

INVESTMENT NOTE

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THE NEW BIG FIVE



IZAK ODENDAAL

OLD MUTUAL MULTI-MANAGERS

“The future ain’t what it used to be,” baseball great and father of dozens of quirky quotes Yogi Berra once mused. He wasn’t the first to raise this point. Back in 1937, French poet and philosopher Paul Valéry wrote: **“The future, like everything else, is no longer quite what it used to be. By that I mean we can no longer think of it with any confidence in our inductions.”**

Valéry’s quote comes from a truly unsettled time of global economic depression and the rise of belligerent dictatorships across Europe. Things are very different today, but we are witnessing profound physical, political, social and economic changes. The future is indeed quite different from what we might have imagined a few years ago.

DEMOGRAPHICS

For most of human history, there was very little economic growth since there were few productivity enhancements. To increase output, you had to increase inputs – land and labour. The Industrial Revolution was a productivity revolution that continues to this day. Advances in medical care also saw a global

That is partly because recent history – the period that roughly falls between the collapse of the Berlin Wall in 1989 and Covid in 2020 – can be thought of as a golden age of globalisation, when capitalism and democracy seemed to march across the globe under the American security blanket. From this perspective, the future looks particularly daunting. However, someone who grew up in the chaotic first half of the 20th century, for instance, would never take progress for granted. Nonetheless, there are big shifts underway with unpredictable outcomes. Today we look at five of the most important trends that take us into uncharted waters.

population explosion. The combination of growing labour forces and rising productivity means today we take economic growth for granted, something an ancestor from 500 years ago would never do.

Today, however, populations are shrinking in several major economies, including Japan, China, Korea and



WEALTH

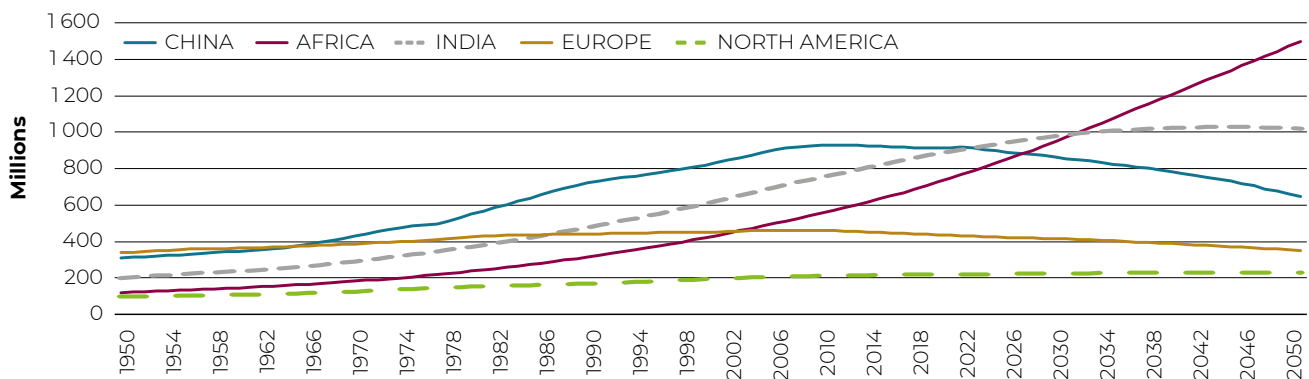
much of Europe, as fertility rates have fallen below the replacement level of 2.1 children per woman in these countries. Fertility rates in the US are also low at 1.7, and population growth is almost entirely due to immigration. This lack of population expansion upends the economic growth story of the past 300-odd years. Growing populations need more homes, furniture, schools, cars, groceries etc. Shrinking populations, however, need fewer.

Shrinking populations also mean fewer workers. Though people are also living longer, extending the retirement age is often a fight. Therefore, many rich countries (and China) face a situation where the number of retirees is ballooning relative to the number of workers. In countries where social security systems are pay-as-you-go, in other words current pensions are funded by current tax revenues and not accumulated savings, this is clearly a problem.

There is one region where population growth continues apace. The average fertility rate in sub-Saharan Africa is still 4.6, Africa's population is projected to double between now and 2050 according to modelling by the United Nations (long-term demographic projections are usually much more accurate than any other form of forecasting).

In other words, Africa will provide the world's workers over the coming decades. But what we don't know is whether Africa can provide enough jobs in a continent already struggling with unemployment. In the 18th and 19th centuries, Europe transplanted its surplus population to the Americas, Australasia and elsewhere. It is not clear whether other countries will accept millions of migrants from Africa as immigration politics have become toxic in the rich countries.

CHART 1: WORKING AGE POPULATION PROJECTIONS



Source: United Nations

Africa's young and growing population therefore offers both promise and peril. It is potentially a huge consumer market that South African firms can tap into, but it also

faces possible further destabilisation as it struggles to accommodate another billion people.

DEBT

The second big trend is debt. The world has more debt now than ever before, and it is only rising. According to the International Monetary Fund, global debt reached 238% of total global income (GDP) in 2022. Of this, government debt is 92%, household debt 55% and non-financial corporate debt 91%.

Now on one level, this shouldn't be too alarming. One person's debt is another's asset, so record debt levels are implicitly also linked to record wealth levels. The problem is that debt can be destabilising and that high debt levels can also weigh on economic activity.

The type of debt also matters. Governments have more capacity to service debt than private entities since they can

expropriate resources from the private sector, but only when they borrow in their own currency.

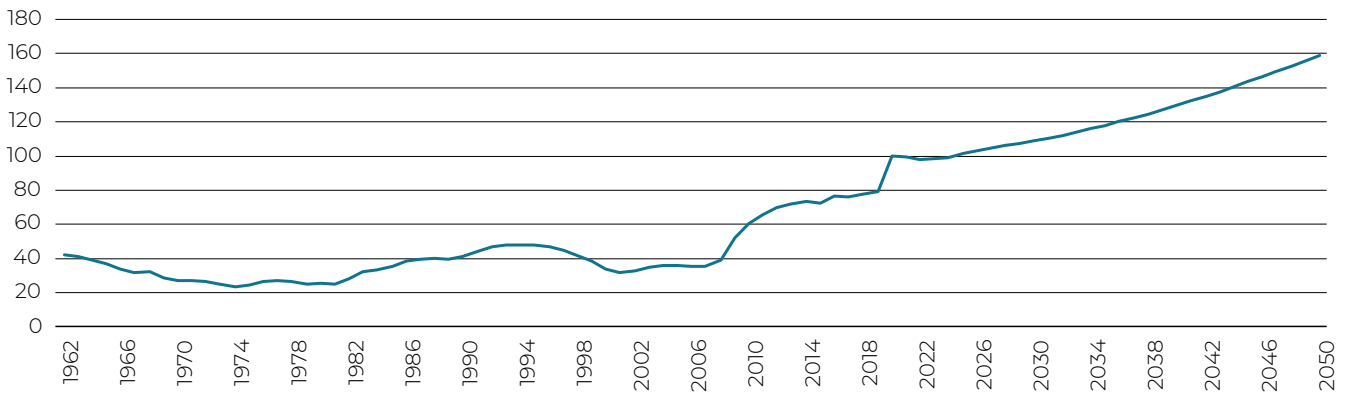
The worst kind of debt is tied to speculative activity, notably associated with property booms when households, banks and developers gear up. If property values then fall, balance sheets become impaired (asset values decline but liabilities remain unchanged), gumming up economic activity. In the end, there are usually large write offs and sometimes the government has to carry the can. We're in the early stage of something like this happening in China.

Elsewhere, however, there are few signs of excessive household gearing, while banks also generally seem in good shape, thanks to strict post-2008 regulations.

But perhaps the biggest question of the moment concerns US government debt. US government debt is already close to 100% of GDP (depending how you measure it) but more worryingly, is likely to keep rising, despite the current strong economy. Based on current legislated budget priorities, the

US will run an annual deficit of around 6% of GDP for the next decade according to the nonpartisan Congressional Budget Office. There is simply no political will in Washington to arrest this trend, and the upcoming elections are unlikely to result in a change in direction.

CHART 2: US GOVERNMENT DEBT-TO-GDP RATIO WITH FORECAST



Source: Congressional Budget Office

US debt – Treasuries – holds a special place in the global financial architecture. It is not just a major asset for pension funds, banks, sovereign wealth funds and more, but it is also the main source of collateral in global finance. Finally, it gives us the risk-free rate, the interest rate that virtually all other financial instruments price off.

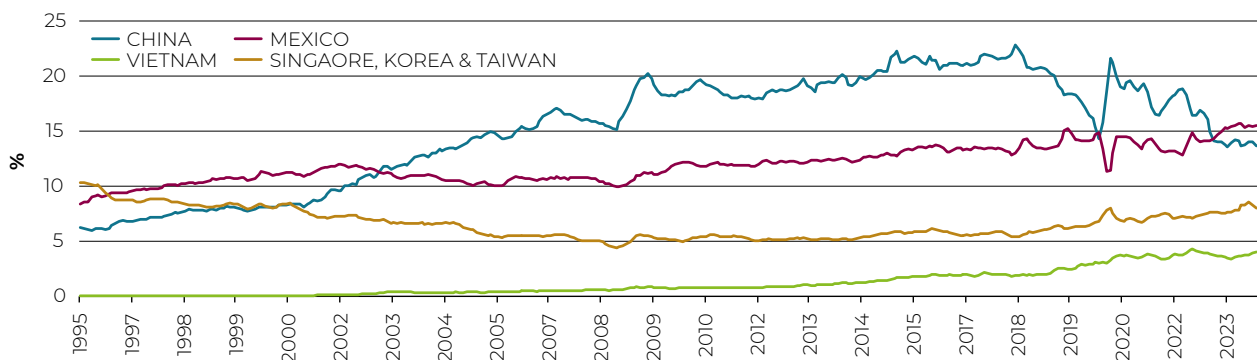
There is no immediate reason for concern. US nominal national income growth comfortably exceeds the government's borrowing costs, and the US not only borrows in its own currency, it borrows in a currency others want. Nonetheless, the time might arrive eventually when the world no longer wants to fund profligate Americans. That would be a pivotal moment.

GLOBAL FRAGMENTATION

Linked to the final point is global fragmentation. One of the reasons America could borrow freely is because other nations were happy to lend to it while Americans bought their manufactures. China, of course, perfected this trade, exporting cheap goods to the US, and recycling the gains into US Treasuries to prevent the yuan from appreciating too much.

But as we all know, this symbiotic relationship between China and the US is breaking down. Trade has already been disrupted, and China has already stopped accumulating US debt. The US now imports more from Mexico than from China, as "nearshoring" and "friendshoring" replaces "offshoring". Vietnam's share of US imports has more than doubled in the last five years. How much of this is simply redirected Chinese exports is up for debate.

CHART 3: SHARE OF US IMPORTS BY SOURCE



Source: LSEG Datastream

“Onshoring” is also back in fashion, and the Biden administration has thrown billions at encouraging production at home, especially of semi-conductors and advanced technologies.

This does not mean that globalisation is going into retreat, but rather that trade flows are increasingly being redirected while economic efficiency is no longer a guiding policy principle. Trade restrictions are rising in many countries and fragmentation is the new name of the game.

CLIMATE CHANGE

Scarily, 2023 was the hottest on record, according to Copernicus, the European Union’s climate change monitor, with average temperatures 1.48 degrees Celsius above pre-industrial records. The previous record was set in 2016.

As the world heats up, extreme weather events are becoming more frequent. Floods, hurricanes, snowstorms, wildfires and prolonged droughts are causing widespread damage and misery. Until now, these types of events only caused temporary disruptions to economic activity. However, it might increasingly be impossible to do business in some areas. It is one thing if, for instance, a factory must be relocated from the coast to higher ground. It is quite another thing when insurance companies pull out of a market because the risks are just too great, as is increasingly the case in California, the largest of US states, due to frequent storms, wildfires and floods.

At least California is not going to disappear. Rising sea levels mean some island nations could be wiped off the map in the decades ahead. The other big concern is that tropical regions become uninhabitable due to the deadly combination of heat and humidity, the so-called wet bulb effect. Wealthy countries like Singapore will manage, but poor ones like the DRC might not.

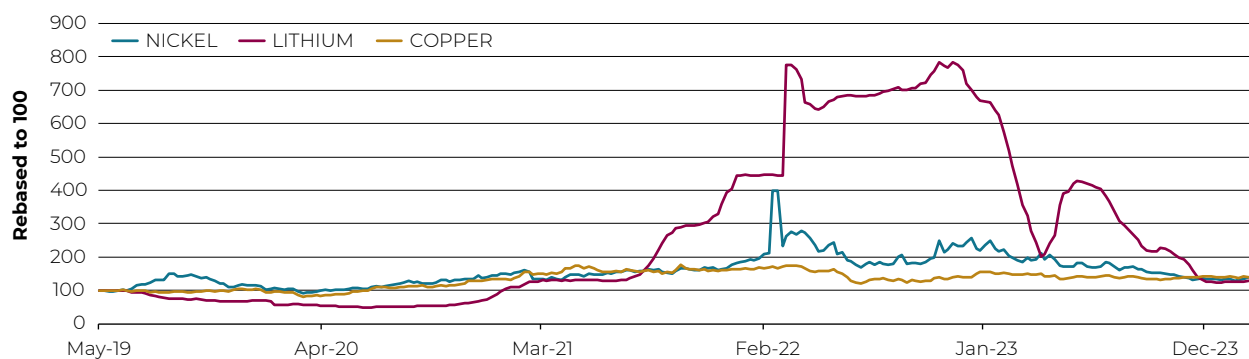
National security is once again a top priority in many capitals, especially in Europe where the folly of Russian appeasement was brutally exposed when tanks rolled into Ukraine two years ago. That doesn’t just refer to defence spending, but also security of supply of energy and other vital goods. The so-called peace dividend that followed the fall of communism is largely a thing of the past. We should once again fear that great-power rivalries could get out of hand, as was the case in the 19th and 20th centuries.

Human life and activity always had to cope with unexpected changes in the weather, including previous climate swings. The Little Ice Age from around 1650 to 1770 coincided with major social, economic and political upheaval; some argue that it caused those changes. But never have so many people – 8 billion of us – been exposed to such a dramatic climatic shift, with so much uncertainty.

There are opportunities, however. Countries will spend vast amounts on building resilience to extreme weather and transitioning away from the fossil fuels that are responsible for climate change to begin with. This is already happening, but there is still a long road ahead. The decrease in the cost of renewable energy, particularly solar, means the obstacles are no longer technical. They are largely political. There will be winners and losers from the energy transition, and the losers are naturally fighting back. The trick for investors is to back the winners and avoid being stranded with assets in the ‘losing’ camp.

Along the way, there will be much hype, and the bigger trick for investors is probably to avoid falling for it. One example: the prices of nickel, lithium and copper – crucial minerals for the energy transition – have been falling of late, not rocketing higher. As with all commodities, there will still be cycles and investors will still have to be disciplined.

CHART 4: DOLLAR PRICES OF NICKEL, LITHIUM AND COPPER



Source: LSEG Datastream

TECHNOLOGICAL BREAKTHROUGHS

Speaking of hype, the last of our New Big Five trends is swimming in it. Generative artificial intelligence (AI) is only one of several exciting new technologies but will potentially have the most far-reaching economic impact.

It could raise productivity across a broad range of tasks, boosting economic growth and prosperity, while potentially offsetting the decline in labour forces in developed countries and exerting disinflationary pressures. However, whole categories of jobs will likely disappear in the process.

Unfortunately, in the wrong hands AI could become a dangerous weapon. Already, regulation is lagging far behind.

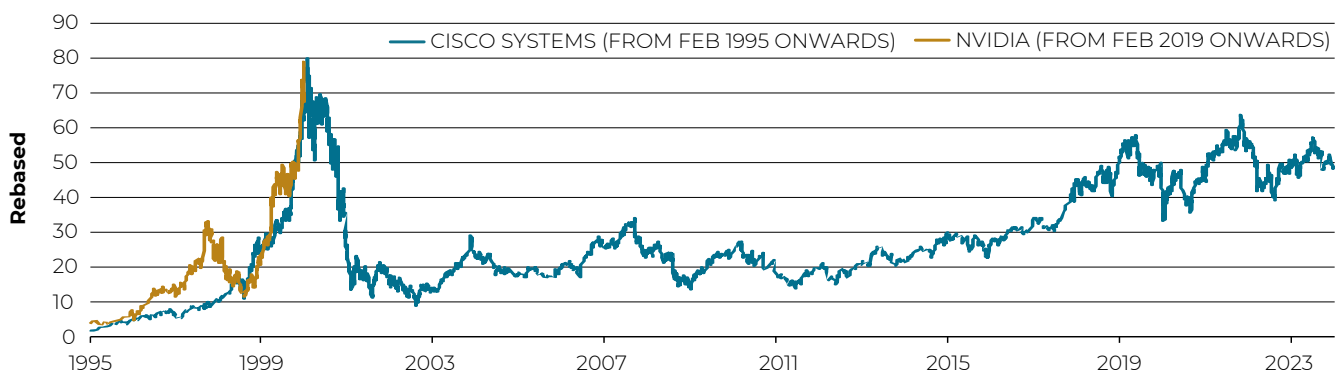
Much of what lies ahead is unpredictable. Past technological revolutions have propelled humanity forwards, but often with nasty side-effects. For instance, the climate crisis discussed above is the result of the energy revolution of the 20th century. Past experience also shows that technologies take time to spread through economies as firms figure out how to best utilise them. The personal computing revolution of the 1980s only impacted productivity a decade later, leading to the famous quip of Robert Solow, economics Nobel laureate and father of growth theory: "You can see the computer age everywhere but in the productivity statistics." Companies will need to work out how AI can enhance their internal processes. That is where the big

impact will be, not students using ChatGPT to write their essays (though clearly education will also have to adapt).

The third lesson from past technological revolutions – whether the canal boom of the 1700s, the railroad boom of the 1800s, the consumer electronics boom of the 1920s or the dotcom bubble of the 1990s – is that the big money is made by those who get in very early and get out near the top, or by those who get in after the crash. Most investors, lured by rising prices in the middle part, don't make money and many lose a lot. AI is likely to be a transformative technology, but there is no guarantee it will be a good investment.

For instance, the big winner so far has been Nvidia, the company that supplies the high-spec computer chips most widely used by AI models. Its share price has increased an incredible 1800% in five years. For many, this is reminiscent of Cisco in the dotcom bubble. It was a darling share, supplier of the hardware on which the internet was built. It remains a solid and profitable company, but its share price was clearly overhyped and has to this day not recovered. As the AI boom gathers steam, expect more companies to emerge with speculative business models. Nvidia is not a speculative company. It is already generating billions of dollars of sales and is growing rapidly. But it can still turn out to be a disappointing investment if too much good news is priced in.

CHART 5: CISCO AND NVIDIA SHARE PRICES



Source: LSEG Datastream

IN SUMMARY

Therefore, when thinking about the New Big Five, there are three investment principles to remember. The first is get used to uncertainty and be prepared to be surprised. Avoid knee-jerk responses to scary news headlines and remember misinformation is going to run rampant. Patience is still a virtue, even in the 21st century.

Secondly, even in this brave new world valuation does not go out the window. It can be difficult to value companies with tremendous growth prospects like Nvidia, or with

exciting but unproven technologies, or with 'old economy' assets that may or may not be rendered obsolete. The way to manage this to match the level of uncertainty with the size of the investment in a portfolio.

Thirdly, diversify, diversify, diversify. Read widely, try to understand the big trends, but do not trust someone who claims to have all the answers. There is just so much we cannot predict.

EQUITIES - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US\$	3 364.0	0.90%	0.81%	6.15%	24.27%
United States	S&P 500	US\$	5 137.0	0.94%	0.80%	7.69%	30.02%
Europe	MSCI Europe	US\$	2 060.0	0.19%	0.73%	1.98%	10.52%
Britain	FTSE 100	US\$	9 723.0	-0.43%	0.93%	-1.25%	2.15%
Germany	DAX	US\$	1 663.0	1.71%	0.79%	5.19%	14.06%
Japan	Nikkei 225	US\$	265.8	2.33%	1.99%	12.02%	31.57%
Emerging Markets	MSCI Emerging Markets	US\$	1 025.0	-0.29%	0.39%	0.10%	4.17%
Brazil	MSCI Brazil	US\$	1 697.0	-0.06%	0.53%	-5.72%	20.10%
China	MSCI China	US\$	54.1	-0.70%	0.60%	-2.56%	-19.44%
India	MSCI India	US\$	981.1	0.32%	1.35%	6.41%	37.79%
South Africa	MSCI South Africa	US\$	371.0	-0.27%	0.54%	-10.60%	-10.82%

EQUITIES - SOUTH AFRICA (TOTAL RETURN UNLESS INDICATED OTHERWISE)

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Share (Capital Only)	All Share (Capital Index)	Rand	72 775.0	-1.94%	0.06%	-5.36%	-7.45%
All Share	All Share (Total Return)	Rand	12 841.0	-1.93%	0.06%	-5.25%	-3.91%
JSE Capped SWIX	Capped SWIX (Total Return)	Rand	31 556.7	-1.53%	0.16%	-4.90%	-3.01%
TOP 40/Large Caps	Top 40	Rand	11 587.0	-2.11%	-0.02%	-5.87%	-5.42%
Mid Caps	Mid Cap	Rand	20 570.0	-1.38%	0.14%	-5.58%	-0.78%
Small Companies	Small Cap	Rand	32 685.0	0.09%	0.41%	0.07%	7.77%
Resources	Resource 20	Rand	4 228.9	-1.78%	-0.47%	-13.01%	-21.88%
Industrials	Industrial 25	Rand	21 666.0	-3.34%	-0.47%	-2.42%	-1.96%
Financials	Financial 15	Rand	12 574.0	-0.53%	1.15%	-2.61%	10.29%
Listed Property	SA Listed Property	Rand	1 947.0	-0.59%	-0.41%	4.45%	17.86%

FIXED INTEREST - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
IBOXX Global Government S&P Overall (USD Unhedged)		US\$	75.8	0.23%	0.14%	-3.35%	-0.61%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Bond	BESA ALBI	Rand	942.5	0.38%	0.04%	0.22%	7.44%
Government Bonds	BESA GOVI	Rand	928.7	0.37%	0.04%	0.19%	7.40%
Inflation Linked Bonds	BESA CILI	Rand	347.2	0.05%	-0.01%	-0.58%	6.99%
Cash	STEFI Composite	Rand	555.9	0.16%	0.02%	1.42%	8.30%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US\$	83.6	2.36%	1.89%	8.51%	-0.54%
Gold	Gold Spot	US\$	2 083.0	2.31%	2.26%	0.97%	13.45%
Platinum	Platinum Spot	US\$	887.0	-1.66%	1.03%	-10.13%	-7.12%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	19.07	0.88%	0.46%	-4.05%	-4.94%
ZAR/Pound	ZAR/GBP	Rand	24.20	1.16%	0.08%	-3.72%	-9.92%
ZAR/Euro	ZAR/EUR	Rand	20.72	0.92%	0.05%	-2.50%	-6.65%
Dollar/Euro	USD/EUR	US\$	1.08	0.00%	0.09%	2.22%	-0.93%
Dollar/Pound	USD/GBP	US\$	1.27	0.13%	-0.44%	0.35%	-5.18%
Dollar/Yen	USD/JPY	US\$	0.01	-0.24%	0.09%	6.47%	10.24%

Source: I-Net, figures as at 1 March 2024

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WEALTH

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