sasfin Wealth

Sasfin Global Equity Model

Quarterly review - Q2 2022
31 March 2022 – 30 June 2022

S Securities

sasfin.com

PERFORMANCE

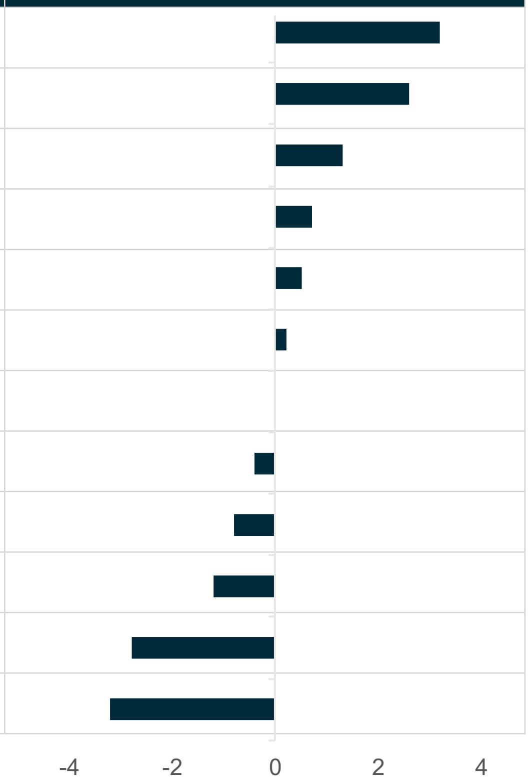
Total Return (%) - Period ended 30 June 2022

	3 Months	YTD	1 Year	3 Years[1]	5 Years[1]	Since Inception[1, 2]
SGEM[3]	(15.4)	(19.0)	(18.3)	4.1	7.5	8.2
MSCI ACWI[4]	(15.7)	(20.2)	(15.8)	6.2	7.0	6.9

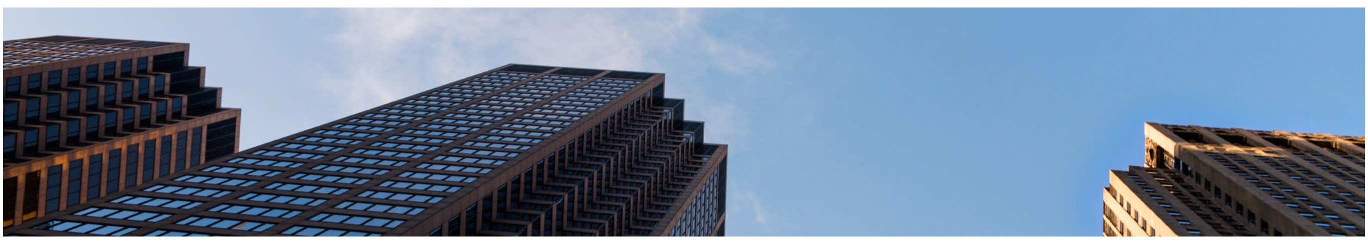
Source: Morningstar
Note:
All performance is net of underlying instruments fees and gross of management fees
1 - Annualised
2 - Inception date: 31 December 2014
3 - SGEM - Sasfin Global Equity Model
4 - MSCI ACWI - MSCI All Country World Index

Portfolio Positioning (% Weight)

Sector	SGEM	MSCI ACWI	Under/Over (%)
Communication Staples	10.8	7.6	
Consumer Discretionary	13.7	11.1	
Cash	1.3	-	
Industrials	10.1	9.4	
Financials	14.9	14.4	
Health Care	13.2	13.0	
Energy	5.0	5.0	
Information Technology	20.5	20.9	
Communication Services	7.1	7.9	
Materials	3.6	4.8	
Real Estate	-	2.8	
Utilities	-	3.2	



Source: Morningstar

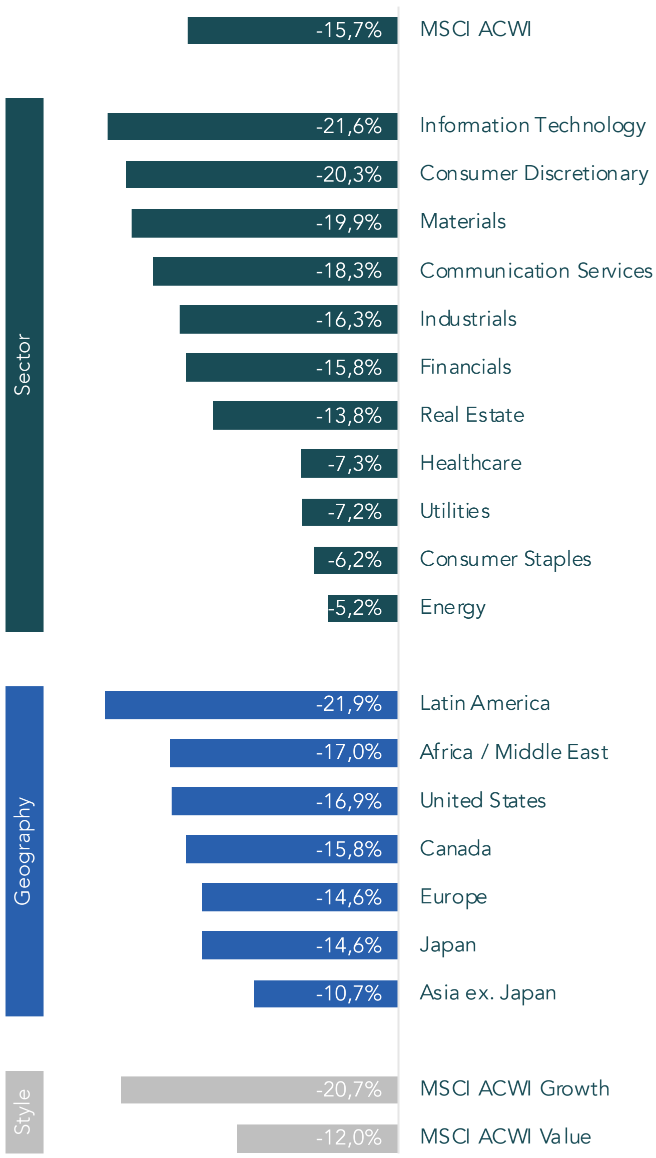


MARKET COMMENTARY

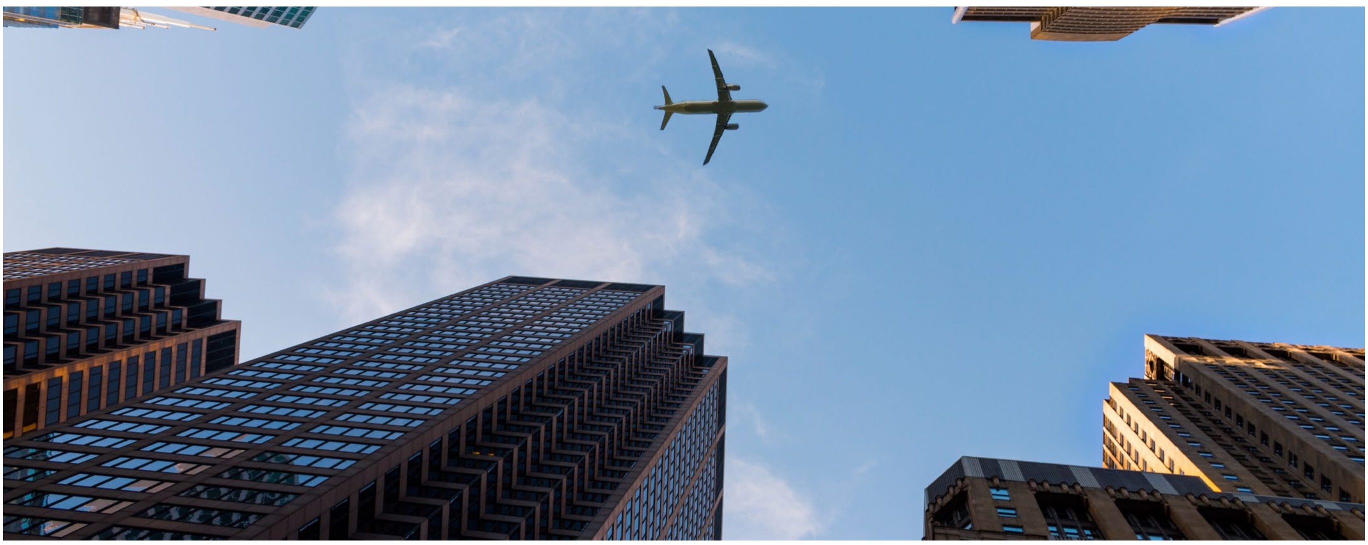
The second quarter of 2022 was an incredibly challenging period for investors as the MSCI All Country World Index, a broad measure of global equity markets, fell 16%. Stock prices experienced a sharp decline during the quarter as central banks opted to accelerate the pace at which they raise interest rates owing to historic levels of inflation which are proving to be stubbornly resistant. In what appears to be somewhat of a vicious circle and is adding further downward pressure to stock prices, is the possibility of a recession in the not-too-distant future, the likelihood of which increases as central banks continue to hike interest rates.

The persistently high level of inflation in both the US as well as Europe has seen their central banks, as well as many others across the globe for that matter, become increasingly hawkish. With US inflation still trending above 8%, the US Federal Reserve ("Fed") opted to raise interest rates by 50 basis points in May followed by an additional increase of 75 basis points in June, the highest single increase in nearly three decades. The UK continued with its trend of raising interest rates as the Bank of England implemented two 25-basis point increases during the quarter. In somewhat of a surprise for markets, for the first time in 15 years, the Swiss National Bank raised its benchmark rate. The 50-basis point increase saw the Swiss benchmark rate increase to minus 0.25% as inflation levels in the country reached 2.9%, their highest level in over a decade. The European Central Bank ("ECB") has to date kept its powder dry but with inflation in the region continuing to trend above 8%, the ECB now intends to raise its benchmark rate by 25 basis points in July with the possibility of an even larger increase in September.

MSCI Index performance (USD%)



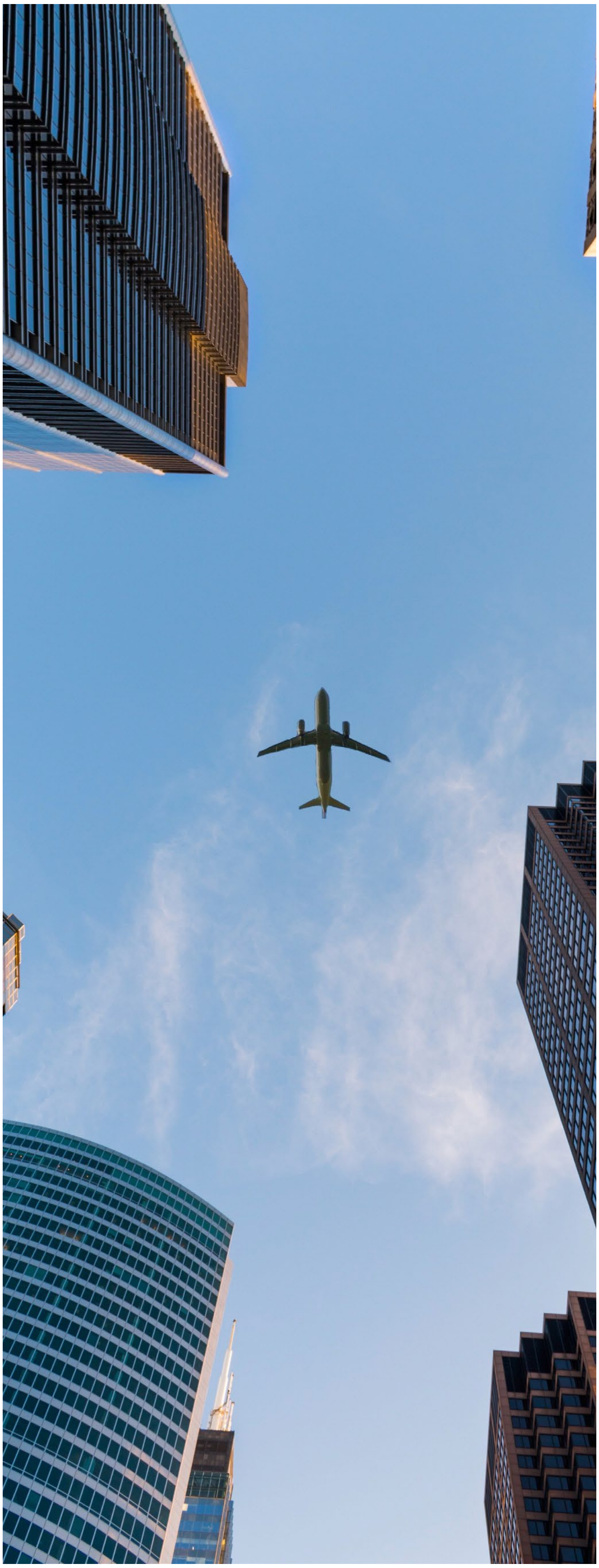
Source: FactSet



Not many stocks escaped the selling pressure during the quarter as the decline in stock prices was broad-based though some fared better than others. Though there were declines in the MSCI All Country World indices for Consumer staples (-6%), Health Care (-7%) and Utilities (-7%) their relative outperformance during the quarter suggests a pattern of investors positioning themselves for a potential recession. On the other end of the spectrum, stocks more closely associated with economic growth that are likely to underperform during a recessionary period were harder hit. As a result, there were steep declines for stocks within the Consumer discretionary and Industrials sectors as reflected by the respective declines in the MSCI All Country World Consumer discretionary (-21%) and Industrials (-16%) indices. The MSCI All Country World Financials index also fell heavily as even financials, which should benefit profitability-wise from higher interest rates, suffered with investors fearful of a stall in lending should a recession ensue. The stock prices of growth-orientated stocks have benefited from lower interest rates, especially during the pandemic, owing to their longer duration profile. It therefore follows that a rise in interest rates would have the opposite effect leading to relatively greater falls in their stock prices. As such, we saw large declines in many TMT (Technology, Media, and Telecommunication) companies leading to large declines in the MSCI All Country World Information technology (-23%) and Communication services (-18%) indices.

Following the onset of the Russian invasion of Ukraine, we saw a surge in commodity prices due to the prospect of supply shortages resulting from the conflict in the region. However, with central bank rate hikes serving as a potential brake to economic growth, demand concerns have counterbalanced those on the supply side leading to a cooldown in commodity prices, specifically certain industrial metals. The steep fall in the prices of the various metals was mirrored in the fall of global metal and mining stocks with the MSCI All Country World Metals and Mining Index falling 27% during the quarter.

One commodity-based segment that remains elevated is the energy sector. The impact of the US and Europe banning the import of Russian oil and gas has already been felt as the gap in supply saw the price of Brent crude climb above $120 a barrel. However, the potential impact of higher interest rates on economic growth led to concerns over demand for oil, pushing the price back down to $115 a barrel, still 7% higher compared to the end of the previous quarter. Despite the modest increase in the price of oil, stocks within the global energy sector declined during the quarter, as the MSCI All Country World Energy Index ended the period down 5%.



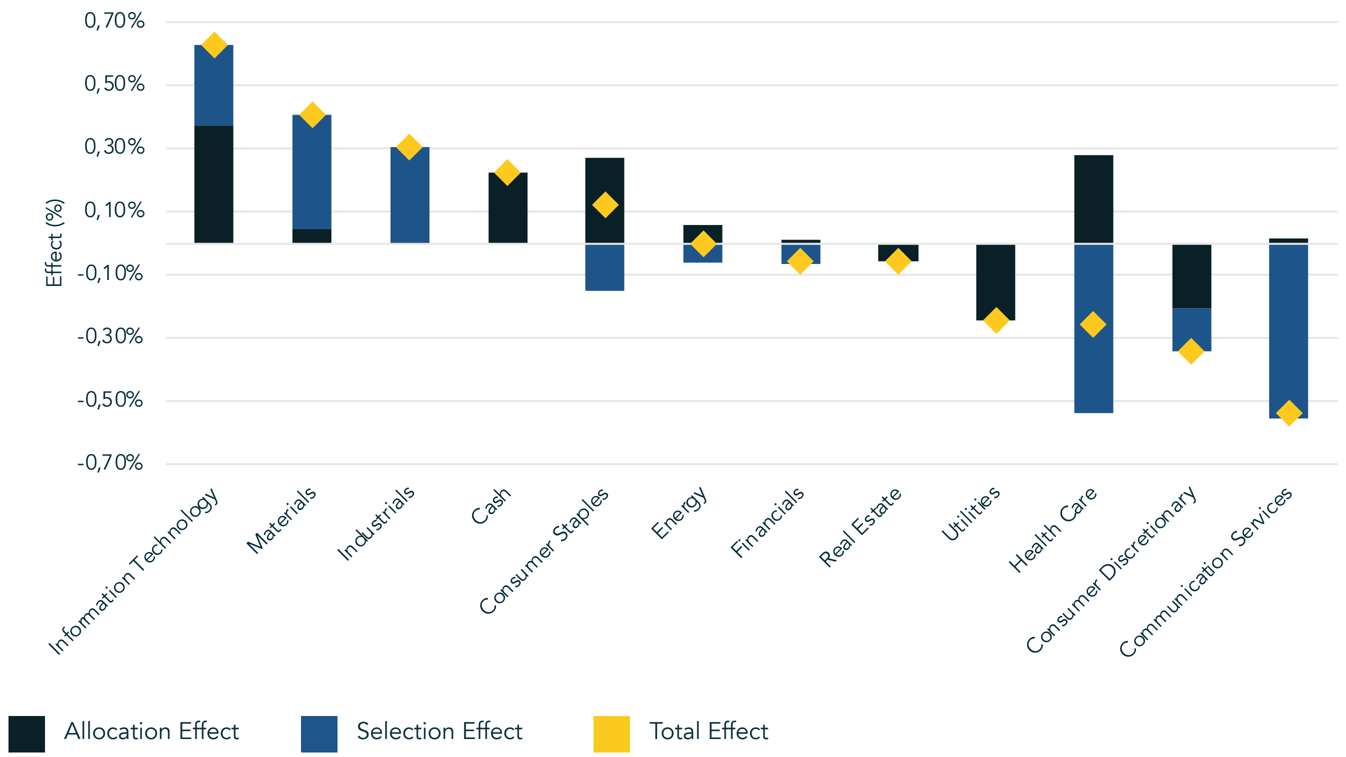
PERFORMANCE AND ATTRIBUTION

During the quarter, the SGEM declined 15.4% compared to a 15.7% decline in the MSCI ACWI. From a sector overview perspective, the outperformance by the SGEM during the quarter can be ascribed to the allocation effect (SGEM's weighting towards a sector relative to its benchmark, namely the MSCI ACWI). From a positive standpoint, the SGEM benefitted from its overweighting towards the Healthcare and Consumer Staples sectors as well as its underweighting towards the Information Technology sector. In addition, a positive weighting, albeit minor, towards cash also contributed in terms of a positive allocation effect. Slightly detracting from the positive allocation effect was the SGEM's lower relative weighting towards the Utilities, Energy and Real Estate sectors. These sectors outperformed the overall MSCI ACWI during the period and the SGEM has only one holding within these sectors, namely Shell.

Whilst the overall allocation effect during the quarter was positive, it was however slightly offset by an overall negative selection effect (specific stock selection). The main sectors detracting from performance in this regard were the Communication Services, Consumer Discretionary, and Healthcare sectors. Drilling down into the negative selection effects for the above sectors identifies the likes of Disney (Communication Services) and Amazon (Consumer Discretionary) as significant underperformers during the quarter.

In addition, despite the overall Healthcare sector outperforming the broader MSCI ACWI Index, we saw relative underperformance by certain Healthcare counters held within the SGEM, namely Medtronic, Philips and Roche. At this point, we would highlight that the SGEM exited its positions in both Medtronic and Philips during the quarter – see below "Changes in Holdings" for more detail. We do however remain confident in the prospects of Roche. The Swiss-based Pharmaceutical group experienced a setback during the quarter following disappointing results related to a cancer immunotherapy currently in its trial phase. The negative sentiment that followed the disappointing news was further compounded by the US Dollar strengthening against the Swiss Franc during the quarter. Despite the setback, Roche's still possess a deep and well-diversified pipeline of treatments and in our eyes remains a high-quality business capable of navigating a challenging economic environment.

Performance Attribution by Sector: SGEM vs. MSCI ACWI



Source: Morningstar

One particular thematic that is currently experiencing negative sentiment and that pertains to **Disney,** is that of "streaming". Netflix, the largest streaming company in terms of subscribers, reported a slowdown in subscriber growth during the quarter which led to a sharp fall in the company's share price. The negativity spilled over to other company's associated with streaming including the likes of Disney. It should be noted however that while Disney may have experienced a similar, though not as severe fall as Netflix, circumstances surrounding the media giant are somewhat different. To begin with, Disney reported better-than-expected growth in its subscriber base, which has now crossed the 200 million-mark. In addition, streaming is but one element of the Disney conglomerate and its in-person entertainment experiences, which include its world-famous theme parks, cruise ships as well as blockbuster theatrical releases, are returning to their pre-covid capacity levels.

While examining the performance of the SGEM from a sector perspective does provide useful insights towards understanding the underperformance, a more informative approach would be to examine the SGEM's style exposure, specifically to growth and value factors. Relative to its benchmark, the SGEM is relatively more exposed to stocks that can be considered higher quality when compared to the MSCI ACWI. In terms of growth, the SGEM's exposure to the growth factor was similar to that of the benchmark. The SGEM's exposure to the combination of the quality and growth factors meant that it held a relatively greater exposure to "quality-growth" stocks, which are typically more expensively priced than their value counterparts. Owing to the accelerated rise in interest rates brought about by central bank rate hiking, these faster growing, more richly valued quality stocks, which some may argue were already priced for perfection at best, fared worse than their more lowly-valued, cyclical counterparts. The underperformance of the MSCI ACWI Growth Index relative to its value counterpart visibly illustrates this point. As such, we saw larger relative declines in quality growth names such **Alphabet, Amazon, ASML, Diageo and Microsoft.**

In addition to higher interest rates, a number of shorter-term factors have created further downward pressure to the prices of these quality-growth stocks. Semiconductor stocks, which we believe still remain attractive over the long-term given secular tailwinds, are being impacted by a slowdown in PC equipment sales following a surge in demand people began working from home. In particular, semiconductor chips manufactured for "memory" purposes are experiencing demand and pricing pressures which has contributed to the underperformance of **Samsung**, the world's largest manufacturer of memory chips.

The driving factor behind increasing interest rates, inflation, has dented the operating margins for **Amazon**. The e-commerce giant enjoyed a tremendous pull-forward of growth during the pandemic era. Growth that would have taken place over a couple years took place in a matter of just over a year as e-commerce penetration accelerated during the pandemic. However, as the world has begun to return to some level of normality e-commerce growth, and consequently Amazon's retail business growth, has begun to decelerate, further compounded by elevated base effects related to growth. Amazon's margins have also been negatively impacted by its current level excess capacity. Amazon ramped up its staff count and warehouse space during the pandemic to cope with the significant pick-up in demand, demand which has begun to shrink forcing Amazon to rent out excess warehouse space and reduce heat count – all of which should be positive the company's operating margin going forward.

With the market positioning itself for a potential slowdown, possibly a recession, there was relative outperformance by more defensive sectors (Consumer Staples, Utilities, Healthcare), those that are expected to perform relatively better during such an economic environment. It is therefore no coincidence that the SGEM's better performing holdings **(Philip Morris, UnitedHealth, Johnson and Johnson)** are located within these sectors. In addition, the conflict in Ukraine continues to benefit defence contractors such as **Raytheon** as evidenced by its relative outperformance. The conflict has however served a catalyst for negative sentiment towards those countries and industries situated nearby. More specifically, fears over energy supply as well as a contraction in manufacturing have dented sentiment towards German companies thus accounting for the relative underperformance by German industrial conglomerate Siemens.

LEADING CONTRIBUTORS*			LEADING DETRACTORS*		
COMPANY	**GICS SECTOR**	**CONTRIBUTION (USD %)**	**COMPANY**	**GICS SECTOR**	**CONTRIBUTION (USD %)**
Philip Morris	Consumer Staples	0.2	Amazon	Consumer Discretionary	(1.6)
AIA	Financials	0.1	Berkshire	Financials	(1.1)
UnitedHealth	Healthcare	0.0	Alphabet	Communication Services	(1.0)
Johnson & Johnson	Healthcare	0.0	Disney	Communication Services	(0.9)
Raytheon	Industrials	(0.1)	Siemens	Industrials	(0.9)

Source: Morningstar

Note: * Only considers performance of stocks held for more than three months

CHANGES IN HOLDINGS

As mentioned, the sharp fall in equity markets has been particularly painful for companies that might have been considered "richly" valued, specifically those in the quality-growth cohort. We believe that companies falling into this bucket represent attractive long-term investment opportunities given their ability to compound wealth for shareholders. The relatively greater fall in price experienced by these companies means that many are currently trading at attractive levels, often at a healthy discount to their intrinsic value or "true" worth. With equity markets displaying negative sentiment towards these stocks, we opted to capitalise on the situation by investing in a few of these counters, specifically **Apple, Nike and Nvidia.**

Apple, one of the largest and most profitable companies in the world, at a reasonable entry point. The tech giant generates vast amounts of cash through the sale of its premium products, most notably the iPhone as well as MacBooks, iPads and wearables such as the Apple Watch and AirPods. While the majority of Apple's revenue still stems from these products, services, which includes App Store revenue, subscriptions to Apple Music and Apple TV as well as gaming, are becomingly an increasingly larger portion of Apple's revenue base

.

Nvidia is a semiconductor company with an incredibly exciting future ahead of it. Nvidia is the world's leading designer of GPUs (Graphics Processing Units). The company's products are best known amongst the PC gaming community for their ability to render incredibly detailed images on computer screens. Nvidia's semiconductors or "microchips" are designed to perform multiple complex calculations simultaneously which means that they are well-suited for another area in computing, fast growing in prominence, AI or artificial intelligence. Tech giants such as Amazon, Meta and Microsoft have an incredible thirst for GPUs as they are used for machine learning purposes, a branch of artificial intelligence, to recognise patterns such that they are able to recognise an image or enable Amazon's Alexa to understand what a person is saying when they order a pair of shoes online.

One brand of shoes that will not be sold on Amazon or at least the full range is **Nike** (pronounced "nai kee"). Nike's shoes are highly sought after and the company is able to command a premium for their products owing to incredible brand strength. The world's largest footwear company, whose brand is best displayed by the sport stars that endorse the brand, has significantly invested in a direct-to-consumer approach which has seen its digital initiatives (Nike app) experience tremendous growth having reduced exposure to many third-party retailers. By moving closer to the consumer and growing its membership base via digital channels, Nike will be able to grow its already healthy gross margin and maintain its long history of generating high returns on capital thus creating value for shareholders.

To establish positions in these attractively priced, quality-growth names required that we exit certain positions to free up cash to establish meaningful weightings. As a result, we have decided to exit our holding in companies that we have grown less confident in, be it due to uncertainties that are operational, management-related or growing geopolitical risks. Those that we sold during the quarter and no longer have a position in are medical equipment companies Medtronic and Philips as well as Chinese e-commerce giant Alibaba.

We decided to exit our positions in **Medtronic** and **Philips** owing to concerns over their respective management's ability to meaningfully increase shareholder value. Relative to many of their peers in the medical technology field, free cash flow generation by Medtronic and Philips has been pedestrian at best despite the competitive advantages that they both possess in a number of medical device segments. In the case of Philips, we had also grown concerned over management's ability to deal with a recall on specific sleep apnoea devices and the potential danger they may present to users. Whilst the recall itself may open the company up to costly liabilities, the manner in which management have to date handled the situation, specifically their communication thereof has left us feeling uneasy and cast doubt over their ability to steer the ship in the right direction. We do however remain positive on the overall Healthcare sector but believe that your capital will be better deployed elsewhere.

Alibaba, once China's largest company by market cap, has endured a torrid period of scrutiny since Chinese authorities began to shine a spotlight on the company beginning with the scuppering of the proposed listing of Alibaba's payment platform, Ant Group, in November of 2020. The ruling party in China has come down with an iron fist on influential companies and their outspoken CEO's, specifically within sensitive sectors such as technology. Alibaba has also had to deal with the added challenge of increasing competition within e-commerce which has forced Alibaba to reinvest more into the business to protect a space that it dominated not too long ago. Alibaba remains a wonderful company and with the largest population on Earth as your consumer base, the potential to continue to grow remains attractive. That said, the political interference we have seen from the Chinese government remains a concern and left us feeling wary of investing directly into Chinese companies at this point in time. In addition, the intense competition that Alibaba faces within the region we believe will continue to place pressure on its ability to achieve growth rates seen in prior years.

POSITIONS ESTABLISHED		POSITIONS SOLD	
COMPANY	**GICS SECTOR**	**COMPANY**	**GICS SECTOR**
Apple	Information Technology	Alibaba	Consumer Discretionary
Nike	Consumer Discretionary	Medtronic	Healthcare
Nvidia	Information Technology	Philips	Healthcare

Source: FactSet

OUTLOOK AND WAY FORWARD

The second quarter of 2022 has been particularly challenging for global equities. Over the past few years, particularly during the pandemic period, equities have benefited from monetary support from central banks but the withdrawal of this assistance and the hiking of interest rates in the wake of rampant inflations will make the forthcoming economic environment particularly challenging for companies.

We believe that the companies held within the SGEM are well-suited to weather an environment where high levels of inflation impact company profit margins. Many of the companies that we are invested in possess strong competitive advantages and are relatively better positioned than their peers to pass on increased costs to their customers.

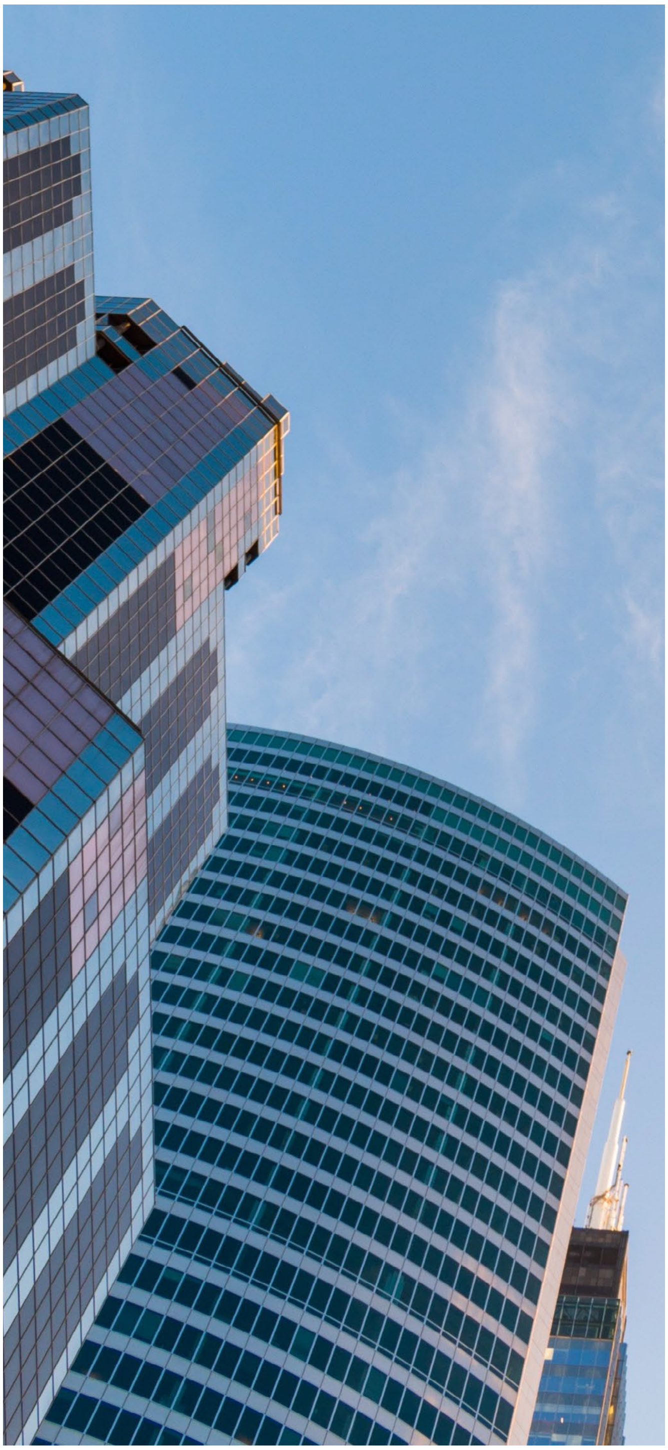
Higher interest rates my derail economic growth but there are many structural themes that are still likely to play out, albeit at more normalised rates of growth. Our exposure to key thematics, which we expect will provide long-term tailwinds towards the growth in earnings and more importantly cash flows for our companies, include the likes of artificial intelligence, cloud computing, automation, digital payments and e-commerce.

That said, we remain ever mindful of a number of systematic risks that have grown in prominence more recently. Geopolitical events such as the Russian invasion of Ukraine and perhaps even more concerning, the escalating tensions in the South China Sea region over a potential invasion of Taiwan by China. We continue to monitor these risks closely and will react accordingly as the threat level from systematic risks shift.

Regardless of the economic environment and associated risks, our approach to how we invest remains the same. We have and will continue to invest in companies that we believe are high-quality businesses, underpinned by defensible economic moats, and possess attractive growth prospects within their industry. We are however, not of the mind to follow a GAAP approach – Growth At Any Price.

We spend a large amount of time trying to understand what we believe a company is worth given the quality, growth prospects and risks to the business. This will inform the decision as to what price we are willing to pay should we choose to invest.

While the sharp fall in equity prices that we have recently experienced has been painful, we are excited by the investment opportunities that we were able to execute. Many other high-quality businesses that meet our criteria but have proven too richly-valued to invest in are now trading at more attractive price levels and we will continue to monitor these companies for potential investment opportunities.



PORTFOLIO CHARACTERISTICS					
	SGEM	MSCI ACWI		SGEM	MSCI ACWI
Quality			**Valuation**		
ROE	39.9%	16.0%	P/Earnings	20.8x	13.9x
ROIC	22.0%	8.6%	P/Book	6.2x	2.3x
EBIT	25.0%	14.5%	P/Sales	4.3x	1.7x
Gross Profit	48.9%	35.0%	FCF Yield	5.5%	5.8%
Growth			**Risk/Volatility[2]**		
Sales growth[1]	7.3%	4.2%	Beta	0.75	0.77
Earnings growth[1]	18.3%	6.8%	Std Deviation	18.1	17.9
Size & Turnover			Sharpe Ratio	0.63	0.55
Market cap	USD498bn	USD313bn	Sortino Ratio	0.74	0.62

Source: FactSet, Morningstar

Notes:

1 - Trailing twelve months 3-yr annualised growth rate

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

TOP ADVICE BROKER

intellidex®

2020 | 2021

sasfin.com