Sasfin Global Equity Model (SGEM)

Quarterly Review – Q1 2023:
1 January 2023 - 31 March 2023

Securities

sasfin.com

PERFORMANCE

Total Return (%) - Period ended 31 March 2023

	Quarter	YTD	1 Year	3 Years[1]	5 Years[1]	Since Inception[1, 2]
SGEM	8.7	8.7	(4.6)	11.8	7.7	9.0
MSCI ACWI[3]	7.3	7.3	(7.4)	15.4	6.9	7.4

Source: Morningstar
Note:
1 – Annualised
2 – Inception date: 31 December 2014
3 – MSCI All Country World Index

Portfolio Positioning (% Weight)

Sector	SGEM	MSCI ACWI	Under/Over (%)
Cash	3.6	-	
Consumer Discretionary	14.7	11.1	
Financials	17.2	13.9	
Consumer Staples	9.8	7.5	
Industrials	11.2	10.2	
Health Care	12.7	12.3	
Materials	4.0	4.9	
Communication Services	6.4	7.3	
Energy	3.1	5.0	
Real Estate	-	2.4	
Utilities	-	2.9	
Information Technology	17.2	22.5	

Source: FactSet

MARKET COMMENTARY

Global equities enjoyed a positive start to the year as the MSCI All Country World Index, returned 7.3% during the first quarter of 2023. Market participants have grown increasingly confident that the US Federal Reserve's ("Fed") rate hiking cycle will soon come to an end. Factors supporting the market's current view include the continued deceleration in inflation levels as well as the recent turmoil in the banking sector.

Evidence continues to suggest that inflation in the US has peaked, as the annualised US CPI level fell from 7.1% in November of last year to 6.0% in February. Core inflation, which excludes pricing changes in energy and food, decelerated from 6.0% to 5.5%. Despite the downward trend, high levels of inflation are still proving to be somewhat sticky and many Fed officials continued to voice their support for further rate hikes.

That was until the emergence of the recent banking turmoil, complicating matters for the Fed, as well as other central banks. To date, two mid-sized regional US banks have failed, a third was on the brink of failure before intervention from other large US banks and Swiss authorities forced ailing Credit Suisse to merge with its bitter rival UBS to prevent the banking giant from an almost certain collapse. There are a number of reasons that led to depositors fleeing and trust evaporating for the banks but the rate hiking by central banks certainly played its part. Further rate hikes could lead to additional strain in the sector, resulting in even more banking casualties, giving central bank officials reason for pause on future increases.

The bond market seems to believe that at this point, the rate hiking cycle may be coming to an end as evidenced by the fall in longer-term bond yields. The US 10-year benchmark fell close to 40 basis points as it ended the quarter at 3.49% and the US 10-Year real interest rate, which strips out inflation, fell slightly more than 40 basis points to end the period at 1.16%.

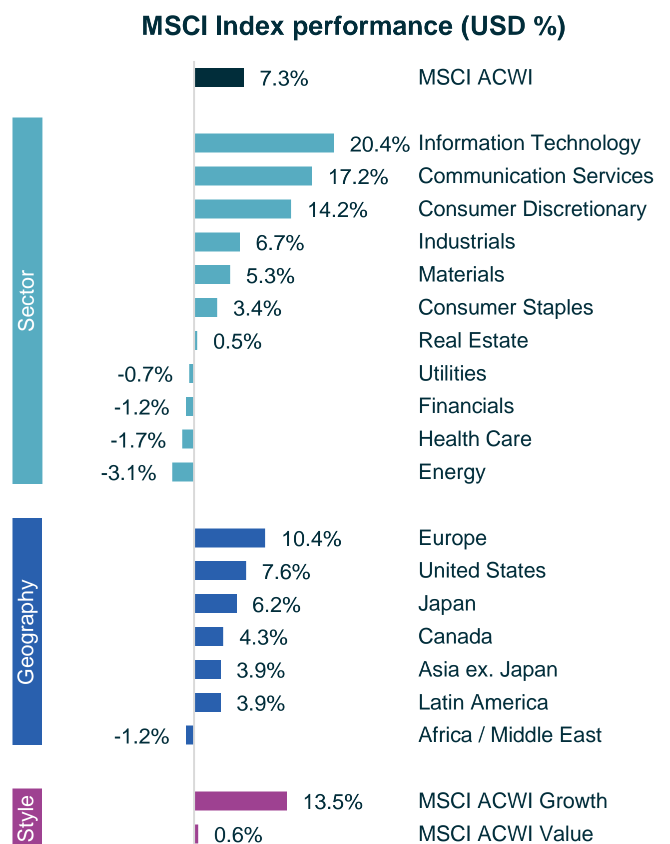
Long duration stocks, those whose cash flows lie further out into the future such as growth stocks, benefitted from the fall in longer-term yields. Technology stocks generally possess a growth tilt thus accounting for the strong gains in the Information Technology sector as well as the Communication Services sector which includes Big tech names such as Alphabet, Meta, Netflix and Tencent. Similarly, the Consumer Discretionary sector includes technology-like counters that benefitted from lower interest rates such as Amazon, Alibaba and Tesla (for those that consider the EV maker "tech-like").

Gains in growth stocks came at the expense of stocks that are more value-orientated, specifically those that are less volatile and more defensive in nature. This is evidenced by the quarterly underperformance of the Consumer Staples, Health Care, Real Estate and Utilities sectors.

Financials also underperformed during the quarter as the emergence of a potential banking crisis dragged the sector down. The fallout from the banking sector spilled over into oil markets with some fearful that a banking crisis could result in declining economic growth, leading to lower oil demand. Both Brent crude and WTI fell to around the $70 a barrel level before recovering somewhat to close the quarter out at $80 and $76 a barrel respectively, still below their opening price levels at the beginning of the year.

One commodity that has reacted positively to the banking sector jitters is gold. Fearful over the stability of regional US banks, many have piled into the safe haven hard currency asset, briefly pushing its price above $2,000/oz, whereafter it pulled back slightly to close the quarter at $1,980/oz. Bullion does not offer a yield and therefore the recent fall in real interest rates has also added to its allure.

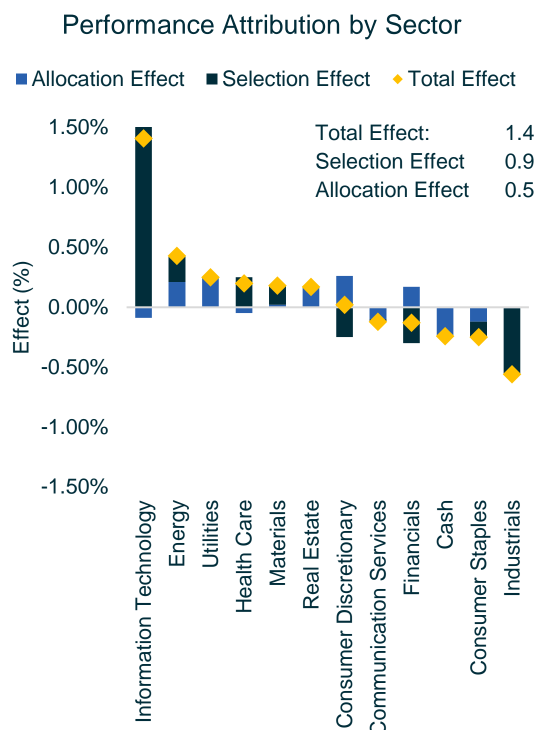
MSCI Index performance (USD %)



Source: FactSet

PERFORMANCE AND ATTRIBUTION

The first quarter of 2023 was once again positive for global equity markets as well the SGEM which outperformed its benchmark (MSCI ACWI) having returned 8.7% during the period.



Source: Morningstar
Note: Attribution based on combined performance of all share classes

The relative outperformance against the benchmark can largely be ascribed to the Selection Effect. This is the portion of the outperformance which is based on the returns of specific stocks selected to be included in the SGEM and their individual weightings in the SGEM relative to their weightings in the benchmark. While the Selection Effect was mixed across sectors, with Industrials in particular detracting from positive relative performance, there was a standout positive contribution from the Information Technology sector.

The Allocation Effect, which indicates the portion of the outperformance that can be attributed to the SGEM's over or under weighting of sectors relative to the benchmark was also positive for the quarter. Contributions were mixed across sectors with notable positive contributions stemming from relative underweighting's towards underperforming sectors such as the Energy, Real Estate and Utilities.

Stocks within the Information Technology sector, which are generally considered longer duration in nature, benefitted from falling longer-term interest rates, specifically the US 10-year real interest rate. The SGEM's holdings within this sector include semiconductor names such as **ASML** and **Nvidia**, as well as Big tech giants **Apple** and **Microsoft**, all of which experienced sizable gains during the quarter. While not included in the Information Technology sector, other Big tech companies held by the SGEM, specifically **Alphabet** (Communication Services) and **Amazon** (Consumer Discretionary), were also lifted higher by falling interest rates.

By far and away the best performing stock within the SGEM during the quarter was Nvidia. The company, which is best known for its GPU's ("Graphic Processing Units"), saw its stock price nearly double during the first three months of the year. Some perspective is however necessary when evaluating this sizable gain. The stock was actually down more than 50% last year as investors fretted over excess supply of semiconductor chips leading to steep falls in many semiconductor counters. In the case of Nvidia, excess inventory was written down owing to weaker than expected demand in gaming as well as a significantly reduced use case of GPUs for cryptocurrency mining purposes. In addition, concern over the impact of export restrictions to China by the US government on certain high-end AI chips cast an even darker cloud over the chip company.

Sentiment towards Nvidia has however shifted dramatically in recent months and the driving force behind the turnaround is the rapid proliferation of ChatGPT. When ChatGPT, an AI-powered chatbot, launched late last year, it signalled the next evolution in AI, what Nvidia CEO Jensen Huang has dubbed the "iPhone moment" for AI. According to UBS, ChatGPT became the fastest growing application in history, having reached 100 million users in just two months. For context, it took Instagram nearly three years to accomplish such a feat and TikTok was "only" able to do it in nine months. What is relevant about ChatGPT, as far as Nvidia is concerned, is that the computer models that were developed and trained to support ChatGPT were done so using Nvidia chips.

While they may have held up relatively well last year amidst rising interest rates, low volatility ("Low Vol") defensive stocks underperformed during the quarter as investors rotated into longer duration or growth areas of the market. Sectors that are generally considered to be Low Vol and defensive in nature include Consumer Staples, Health Care, Real Estate and Utilities, all of which underperformed the broader market during the quarter. In the case of the SGEM's holdings, the relative underperformance came through in the form of more defensive Health Care sector names such as **Johnson & Johnson** and **UnitedHealth.**

Consumer Staple holdings such as **Diageo**, **Nestlé** and **Philip Morris** also underperformed the broader market, though their underperformance was less pronounced than that of our defensive Health Care counters.

Certain Industrial sector names held by the SGEM, that could be considered Low Vol defensives, were also underperformers during the quarter and they include defense contractor **Raytheon** as well as industrial conglomerate **Honeywell**.

It should come as no surprise that the largest underperforming stock during the quarter was **Bank of America**. Despite rumblings of further troubles within the sector, fears over further contagion seem to have been quelled, at least for now. It is also worth pointing out that Bank of America is in a much stronger position than the regional US banks that failed or that might have an asterisk in their margin.

Unlike depositors in small and mid-sized banks, Bank of America depositors are quite sticky and less likely to withdraw their deposits. In addition, Bank of America is significantly better positioned from a solvency perspective. Post the financial crisis, regulatory authorities lifted the threshold for banks that would be subject to stricter liquidity and solvency rules which meant smaller banks, such as those that failed, were able to hold significantly lower proportions of highly liquid capital in reserve. In contrast, large banks like Bank of America are required to hold a much greater portion of their assets in highly liquid capital reserves.

Beyond being better capitalised, the Bank of America management team, led by CEO Brian Moynihan, is regarded as one of the best on Wall Street, certainly more capable than the revolving door of managers that have been through Credit Suisse.

Our confidence in Bank of America aside, we main cognisant of potential financial losses that may arise within the banking sector. It is common practice in banking for the maturities of their assets (long-term maturities) and liabilities (short-term maturities) to be mismatched, a model that works well in “ordinary” environments where longer term interest rates are higher than the short-term.

However, an environment when the yield curve is inverted – shorter term yields exceed the longer term – can lead to weaker profitability for banks and in severe cases, as we have already begun to see, significant financial losses.

TOP PERFORMING STOCKS			BOTTOM PERFORMING STOCKS		
COMPANY	**GICS SECTOR**	**CONTRIBUTION (USD %)**	**COMPANY**	**GICS SECTOR**	**CONTRIBUTION (USD %)**
Nvidia	Information Technology	2.3	J&J	Health Care	(0.5)
LVMH	Consumer Discretionary	1.2	Honeywell	Industrials	(0.4)
ASML	Information Technology	1.0	UnitedHealth	Health Care	(0.4)
Microsoft	Information Technology	0.9	Bank of America	Financials	(0.4)
Siemens	Industrials	0.8	Home Depot	Consumer Discretionary	(0.2)

Source: Morningstar

CHANGES IN HOLDINGS

There were no changes in holdings during the quarter.

OUTLOOK AND WAY FORWARD

The evolving macroeconomic environment, which has now shifted towards a deceleration in the rate of inflation as well as a fall in longer-term interest rates, has been a boon for long duration stocks. Our philosophy of focusing on quality growth businesses means that many of our holdings benefited from this recent trend given that they are of longer duration in nature. While we will gladly accept the positive outcome for the portfolio, it is important that we remain grounded by our investment process which determines where our focus should be directed.

We must therefore remind ourselves that as influential as macroeconomic variables such as interest rates are on stock returns, they are incredibly difficult to predict and nigh on impossible to forecast over the long-term. Instead, our focus must remain directed towards the fundamental factors that affect businesses and the industries within which they operate. These are the factors that ultimately determine the earnings or as we prefer, the cash flows, that a company is able generate over the long-term. Growth in earnings or cash flows is arguably the single largest determining factor in the long-term performance of a stock.

It is for this reason that we prefer to focus on quality growth businesses. This type of company would have demonstrated a track record of being able to consistently grow its cash flows over time and there is a high likelihood that it will be able to continue to do so over the long-term. Businesses that fit this quality growth description tend to generate high returns on capital. This in turn results in sizable cash flows that can be reinvested back into the business to protect or grow the company's economic moat, thereby sustaining the high returns on capital. A cursory view of our portfolio characteristics will clearly show that our holdings generate higher returns on capital than the broader market, a clear sign of our quality tilt.

Growth pairs well with high returns on capital as the more a business is able to reinvest at high returns on capital, the more cash it is able to generate and the more valuable a company will become.

At this point it is worth noting that the current outlook for global growth is quite depressed to say the least. A review of our portfolio characteristics shows, that on average, the companies held in the SGEM tend to grow at faster rates than the broader market. Many of these businesses are located within industries with above-average growth rates underpinned by secular growth trends that are likely to persist, regardless of the economic environment.

An element of quality growth companies that is often underappreciated, at least until the moment arises during a period of crisis, is their solid financial standing. A quality growth business will possess a strong balance sheet and is able to generate cash flows on a sustainable basis enabling the firm to weather challenging market conditions, certainly better than most. The banking turmoil that unfolded towards the end of the quarter would have sent shivers down the spine of those that lived through the Global Financial Crisis. For now, the contagion risk seems to have been contained but one cannot rule out the possibility that there may still be a number of underwater bombs currently exploding, damaging the already strained financial plumbing of global monetary systems, the consequences of which will only emerge at a future date.

Of course, owning companies that offer high returns on capital, growth and financial stability does come at a price. The portfolio characteristics show that our holdings are on average more expensive than our benchmark across all relative multiple valuation metrics and the recent strong performance of longer duration stocks exacerbated the valuation gap. The price to earnings multiple is the most widely used metric when assessing relative valuations but we would argue that a metric such as the free cash flow ("FCF") yield is even more relevant given our preference of cash flows over earnings. Referencing this metric, the difference between our portfolio and the benchmark is not that different yet our holdings are on average superior in terms of both quality and growth.

OUTLOOK AND WAY FORWARD (cont.)

As to whether we will experience another crisis, the truth is we do not know. The contagion risk in the banking sector seems to have been contained for now but perhaps we have witnessed the beginning of a credit crunch that could lead to a spate of defaults. We do know that markets go through cycles and there will be peaks and troughs but predicting these points almost requires an element of hindsight.

There will almost certainly be other shocks to the system which again, we cannot predict. What we can do is hold companies that are better equipped to cope during periods of strain, often emerging stronger than their lower-quality peers.

We also cannot say with any degree of certainty as to when inflation will return to historical levels, if at all, or whether we could re-enter a period of deflation. What we can do is hold companies that are able to manage periods of higher inflation or deflation better than others.

During periods of higher inflation, businesses that possess superior pricing power are able to pass on higher input costs to their customers. In a deflationary environment, companies with pricing power are able to raise prices in a low-price world. For the most part, the quality growth companies that we hold are able to wield pricing power owing to their strong brands, high switching costs or superior cost advantages.

PORTFOLIO CHARACTERISTICS					
	SGEM	**MSCI ACWI**		**SGEM**	**MSCI ACWI**
Quality			**Valuation**		
ROE	33.9%	16.0%	P/Earnings	25.5x	15.6x
ROIC	20.3%	8.1%	P/Book	9.4x	2.4x
EBIT	23.4%	13.9%	P/Sales	5.7x	1.8x
Gross Profit	48.4%	34.3%	FCF Yield	4.4%	5.0%
Growth			**Risk/Volatility**		
Sales growth	8.5%	6.1%	Beta	0.9	0.9
Earnings growth	10.1%	6.8%	Std Deviation	14.6	15.4
Size & Turnover			Sharpe Ratio	0.6	0.5
Market cap	USD518bn	USD350bn	Sortino Ratio	0.9	0.7

Source: FactSet, Morningstar
Notes:
1 – Trailing twelve months 3-yr annualised growth rate
2 – Risk statistics calculated since SGEM inception (31 December 2014)
3 – SGEM Quality, Valuation and Size characteristics calculated using weighted averages, SGEM Growth characteristics reflect median values

sasfin.com

Disclaimer

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

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

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

Sasfin Asset Managers (Pty) Ltd Reg no. 2002/003307/07
Directors: MEE Sassoon* RDEB Sassoon*# (*Non-executive #British)
An authorised financial services provider licence no. 21664
and a member of the Sasfin Group.