South African Market

Macro-Economic Insights

In March locally listed equities contracted due to the impact of the slowing local economy and global banking troubles, resulting in a decrease in risk appetite. The FTSE JSE/ALSI ended the month down (1.26%), primarily due to the financial sector that registered a return of (6.42%). The industrial sector also contributed to the decline, posting a return of (1.22%). However, the resources sector experienced marginal growth, rising 0.7% due to a recovery in gold and other commodity prices. South African listed property also suffered, down (3.7%) falling for the third consecutive month.

After 4 months of declines, South African inflation accelerated, above expectations, with both headline and core CPI ending YoY higher at 7.0% and 5.2% respectively. In light of mounting inflationary pressures, the South African Reserve Bank caused a stir in the market by unexpectedly hiking the repo rate to 7.75%, an increase of 50 basis points (independent economist consensus had been for a 0.25% increase). The Reserve Bank Governor, Lesetja Kganyago, emphasized that inflation is still a significant threat and that the issue is being compounded by continuing power cuts.

The Rand firmed up against the Dollar towards the end of March appreciating by 3.35% to end the month stronger at R17.74, which can be attributed to a weaker Dollar and the recent rate hike by the SARB. The ALBI ended the month up 1.32% and 3.39% Year-to-Date, for its strongest start to the year since Covid. Although the recent rate hike was higher than anticipated, South African 10-year government bond yields ended the month with a slight reduction to end the month at 11.1%, as they gained from the decline in global bond yields.

Fund Manager Insights

Locally as well as globally, one of the major concerns was the recent mini banking crisis centered around American and European banks, and how the contagion in the local banking sector was shaking up. In this context we want to share how STAR Investment Partners approach our exposure to offshore banks and the strategies that our underlying fund managers are implementing for risk mitigation in the current environment.

Taquanta Asset Managers mandates within the STAR Funds have limited exposure to offshore banks via short term call accounts and deposits with the local branches of the offshore banks. Historically, they have not invested in the capital instruments of the offshore banks as part of their credit strategy. There has not been, at present, a contagion to the local South African banking sector from the offshore banking crisis, where they have meaningful exposure in the local banks and in the capital instruments. They have also historically held a very low position in corporate credit in the strategy, owing mainly to the tight pricing of quality credit in the local domestic debt market. Consequently, the credit strategy has maintained a low duration of less than 0.25 with the investments being primarily floating rate instruments linked to 3-month JIBAR and going forward no changes are expected in the duration positioning.

Spreads and yields in the domestic corporate debt market continue to be driven by the low supply vs excess demand for assets. Despite the challenging economic environment, they expect spreads in corporate credit space to remain contained and as such do not expect to make significant changes to their corporate credit allocation.

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In terms of their current CPI outlook (3-6 months out), the risks are now tilted to the downside. Subdued levels of aggregate demand reduced supply-side disruptions and falling global liquidity levels largely underpin this view. Market expectations have also moderated significantly, further buoyed by high base effects to inflation. Over the next two quarters, they expect U.S. and SA's y/y inflation to ease from 3.4% to 3.1%, and 5.9% to 4.8%, respectively.

Saffron Wealth added that in relation to the recent global banking crisis both the ECB and the BoE have emphasized in a historic statement that shareholders would be the first to bear losses before Additional Tier 1 (AT1) holders are affected, as part of reforms enacted after the global financial crisis. Similarly, SARB has issued Guidance Note 6/2017, which specifies that the same principle applies in South Africa, so that AT1 holders will not face losses before common equity holders. Therefore, it is expected that any negative effects from the international AT1 market will be limited inside South Africa. Recent supportive statements from both the BoE and ECB have served to quell market panic and provide a base for recovery.

The strategy within the portfolio is therefore to retain the GBP/USD AT1 positions unless they see further material deterioration in the news flow/metrics. Notwithstanding bank specific risks, history would indicate that AT1 instruments tend to recover to above previous price levels. Specifically, with regard to their current Investec position, they have recently seen domestic AT1 spreads tightening versus their widening offshore comparables, lending support to the expectation of reversion potential. Current yields on the AT1 instruments are c. 21.0% p.a.

Saffron CPI outlook over the next 6 months is that although inflation has peaked it will not be a straight line back to “normal” levels as evidenced in the volatility of the US Forward rate curve. Their view is that the market has been too optimistic on normalised policy rates and that US rates will be more stubborn at these higher levels over the next 6 months.

More than half of the ***PortfolioMetrix*** current portfolio is invested in money market and floating rate instruments, that continues to currently benefit from rising interest rates. Their fixed rate bond exposure of 43% is providing higher yields in the current market environment. They continue to maintain a high level of liquidity in their fund to be able to manage the risk in a volatile market. Markets initially reacted nervously as ghosts of the Great Financial Crisis of 2008 threatened to reappear with this recent banking crisis. However, the intervention of the US Federal Reserve as the lender of last resort halted the contagion causing markets to settle down, but they remain on alert. Their funds current gross running yield of 11.2% remains attractive in both absolute terms and relative to cash. The aggregate duration is currently 3.8, which indicates an interest rate volatility of just over half of the All-Bond Index, which has a current duration of 6.1.

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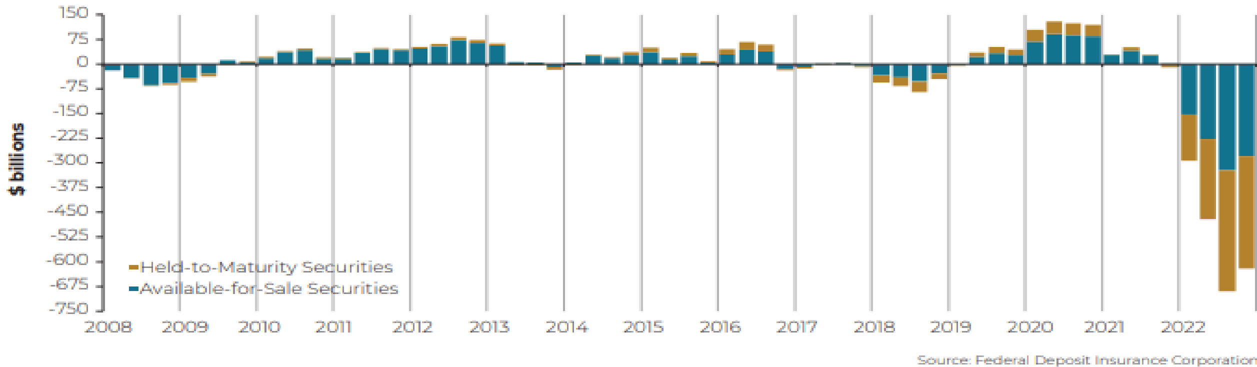
Unrealized Losses and Gains in US Banks:



The above graph illustrates how US bank deposits surged between 2020 and 2021. In the aftermath of this, the banks were faced with the challenge of what to do with this excess cash, as demand for loans was low during Covid and beyond. They decided to maximise returns and increase their holdings of government fixed income securities that offered higher yields than near zero cash, effectively betting that interest rates would stay low for many years ahead. However, this strategy led to a problem as these securities fell sharply in value due to the Fed's decision to hike interest rates to combat rampant inflation. This soon developed into a major problem for certain banks that were now sitting with billions of Dollars in unrealized losses, and banks such as SVB which had particularly high holdings in these long-dated fixed rate bonds. The unrealized losses wiped out the capital bases of these banks forcing their collapse.

Asset Class Performances in ZAR

As of 31st March 2023	MTD	YTD	1 Year	3 Years*	5 Years*	10 Years*
Global Equity – MSCI ACWI	(0.94)	11.62	12.58	15.93	16.06	15.87
Global Property - FTSE EPRA NAREIT DR	(6.58)	5.33	(4.95)	7.61	10.85	11.04
Global Bond - JPM GBI Global Traded	0.15	7.49	10.50	(5.52)	6.20	6.42
Global Cash - ICE LIBOR 1 Month	(2.95)	5.49	25.16	0.90	10.07	7.91
SA Equity - FTSE/JSE All Share	(1.26)	5.17	4.90	24.20	10.42	10.22
SA Property - FTSE/JSE SA Listed Prop	(3.39)	(5.05)	(3.36)	18.19	(4.10)	1.35
SA Bond - BEASSA ALBI	1.32	3.39	5.83	11.63	6.90	7.31
SA Cash - STeFI Call Deposit	0.59	1.70	5.71	4.37	5.25	5.64

ZAR/USD (negative = Rand strength)	(3.35)	4.30	21.31	(0.09)	8.39	6.74
Gold	3.58	11.41	18.46	4.53	14.45	7.23
Brent Crude Oil	(8.09)	(3.18)	(10.24)	51.61	11.19	3.50

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Global Markets

Macro-Economic Insights

Global Markets experienced a volatile month due to investor fears of contagion in the banking sector. Although the banking sector is not yet in the clear, the markets have taken relief in the fact that no further problems have arisen. As a result the MSCI ACWI ended the month up 2.49%, with the MSCI Emerging Market index and MSCI Developed Market Index returning 2.7% and 2.8% respectively.

The March US CPI report fell in line with expectations, with no surprises on the inflation front. Annual inflation in the US has consistently slowed since the start of the year, with a further drop to 6.0%, from 6.4% the previous month, this is also the lowest inflation has been since September 2021. Despite the turbulence in the banking sector, the Federal Reserve maintained its focus on inflation and decided to raise rates by another 25 basis points at their meeting in March, bringing the Interest rate to a range of 4.75% to 5.0%. The rate hike at eight straight meetings marked the most rapid increase since the early 1980s and possibly contributed to the banking crisis, raising the risk that another increase could deepen global banking troubles.

After 3 months of declines, the UK Inflation rate jumped in March to 10.4%, up from 10.1% the previous month as food and energy bills continued to rise, placing further pressure on households. The latest quarterly GDP data revealed that the UK economy had not contracted in Q4 2022, contrary to consensus expectations. As a result, the economy dodged a technical recession. Since that time, wholesale energy prices have fallen considerably as the European energy crisis has abated.

In March, there were three instances of midsized US banks failing. As a result, global bank stock prices experienced a sharp decline and regulators swiftly responded to prevent the potential spread of the issue. Among the failed banks were Silicon Valley Bank (SVB) and Signature Bank, which collapsed due to a bank run on mid-sized lenders. This caused SVB to become the second largest bank failure in US history. Furthermore Credit Suisse, a Switzerland-based global investment bank, announced its biggest annual loss since the 2008 financial crisis, causing its largest investor, Saudi National Bank, to cease its support of Credit Suisse. This led to a 25% drop in Credit Suisse's share price, forcing the Swiss National Bank to initiate a consolidation of Switzerland's two largest lenders. Consequently, UBS purchased Credit Suisse.

Fund Manager Insights

Despite the Scottish Mortgage Investment Trust’s recent share price declines, the Baillie Gifford managed investment Trust continues to remain a firm favourite among long term investors as the Trust primarily invests in high-growth, innovative stocks and have been particularly well-suited to the current era of rapid technological change and innovation. Their aim is to invest in great growth companies, whether they are public or private. Many of the trust’s biggest holdings have seen a recovery recently after a signifacant drop last year, especially with tech stocks, which delivered double digit returns in March. The Trust also have a significant allocation to private companies, with the current allocation now accounting for close to 30% of its total portfolio value. Over the past five years, the stock has returned 11.5% per annum including dividends, while the trust’s NAV has risen 13.8%. Over the past 10 years the performance has been even better producing a return of 18.2% per annum.

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All of the private holdings were revalued at least three times last year, implying that valuations are now realistic. Listed holdings account for 70% of the portfolio, and two- thirds of these are profitable businesses. At Star we see Scottish Mortgage as an ideal and inexpensive way to get exposure to some of the best current and future growth and innovation opportunities.

Below is a video containing current insights into Scottish mortgage Investment Trust thinking:

At Fundsmith Equity & Smithson Investment Trust we get the same three step investment process. 1. Only invest in good companies, which they describe as: high quality businesses that can sustain a high return on operating capital employed; businesses whose advantages are difficult to replicate; businesses which do not require significant leverage to generate returns; businesses with a high degree of certainty of growth from reinvestment of their cashflows, at high rates of return; businesses that are resilient to change, particularly technological innovation; 2. Try not to overpay for these companies. 3. After that do nothing, except leave them to grow and make sure that they don't change their strategy. The Fundsmith team invest in such businesses because they know they are making money and growing regardless of the macro environment the world faces daily. The only real difference between the two funds is the size of the companies namely large cap and medium cap businesses. Long term investment has delivered excellent return outcomes as evidenced by Fundsmith Equity Funds since inception performance of 15.8% p.a. vs 11.2% from the MSCI ACWI. See below, the top 10 holdings for both the Fundsmith Equity fund as well as the Smithson Investment Trust:

Fundsmith Equity Fund	Portfolio Weighting %
Microsoft Corp	7.56%
Novo Nordisk A/S Class B	7.41%
Philip Morris International Inc	5.82%
L'Oreal SA	5.69%
IDEXX Laboratories Inc	4.92%
The Estee Lauder Companies Inc Class A	4.80%
LVMH Moet Hennessy Louis Vuitton SE	4.73%
Stryker Corp	4.65%
Automatic Data Processing Inc	4.36%
McCormick & Co Inc Registered Shs Non Vtg	4.35%

Smithson Investment Trust	Portfolio Weighting %
Moncler SpA	5.42%
Recordati SpA Az nom Post raggruppamento	4.72%
VeriSign Inc	4.35%
Sabre Corp	4.34%
Fevertree Drinks PLC	4.11%
Fortinet Inc	3.95%
Ambu A/S Class B	3.90%
SimCorp A/S	3.63%
Technology One Ltd	3.60%
Rightmove PLC	3.58%

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STAR INVESTMENT PARTNERS

Asset Class Performances in USD

As of 31st March 2023	MTD	YTD	1 Year	3 Years*	5 Years*	10 Years*
Global Equity – MSCI ACWI	2.49	7.04	(7.28)	16.18	7.05	8.48
Global Property - FTSE EPRA NAREIT DR	(3.34)	1.01	(21.71)	7.84	2.25	3.95
Global Bond - JPM GBI Global Traded	3.61	3.08	(8.99)	(5.32)	(2.04)	(0.37)
Global Cash - ICE LIBOR 1 Month	0.41	1.16	3.08	1.13	1.53	1.02
SA Equity - FTSE/JSE All Share	2.16	0.85	(13.61)	24.47	1.86	3.19
SA Property - FTSE/JSE SA Listed Prop	(0.05)	(8.94)	(20.41)	18.45	(11.54)	(5.12)
SA Bond - BEASSA ALBI	4.83	(0.85)	(12.84)	11.87	(1.39)	0.46
SA Cash - STeFI Call Deposit	4.07	(2.47)	(12.94)	4.60	(2.92)	(1.10)

ZAR/USD (negative = dollar strength)	3.46	(4.12)	(17.57)	0.27	(33.17)	(47.92)
Gold	7.17	6.84	(2.44)	4.76	5.58	0.39
Brent Crude Oil	(4.91)	(7.15)	(26.08)	51.94	2.57	(3.11)

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STAR INVESTMENT PARTNERS

Historic Asset Class Performance Matrix

The below performance matrix shows returns (colour coded) for the 4 main indicative sources of return per asset class and separated for South Africa and Global. **All performance figures here shown in ZAR.** The performances show the one-year performance of each asset class up to the displayed date (X-axis) except for the column showing YTD returns up to 31st March 2023.

	YTD	3/2023	3/2022	3/2021	3/2020	3/2019	3/2018	3/2017	3/2016	3/2015	3/2014	3/2013	3/2012
Best	Global Equity 11.6	Global Cash 25.2	SA Property 27.1	SA Equity 54.0	Global Fixed Income 32.9	Global Property 39.9	SA Fixed Income 16.2	SA Fixed Income 11.0	Global Fixed Income 28.5	SA Property 41.4	Global Equity 35.0	Global Property 41.2	Global Property 20.5
	Global Fixed Income 7.5	Global Equity 12.6	SA Equity 18.6	SA Property 34.4	Global Cash 26.3	Global Cash 24.5	SA Equity 9.6	SA Cash 7.0	Global Property 26.7	Global Property 36.1	SA Equity 23.6	SA Property 37.3	SA Property 20.3
	Global Cash 5.5	Global Fixed Income 10.5	Global Property 16.5	Global Equity 31.1	Global Equity 8.6	Global Equity 24.5	SA Cash 6.8	Global Equity 5.8	Global Cash 21.7	Global Equity 21.6	Global Property 18.9	Global Equity 33.4	Global Fixed Income 20.0
	Global Property 5.3	SA Fixed Income 5.8	SA Fixed Income 12.4	SA Fixed Income 17.0	SA Cash 6.6	Global Fixed Income 20.5	Global Equity 2.2	SA Equity 2.5	Global Equity 16.8	Global Cash 15.4	Global Fixed Income 15.7	SA Equity 22.5	Global Cash 13.8
	SA Equity 5.2	SA Cash 5.7	Global Equity 5.5	Global Property 12.5	SA Fixed Income -3.0	SA Cash 6.6	Global Fixed Income -4.9	SA Property 1.5	SA Cash 6.0	SA Equity 12.5	Global Cash 14.8	Global Cash 19.8	SA Fixed Income 13.2
	SA Fixed Income 3.4	SA Equity 4.9	SA Cash 3.6	SA Cash 3.8	Global Property -3.9	SA Equity 5.0	SA Property -7.1	Global Cash -8.3	SA Property 4.6	SA Fixed Income 12.4	SA Cash 4.9	Global Fixed Income 18.8	Global Equity 12.7
	SA Cash 1.7	SA Property -3.4	Global Cash -0.9	Global Fixed Income -17.0	SA Equity -18.4	SA Fixed Income 3.5	Global Property -9.5	Global Property -8.3	SA Equity 3.2	Global Fixed Income 10.9	SA Property 1.1	SA Fixed Income 14.3	SA Equity 7.5
Worst	SA Property -5.1	Global Property -4.9	Global Fixed Income -8.0	Global Cash -17.2	SA Property -47.9	SA Property -5.7	Global Cash -10.4	Global Fixed Income -12.0	SA Fixed Income -0.6	SA Cash 5.6	SA Fixed Income 0.6	SA Cash 5.0	SA Cash 5.3

Source: Morningstar Direct

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