Prosperity

September 2024

- Economic and Market Overview
- Local Equities

Private Clients
by Old Mutual Wealth

ECONOMIC UPDATE

September marked the long-anticipated start of the US interest rate cutting cycle. Since the world economy largely runs on US dollars, the global financial system closely watches shifts in US interest rates. Typically, when US rates rise, the dollar strengthens, placing upward pressure on other countries' interest rates. Now, with the Federal Reserve starting to lower its policy rate, the dollar has eased, providing room for other countries to follow with rate cuts of their own.

Amid some uncertainty about the size of the cut heading into the meeting, the Fed lowered its policy rate by 50 basis points. The case for front-loading interest rate cuts makes sense, given the recent weakening in the labour market. With progress made on inflation, the Fed's dual mandate shifted its focus to maintaining full employment, acting pre-emptively to prevent further rises in unemployment.

A larger rate cut carries risks, as it could be interpreted as a sign of panic. Historically, the Fed has cut by more than 25 basis points only during times of crises, such as the COVID-19 pandemic in 2020 and in the Global Financial Crisis of 2007 - 2008. However, the positive market response suggests that investors did not view the move as a panic signal.

Fed Chair, Jerome Powell emphasised that the Fed's decision was not driven by a crisis or panic. Instead, lower inflation provided the flexibility to make the bigger cut and get ahead of any further weaking in the labour market. Powell maintained that the US economy remains healthy, and the Fed's goal is to keep it that way.

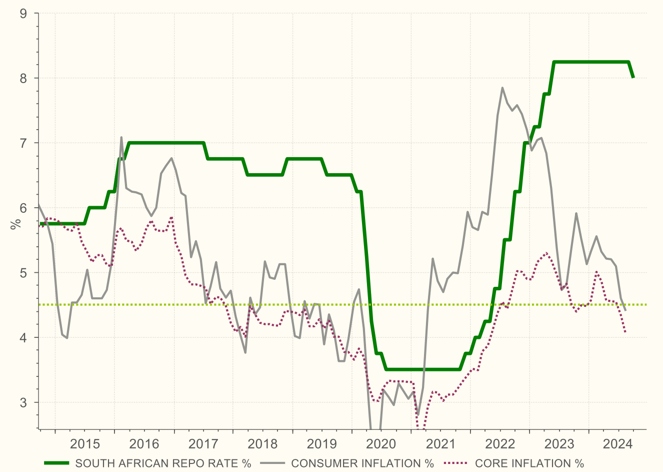
Source: LSEG Datastream/Old Mutual Multi-Managers

Despite the large initial cut, US short-term rates remain restrictive at 5%, compared to a "neutral" interest rate of somewhere around 3%. Further reductions are expected. The key question is whether rates will continue to fall for "good" or "bad" reasons. A "good" decline in interest rates would be a scenario where inflation is under control, growth is slower but not contracting, and unemployment still low – a soft landing, in other words. A "bad" decline would be if the Fed were to slash interest rates as the economy slips into recession. Currently, the outlook leans toward the former.

The South African Reserve Bank's Monetary Policy Committee was more cautious with its first rate cut of the cycle. Like the Fed, the SARB's policy stance had become too restrictive given the state of the economy. Before the recent cuts, the real short-term interest rate had risen to 3% in the US and 4% in South Africa due to falling inflation.

SA consumer inflation declined to 4.4% year-on-year in August, slightly below expectations. With significant petrol price cuts in September and October yet to be reflected in the official numbers, inflation is expected to fall further in the coming months. The SARB's official forecast suggests that inflation will remain just below the 4.5% target over the next two years.

However, unlike the US, SA's economic growth outlook is improving due to structural reforms, particularly improvements in electricity supply. The Reserve Bank expects economic growth to rise from around 1% to 1.8% over the medium term, a forecast that could prove conservative should reforms accelerate.

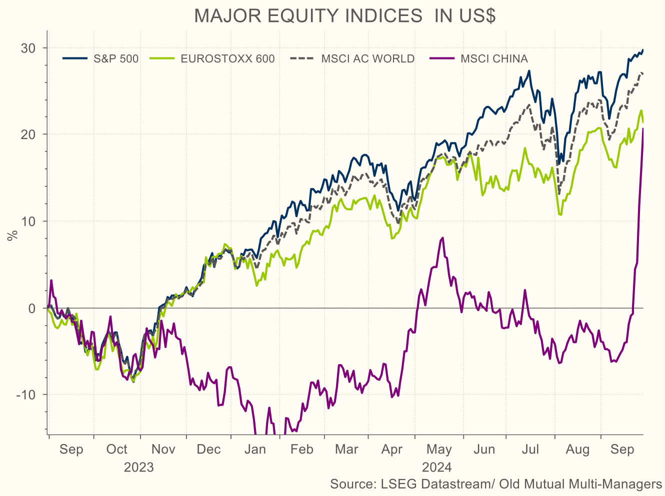


Source: LSEG Datastream/Old Mutual Multi-Managers

It is worth noting that the SARB is an inherently conservative institution and was unlikely to begin the cutting cycle with an aggressive move, particularly given the heightened uncertainty around the short-term impact of two-pot retirement fund withdrawals on consumer spending and inflation. Nevertheless, further rate cuts are expected, and if growth and inflation evolve as anticipated, the repo rate should stabilise at around 7%.

This suggests that the SARB will cut less aggressively than the Fed, which may provide additional support to the rand, which ended the month at R17.23 against the dollar – its best level in nearly two years.

MARKET UPDATE



After the 50-basis point rate cut, global markets finished the month strong, with the MSCI World Index closing the month up 1.7%.

In the US, major indices performed well, with the Dow Jones rising by 1.9% to reach new all-time highs, while the S&P 500 ended the month 1.7% higher. The Nasdaq also performed well, gaining 2.1% as tech stocks rallied. European markets showed less resilience, with the UK's FTSE-100 losing 1.6%, and the Eurostoxx 600 closing 0.40% lower. Lacklustre German economic activity is still weighing heavily on Europe with no signs of significant turnaround.

Asian markets had one of the best months on record as Chinese authorities unleashed a mix of monetary and economic stimulus measures, which boosted markets and investor confidence. The Shanghai Composite Index gained 17.4% and Hong Kong's Hang Seng Index climbed by 17.8%.

On the local front, the JSE All Share Index rose by 3.3% in September, closing near the record high of 87 579 on 27 September. Industrials led the way with a 4.8% increase, while Financials gained 1.4%. The local listed property sector ended the month 4.7% higher and is up 26% for the year. Resources benefitted from higher metals prices and ended September 3.1% higher. The rand strengthened against the US dollar, appreciating by 3% to close at R17.2590/US$1. Gold prices continued to rise, ending the month up 5.1% at US$2 631/oz. In contrast, Brent crude oil prices fell by 8.9%, reflecting concerns over supply disruptions and global demand. The platinum price rallied by 5.7%, supported by robust industrial demand.

LOCAL EQUITIES

Shoprite

Shoprite's full-year results met expectations, with group sales up 12%, led by its RSA supermarkets. South African sales grew 12.3%, driven by Checkers and Checkers Hyper (+12.3%) and Sixty60 (+58.1%). Checkers remains the fastest-growing grocer in SA's premium food segment. Shoprite and USave focused on low prices, delivering 10.7% sales growth, while Liquorshop saw a 20% sales increase. As part of its strategy to focus on the core food business, Shoprite will sell OK Furniture and House & Home (excluding Angola and Mozambique) to Pepkor and is in talks to acquire the remaining 50% of Pingo Delivery.

Gross margins dipped slightly to 24%, while trading profit rose 12.4%, with trading margins at 5.6%. Despite lower loadshedding, operating costs increased, and the group spent R754m on diesel. A final dividend of 445 cents per share was declared, bringing the full-year dividend to 712 cents, a 7.4% rise.

We believe that Shoprite's diverse brands and store formats across regions provide resilience, supporting margins over time. The company's scale drives strong cash flow and attractive margins, aiding balance sheet management and shareholder returns. With capital expenditure now behind it, management is focused on optimising operations and growing market share, which should boost free cash flow and enhance returns. Having gained market share among more affluent consumers, Shoprite's focus on premium products is driving profitability. This, combined with their new IT platform, positions the company for further growth and margin improvement.

Sanlam

Sanlam delivered strong 2024 interim results, continuing its trend of solid growth. Group-wide new business volumes rose 7%, with Life Insurance up 14%, driven by strong performances in SA and Asia, where volumes surged over 50%. However, increased investment tempered new business margins. The Investment Management segment posted net client inflows of R4.1bn, a turnaround from previous outflows, while Short-Term Insurance saw a 7% increase in net earned premiums, supported by Santam's solid performance. Overall, net results from financial services rose 14% to R7.1bn, with net operating earnings up 8% to R8.1bn. Sanlam also made strategic moves, aiming to strengthen its presence in SA and Africa. The group plans to increase its stake in Shriram Life and General Insurance in India to over 50% and acquire 60% of MultiChoice's insurance business. Both deals, expected to close by Q4 2024, are set to boost earnings growth.

We view Sanlam as a leading African insurer with strong positions in growth markets like Morocco, Nigeria and Kenya. Its joint venture with Allianz is expected to drive growth in Egypt and other regions, with the rest of Africa likely to be the fastest-growing segment.

In SA, Sanlam continues to compete effectively, bolstered by acquisitions such as Absa Investment Management, AfroCentric and Capital Legacy. With solid solvency ratios and a strong balance sheet, Sanlam is well-positioned to balance dividend growth and investment in key growth areas.

FirstRand

FirstRand, which includes FNB, Wesbank, RMB, and the UK's Aldermore and MotoNovo, reported a resilient full-year performance despite uncertainty surrounding the UK Financial Conduct Authority's investigation into dealer commissions in the motor finance sector. The bank confirmed a provision of R3bn and an additional R300m in related expenses, which resulted in a R3.3bn impact. Nevertheless, FirstRand's normalised earnings grew by 3.7% to R38bn. Some key metrics showed slight deterioration: the cost-to-income ratio increased from 51.4% to 52.6%, and return on equity (ROE) declined by 100bps to 20.1%. Operationally, FirstRand navigated the credit cycle well, with a credit loss ratio of 81bps, which is at the lower end of management's target range of 80bps to 100bps. Although this was slightly higher than FY 2023, it was expected due to weakening consumer credit affordability.

FirstRand's balance sheet remains strong, with a total capital adequacy ratio of 16.1%, comfortably above its 14.75% target. This financial strength allowed the Board to increase the final dividend by 10%, resulting in an overall 8% dividend growth for FY 2024 – double the growth rate of earnings per share.

Despite the challenging operating environment, we believe FirstRand can achieve low double-digit earnings growth in the medium term, supported by effective cost management and its existing customer base. We expect FNB to maintain market share, particularly in the premium segment. As a leader in digital adoption, FNB fosters customer loyalty through holistic banking solutions and the eBucks loyalty programme. We anticipate that their digital platform will drive volumes and enhance profitability. The group is well-capitalised, with total capital adequacy and CET1 ratios of 16.1% and 13.5%, respectively.

OUTsurance

OUTsurance Holdings reported solid full-year results, with a notable recovery in the second half. Despite significant natural disaster claims in Australia, group operating profit grew by 15.5% to R4.8bn, supported by a 20.5% increase in short-term insurance gross written premiums in both Australia and South Africa. Annualised new business premiums rose by 30.4% to R10bn, driven by disciplined pricing and organic expansion. The company declared a full-year dividend of 174.4c per share, a 29.4% increase from last year, along with a special dividend of 40c per share. Management is optimistic about a stable reinsurance market to meet future capital needs.

As expected, OUTsurance reported a R180m loss in its new Irish venture after launching operations in April. While it's too early to gauge long-term prospects in Ireland, we see this expansion as a positive move to diversify into new markets, following its success in Australia.

We view OUTsurance as a strong short-term insurer with room to expand its market share, especially in Australia. The group's solid balance sheet, with capital above target and strong underwriting performance, is supported by its leading position in the motor insurance segment, which we expect it to maintain. With a diversified portfolio across motor and property insurance, there is further growth potential in the business insurance segment, where management is focusing on investments. The Australian operations add valuable diversification, complementing OUTsurance's strong SA base.

Remgro

Remgro, a diversified financials and industrials investment holding company, faced challenges in full-year 2024 due to the integration of significant corporate actions, which impacted earnings by R1.3bn. This, combined with weaker performances from Heineken/Distell and CIVH, led to a 20% decline in headline earnings to R5.6bn. Share buybacks softened the blow, resulting in an 18.8% drop in headline earnings per share to R10.18. Mediclinic struggled with low growth in Switzerland, while Heineken Beverages SA reported modest growth, with better performance outside SA. CIVH's profitability was hit by rising costs, but Siqalo Foods, RCL Foods, and the industrial portfolio performed strongly, benefiting from lower inflation and reduced loadshedding.

Remgro is now focused on optimising the performance of its investee companies. As part of its portfolio strategy, it sold its remaining 9.4% stake in Momentum. Despite earnings pressures, the group increased its full-year 2024 dividend per share by 10%, reaffirming its commitment to shareholders.

Remgro maintains a high-quality portfolio of largely industrial and financial companies that provide diversified exposure to businesses operating in both defensive and high-growth sectors with long-term thematic tailwinds. Historically focused on listed companies, Remgro is shifting towards unlisted investments, unbundling some listed assets to enhance control. We believe that this transition positions Remgro as an attractive investment vehicle, combining unique private assets with the stability of listed holdings.

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