2% to $82 and $85 a barrel respectively.

Central bank purchases of **gold** continued to push the price of bullion higher. The yellow metal ended the quarter above the **$2,300/ozt (+5.5%)** level owing to the prospect of lower interest rates as well as concerns around the staggering levels of national debt.

MSCI Index performance (USD %)



Source: FactSet

PERFORMANCE AND ATTRIBUTION

The **SGEM** maintained its positive momentum for the year, returning **4.5%** during the second quarter, outperforming the benchmark's (MSCI ACWI) gain of 2.9%.

Much of the SGEM's outperformance can be ascribed to its relative overweighting to those sectors exposed to the AI theme, namely Information Technology and Communication Services, as well as specific stock selections within those sectors.

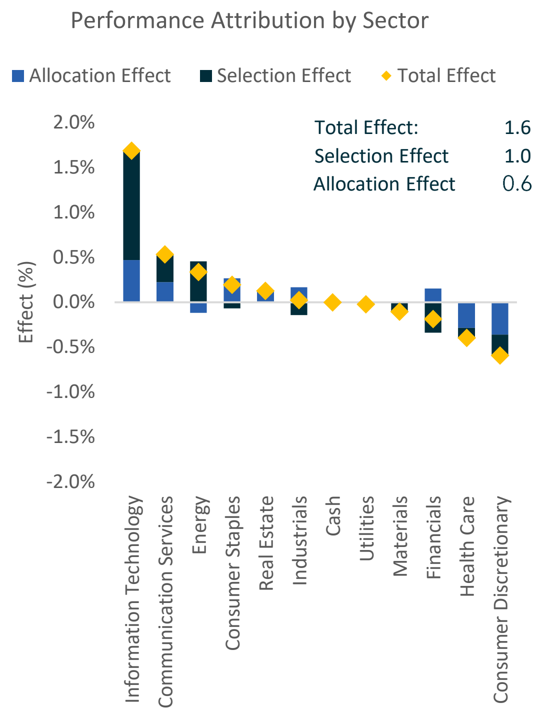
The standout performer, as it has been for some time now, was **Nvidia**. During the quarter, the US-based chip designer briefly overtook Apple and Microsoft as the world's most valuable company when its market cap peaked at $3.3 trillion. The firm reported another set of spectacular results which once again showcased the incredible demand for its products and solutions.

The AI theme served as a catalyst for another sizable tech titan, **Apple**. At its highly-anticipated annual developers conference, the firm (finally) announced how it would be incorporating AI across its range of products. The iPhone maker introduced the world to its AI platform aptly named Apple Intelligence. "Core" to its value proposition will be the aspect of privacy. Personal information contained on an iPhone can be utilised by Apple Intelligence but importantly the user's information will never leave the device without permission of the user. Apple will also partner with other AI companies to make use of their AI models and OpenAI's ChatGPT was announced as the first significant partnership.

Other tech names that continued to ride the wave of positivity around AI and that delivered above-average returns during the quarter included **Alphabet, Amazon, ASML, Meta and Microsoft**.

Apart from the AI mega trend, another theme that continues to gain traction is that of weight-loss drugs. The market leader, thus far, has been **Novo Nordisk**, one of the Health Care sector holdings within the SGEM. The Danish-based firm continued to see exceptional demand for its weight-loss drugs, driving its stock price even higher during the quarter.

Novo Nordisk was however the one ray of sunshine piercing through what remains a sector shrouded in grey clouds. The Health Care sector continues to lag the broader market and as a result our overweight allocation to the sector detracted from our overall performance. A number of our stock selections within the sector were notable laggards. **Johnson & Johnson** reported a mixed set of results with lower-than-expected sales from its blockbuster psoriasis drug, Stelara, which is also expected to face stiff competition from biosimilars next year.



Source: Morningstar

IDEXX experienced a decline in its stock price following a mixed set of results by the veterinary equipment maker. Top-line growth remains below expected levels and the firm trimmed, albeit it slightly, its growth outlook for the remainder of 2024, with declining veterinary visits a core concern.

Relative to our benchmark, our overweight allocation to the Consumer Discretionary sector was also a detractor from our performance as concerns have begun to mount over the health of the consumer. Signs of consumer spend shifting away from big ticket discretionary items have grown in prominence with declining spend on luxury goods a notable point of interest. **LVMH**, the world's largest luxury goods conglomerate, reported a decline in revenue for the most recent quarter leading to a fall in the firm's stock price.

The French-based firm's stock price came under further pressure over the anticipated outcome of the French parliamentary elections. At the end of the quarter, Marine Len Pen's far-right party, *Rassemblement National* (National Rally) appeared to be in pole position to gain a majority of the votes. The possibility of right-wing government left market participants somewhat jittery over how it might treat businesses as well the broader impact of its policies on the Euro. However, as of writing, in a dramatic turn of events, the left-wing *Nouveau Front Populaire* (New Popular Front) won the most votes during the second round of voting, relegating the National Rally to third place. A left-leaning government may not placate market concerns, as its plans to increase social spending which will only add to France's ballooning national debt.

PERFORMANCE AND ATTRIBUTION (cont.)

Further evidence of consumer spending diverting away from big ticket items could be seen in the performance of Home Depot. The world's largest home improvement retailer recorded its fourth consecutive quarter of declining revenue, with management highlighting lower spend on big ticket items such as appliances and furniture. The firm finds itself at a rather interesting juxtaposition with home prices in the US at record highs but with mortgage rates at the highest level experienced in over two decades. High housing prices and high mortgages makes it difficult for buyers, especially first-time buyers, to purchase a house.

Somewhat surprising to us has been the relative underperformance of Visa. Fundamentally, the payments processor appears to be in rude health as reflected by its most recent quarterly results. One could point to a lawsuit facing the firm around swipe fees that appeared to have been settled in March only for a federal judge to intervene and advise that the settlement would not be approved. The two-decade long lawsuit sought to reduce the amount merchants were charged for swiping cards (interchange fees) and the agreement would have seen a reduction in the fees charged. However, the judge raised concerns that Visa, as well as Mastercard, were still in the position of being able to centrally price swipe fees.

We will have to wait for the full judgement to understand the proposed recommendations, but any further amendments are unlikely to result in a material impact to Visa's bottom line.

Another concern being whispered across trading desks has to do with the Fed. The US central bank launched a real-time payments service last July that competes with Visa Direct. The service, called FedNow, allows for instant digital payments at a lower cost than using a bank debit card. A number of financial-services firms have signed up for the service as well as major banks. There are worries that the Fed's payment transfer service could eat into Visa's business. As with the judgement, we will have to carefully watch this development and how big of a threat it poses to Visa's business model.

Industrial gas giant, Linde, reported an underwhelming set of results during the quarter with topline growth coming in below expectations. Market participants were left further disappointed as management lowered full-year guidance for the firm, the resultant impact of which led to Linde's stock price ending the quarter in negative territory.

TOP PERFORMING STOCKS			BOTTOM PERFORMING STOCKS		
COMPANY	**GICS SECTOR**	**CONTRIBUTION (USD %)**	**COMPANY**	**GICS SECTOR**	**CONTRIBUTION (USD %)**
Nvidia	Information Technology	2.6	LVMH	Consumer Discretionary	(0.6)
Alphabet	Communication Services	1.0	Home Depot	Consumer Discretionary	(0.4)
Apple	Information Technology	0.6	Visa	Financials	(0.3)
Amazon	Consumer Discretionary	0.4	IDEXX	Health Care	(0.3)
Novo Nordisk	Health Care	0.4	Linde	Materials	(0.2)

Source: Morningstar

CHANGES IN HOLDINGS

During the second quarter we exited our positions in **Honeywell, Nestle** and **Nike**. In terms of new additions, we have initiated positions in Stryker and **TransDigm**.

Honeywell has been a long-standing holding within the SGEM owing to its consistent, above-average returns on capital and it provided exposure to a number of structural drivers that we favour. These include the shift to clean energy, e-commerce and the related warehouse automation, rising national security concerns and the expected increase in defence spend and the continued growth in air travel.

Despite exposure to these attractive themes, the firm's revenue growth has been somewhat pedestrian and margin expansion has failed to materialise despite management's best laid plans. We have grown increasingly sceptical of management's ability to deliver on its growth objectives and decided to exit our position in the industrial conglomerate. We believe your capital can be redeployed into more attractive opportunities.

One such opportunity that we have identified is **TransDigm**. The US-based firm specialises in acquiring companies that supply parts for the aerospace industry, which can range from electronic components located within the cockpit to the door handles of the bathroom stall. TransDigm has a history of earning high returns of capital as well as growing well above industry-average rates.

What adds to the appeal of the firm is that the businesses that they acquire are often the sole supplier of the specific part. This provides TransDigm with substantial pricing power and the oft-critical nature of these components leads to high switching costs, the foundation of the firm's sizable competitive advantage. In addition, management has a long track record of assisting the management of acquired firms to improve contract terms with their customers and ultimately improve profitability.

Another long-standing position within the SGEM has been **Nestle**. We still regard the Swiss-based consumer goods company as high quality in nature as it has continually delivered high returns on capital, and we expect the firm to continue to do so well into the future. However, the firm's growth rate has been far less impressive, and we expect that its low growth trajectory is likely to persist. As we remain committed to investing in what we consider "Quality Growth" businesses, we have made the decision to exit our position in Nestle.

A stock that has had a far shorter tenure in the SGEM is Nike. We initially invested in the world's largest shoemaker under the assumption that its strategy of going "digital" and selling directly to customers, as opposed to using wholesalers, could lead to a material uplift in the firm's profitability.

Disappointingly, management's strategy has not panned out and it appears that Nike is also losing market share to competitors. While we cannot deny the appeal of the Nike brand and its ability to continually attract customers, the increased likelihood that our core investment thesis would not come to fruition along with the firm's declining market share, provided enough cause for concern to exit our position.

Despite underperforming the broader market for the past 15 months, we still remain attracted to the Health Care sector. Many of the sub-industries therein offer favourable industry structures that allow for both high returns on capital as well as above-average growth. We were therefore comfortable increasing our exposure to the sector during the quarter through our investment in medical device maker **Stryker.**

Unlike most other firms in the medical device space, Stryker is well diversified across a range of segments which provides an element of stability to its earnings, should a particular niche experience a downturn. The firm is, however, best known for its products within the orthopaedics space, specifically hip and knee replacements. While Stryker does have competitors in its various sectors, the numbers are quite low, given the stringent regulatory approvals surrounding medical equipment, which does protect the firm from seeing its high returns on capital being eroded away.

The probability of Stryker's returns on capital remaining high are increased given that many surgeons have trained using Stryker's equipment. It is reasonable to believe that they would be unwilling to change to a competitor's offering owing to high switching costs, be it the time required to train on a new piece or equipment or the risk of an unfavourable outcome.

Apart from the Covid period, where many procedures were placed on hold, Stryker has consistently generated above-average revenue growth. A key driver in this regard is the structural trends of aging populations as well as increased obesity, both of which often lead to patients requiring various types of hip or knee surgery.

OUTLOOK AND WAY FORWARD

Staring into the abyss

Equity markets, particularly the US, continue to defy the expectations of many Wall Street investment strategists as they proceed to make new highs. To avoid being left behind, these "experts" race to upgrade their expectations lest they stray too far behind the herd, all the while whitewashing their previous "guesses" as to where they think the market might end up over the next couple of months.

To be clear, we pay little-to-no attention to these short-term forecasts, other than to scoff at the notion that anyone can accurately and consistently make predictions of this nature. Admittedly, the scoff can sometimes escalate into a snort given the discrepancy between the prediction and the actual outcome.

Short-term market predictions aside, the fact remains that markets have continued to reach new heights. When markets make new highs, it immediately leads to uncertainty as one is effectively staring into the abyss, not knowing whether the path ahead will lead you higher or simply towards the edge of a cliff. Against a backdrop of high interest rates, rising political tensions and a consumer that is seemingly coming under more pressure, one might be inclined to think that the next leg might be down. Unlike our Wall Street counterparts, we will not try make a guess. We could make a case for more highs based on the rate cuts that are "supposed" to come to fruition. In theory, falling interest rates would be beneficial for stocks, particularly those with longer durations such as technology.

This, however, is not something we will do. Our investment approach does not spend much time (if any) focusing on where interest rates might go. Importantly, we do not base our investment decisions on predicting the direction of macroeconomic variables as we regard such an exercise as a fool's errand. We do take note of where we currently find ourselves from a macro perspective as it does help inform our understanding of how various parts of the market are currently being valued by participants which ultimately ties into the idea of what would be a "fair" price for a particular stock.

Returning to the concern of markets making new highs, we do not regard this as a risk in and of itself. While the so-called lack of visibility might feel uncomfortable, history has shown that markets making new highs tends to lead to markets…making even more new highs.

It is quite rare than an all-time high is immediately followed by a market crash. In fact, an interesting piece of research by JPMorgan1 provides some intriguing insight on this matter. If one had invested in the S&P500 on any random day since the start of 1988, your investment would have made money over the course of the next year 83% of the time and on average your one-year total return was +11.7%. It is worth noting that at this point in time the market was near a low having just experienced the 1987 market crash more commonly referred to as Black Monday,

However, if you only invested your money on days when the S&P500 closed at an all-time high, your returns were actually better! Your investment over the course of the next year would have made money 88% of the time and your average total return was +14.6%.

The purpose of this exercise was not to advise you to only invest when the market makes new highs but rather to provide some comfort around investing during these "uncomfortable" times. It is at this point that we have to bring up the disclaimer that "past performance is no guarantee of future results".

Too much of a good thing is bad for you?

Another concern that has become more topical of late has been the increase in concentration of markets, specifically the S&P500. The largest stocks in the US market have increased their share of the total market capitalisation and the fact that most of these companies are linked to the AI theme, which some regard as pure hype, has led many to speculate that the stock market may be in the midst of a bubble.

The Perez Technological Surge Cycle2 provides a useful, albeit high-level, framework to try and assess whether or not these stocks might indeed be in a bubble. One could reasonably draw a conclusion that we are likely between the stages of "Irruption" and "Frenzy". During this period, a bubble is likely to form but the difficulty lies in determining how close to peak frenzy are we – is the bubble only beginning to form or is it about to pop?

Our view, at least for now, is that we are not in bubble-bursting territory yet. The fundamentals for these large tech firms remain incredibly strong, especially when compared to most of the companies in non-tech sectors and their valuations are not even close to what was experienced during the Dot-com crash at the start of the millennium.

OUTLOOK AND WAY FORWARD (cont.)

If our assessment was not sufficiently convincing, perhaps a recent article by the always insightful Michael Mauboussin3 might provide some more comfort. On the topic of market concentration, he noted a number of key points that would not appear obvious to the uninformed or even those that are quite well informed for that matter. The article notes that while concentration in the US market has increased, high levels of concentration are not unique to the US alone and many other major markets have much higher levels of concentration among their large cap stocks.

He also highlights that perhaps the increased level of concentration may have less to do with currently high levels but rather the lower concentration that existed a decade ago. One could make an argument that perhaps these tech giants that currently dominate the market were mispriced in the past and had they been correctly priced during that period, the higher level of concentration we are currently seeing would not seem too different from the past. Another interesting bit of insight uncovered by Mr. Mauboussin was that periods of rising concentration within the S&P500 were also associated with above average performance by the index.

From our perspective, the analysis contained in the article around the fundamentals of these companies justifying their relatively higher concentration is perhaps the most reasonably sound argument as to why the currently high level of concentration in the market does not represent a risk in and of itself. An analysis of the profitability of the top 10 stocks over the last decade, many of which are large tech, showed that while they accounted for nearly 20% of the total market cap of the S&P500, their share of the entire profit pool was closer to 50%. Clearly there is some justification for a small number of firms accounting for a large portion of the market's value if those same firms are contributing a significant amount to the overall profit pool - nearly the same amount as the other 490 companies.

What does keep us awake at night?

Our dear reader might conclude from this discussion that we appear to have no concerns whatsoever. This is far from the truth. Where our worries lie are more on the fundamental and structural factors that affect the businesses that you are invested in.

Our notable concerns include but are not limited to:

- Will a viable alternative to Nvidia's CUDA software become mainstream, effectively wiping out much of the firm's existing competitive advantage?
- Will the significant capex spend by the big tech firms (Alphabet, Amazon, Meta, Microsoft), a big portion of which is flowing through to Nvidia for its GPUs (AI chips), translate into meaningful returns down the line?
- Will AI lead to a significant disruption in the business models of tech giants with Google's highly-profitable search business a notable target?
- Are we going to see any significant side effects to Novo Nordisk's weight-loss drugs rendering them unsafe and will future versions of the drug provide sufficient differentiation to ensure Denmark's largest company does not lose significant market share to generic alternatives once existing drug patents expire?
- Will ultra-wealthy Chinese consumers continue to fuel the growth in luxury spend?
- Will we eventually see significant healthcare reform take place in the United States, significantly reducing costs for the consumer as well the healthy profit margins of pharmaceutical companies (Novo Nordisk), medical device makers (Stryker) and managed care organisations (UnitedHealth)?

Many of these concerns are nigh on impossible to answer with any certainty and at best can only be assessed on a balance of probabilities, much in the same way we would take into consideration the potential future returns of businesses that we are invested in on your behalf or which we may look to invest your money in. We believe that the best approach to managing the risk-return trade-off is to ensure that the pool of earnings within the portfolio is sufficiently diversified from risk contagion whilst still ensuring the portfolio maintains a healthy concentration to opportunities that are, in our view, likely to yield above-average or high returns, consistently, over the long-term. We don't know what the future holds but we maintain the belief that holding quality growth businesses is the best way to deal with uncertainty whilst still generating healthy returns over the long-term.

Notes:

1. https://www.jpmorgan.com/content/dam/jpm/securities/documents/cwm-documents/Is-it-worth-considering-investing-at-all-time-highs.pdf

2. https://en.wikipedia.org/wiki/Technological_Revolutions_and_Financial_Capital

3. https://www.morganstanley.com/im/en-us/individual-investor/insights/articles/stock-market-concentration.html

PORTFOLIO CHARACTERISTICS					
	SGEM	MSCI ACWI		SGEM	MSCI ACWI
Quality[3]			**Valuation[3]**		
Return on Equity (ROE)	41.8%	15.5%	P/Earnings	28.6x	17.6x
Return on Invested Capital (ROIC)	27.0%	7.8%	P/Book	11.5x	2.8x
Earnings Before Interest and Tax (EBIT)	29.8%	13.3%	P/Sales	8.2x	2.1x
Gross Profit	56.3%	34.8%	FCF Yield	3.8%	4.4%
Growth[3]			**Risk/Volatility[2]**		
Sales growth[1]	14.2%	8.7%	Beta	0.9	0.9
Earnings growth[1]	23.3%	13.8%	Std Deviation	14.5	15.1
Size[3]			Sharpe Ratio	0.7	0.5
Market cap	USD1,032bn	USD668bn	Sortino Ratio	1.0	0.8

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

intellidex

TOP FULL-SERVICE BROKER

2022 WINNER

intellidex

LUMP-SUM INVESTOR ARCHETYPE

2022 WINNER

intellidex

TOP ADVICE BROKER

2020 WINNER

intellidex

TOP ADVICE BROKER

2021 WINNER

sasfin.com