INVESTMENT ENVIRONMENT

DOUGLAS INVESTMENTS

Introduction

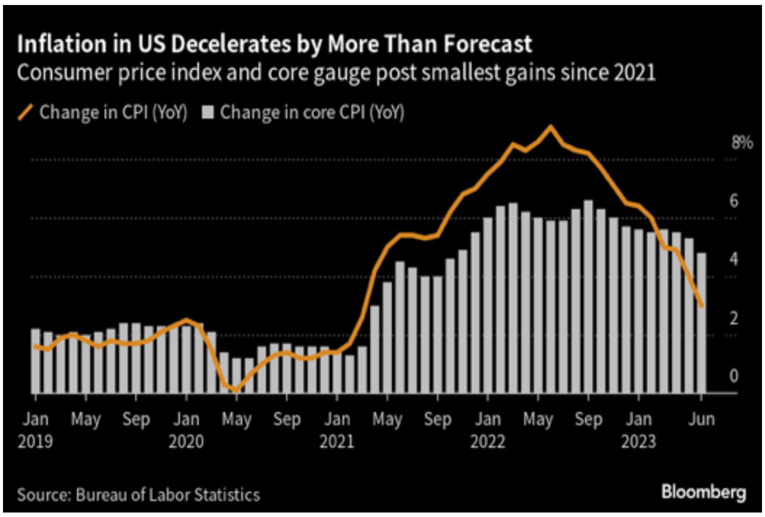
July was a busy month for markets with lots of news flow from a macro perspective as well as some of the biggest companies reporting. Across most markets, performance was strong as inflation trended downwards and a number of data points reflected economic resilience. Looking at inflation specifically the market was very pleased to see the US inflation coming in at 3.0% which was below expectations of 3.1%. it is important to note that the fuel price was at a peak in June 2022, so fuel had a deflationary impact on the reading, and it is likely to cause an increase in the July reading. It is also positive to see that some headway is being made in the UK with inflation coming in at 7.9%, which was also below market expectations and hopefully indicates a turning point for the UK economy.

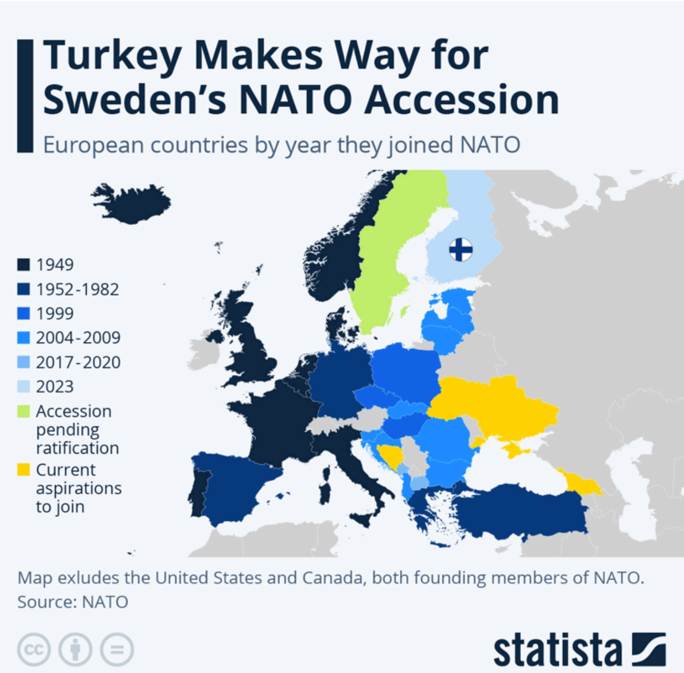
The Fed and ECB hiked rates by 25bps whereas South Africa kept rates on hold. The BOE is expected to also hike rates by 25bps on 3 August. The geopolitical tensions between the US and China continue to add risk to the macro environment although Janet Yellen made a visit earlier in July to discuss how the two superpowers can work together from an economic perspective. China's economic data has been continuing to disappoint and the market is watching closely for any further suggestions of stimulus as a catalyst for some commodity strength. France saw days of rioting following the shooting of a teenager by the police. Currently societal tensions are running high with a number of divides being seen in the country. As Russia and Ukraine continue to fight in what appears to be a never-ending conflict in what could largely be seen as a win for the West Turkey has agreed to support Sweden's NATO entry. The Bank of Japan (**BOJ**) caused some market volatility when they indicated that would make an adjustment to yield-curve control. This resulted in significant volatility in the Yen. Markets are concerned that should yields increase in Japan that this will pull investors away from the US Treasury market.

Locally South Africa received some positive news that Putin would not be attending the BRICS Summit in person but rather attend virtually. This has avoided the political noise around whether our Government would go ahead and arrest Putin should he arrive in the country and put our global relationships under significant pressure. Following the announcement, the Government did indicate they would arrest Putin if he had attended the Summit physically which although after the fact should hopefully ease some tensions with our Western partners.

Macro Environment

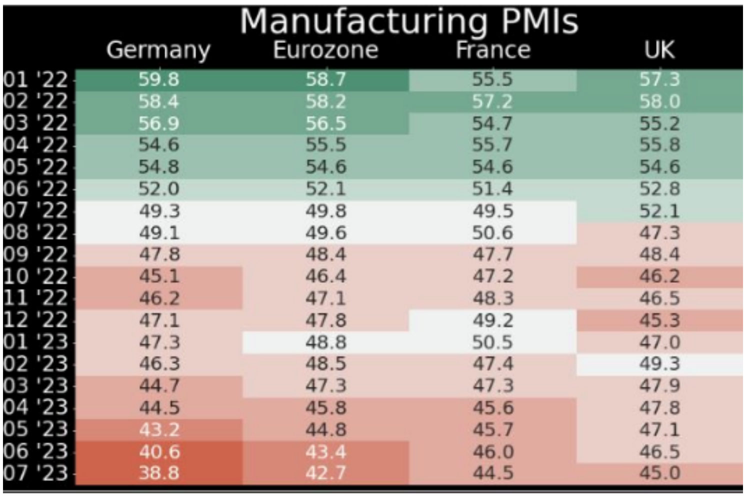
The market is starting to believe that inflation could be brought under control and that a soft landing may be possible. A number of commentators have referred to a "Goldilocks" scenario where the Fed manages to navigate this high inflation, bring it under control and not hurt the economy. There is still a lot to unpack in the months ahead but looking at the chart on the right from Bloomberg the inflation picture is looking a lot better than it was a year ago. At the same time a number of other data points such as unemployment, jobless claims, GDP and housing stats are showing a US economy that is still growing and does not appear close to a recession.





Sadly, the war in Ukraine seems to be a permanent feature of world conflict and something markets have largely moved to accept. Previously Turkey looked to block Sweden joining NATO but has now reversed this view providing approval for them to join. Putin has been very vocal about his views on NATO and not wanting the alliance to spread East as more countries who Russia share a border with fall into the alliance. He is getting the opposite of his wish as more countries form part of the alliance gaining support in the form of weapons and expertise which is putting pressure on Russia's borders. The chart on the left from Statista outlines the expansion of NATO over the years and emphasised how the alliance has spread East, and this is highlights Putin's previous concerns with the war effort actually working against him.

The US macro picture is looking robust with several data points coming through better than expected and the market rallying on the downward trend in inflation. This is spurring hopes that the Fed is done hiking making risky assets more attractive. Unfortunately, the same can't be said for the Euro where despite avoiding the energy crisis, the impact of the significant rate hikes is having a clear impact on the economy. The slowdown is clearly reflected in the Bloomberg chart on the right reflecting some of the regions manufacturing PMI's. Overall, the macro landscape has some positive shoots although certain regions should we watched closely.



Manufacturing PMIs

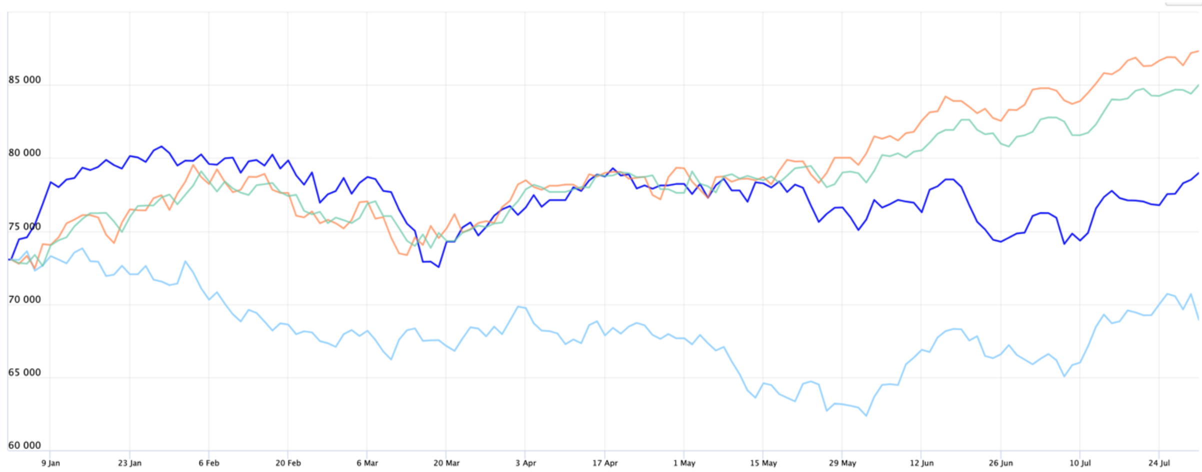
	Germany	Eurozone	France	UK
01 '22	59.8	58.7	55.5	57.3
02 '22	58.4	58.2	57.2	58.0
03 '22	56.9	56.5	54.7	55.2
04 '22	54.6	55.5	55.7	55.8
05 '22	54.8	54.6	54.6	54.6
06 '22	52.0	52.1	51.4	52.8
07 '22	49.3	49.8	49.5	52.1
08 '22	49.1	49.6	50.6	47.3
09 '22	47.8	48.4	47.7	48.4
10 '22	45.1	46.4	47.2	46.2
11 '22	46.2	47.1	48.3	46.5
12 '22	47.1	47.8	49.2	45.3
01 '23	47.3	48.8	50.5	47.0
02 '23	46.3	48.5	47.4	49.3
03 '23	44.7	47.3	47.3	47.9
04 '23	44.5	45.8	45.6	47.8
05 '23	43.2	44.8	45.7	47.1
06 '23	40.6	43.4	46.0	46.5
07 '23	38.8	42.7	44.5	45.0

Asset Allocation

We are comfortable with our asset allocation where we have remained in markets with a tech bias but also managed across asset classes to get the benefit of diversification. We are a bit wary of some of the tech valuations currently so have been trimming certain positions for clients but still believe there is opportunity in the US as the S&P500 return has been very narrow with concentration in the 'magnificent 7'. As the market breadth widens, we could see some of our other preferred name's benefit. This has allowed for our equity weighting to remain largely unchanged despite the repositioning. Fixed Income as well as Structured Notes continue to play an important role in the portfolio with a balance of cash maintained to take advantage of opportunities. Overall, we are comfortable with how clients' portfolios are positioned and should see benefit if the market rally broadens out a bit.

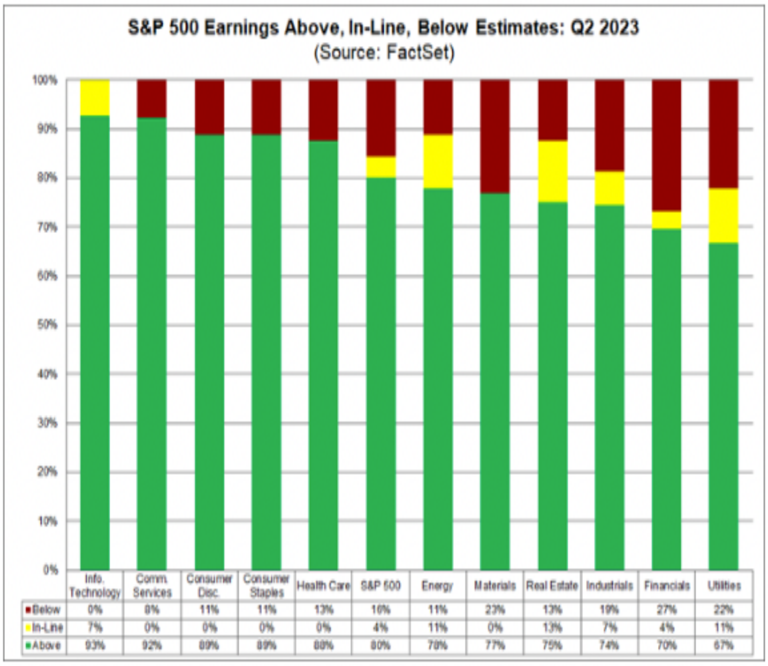
Market Performance

July saw a strong month for markets in general driven by lower inflation and some strong economic data. Globally the MSCI World was up 2.86%. The S&P500 ended the month up 2.99%. The JSE was up 3.6% in July. The chart below depicts the market movements for the year to date with the blue line showing the JSE all share up 8.12% and the light blue line showing the ZAR/USD exchange rate declining YTD by 5.63%, the orange line showing the S&P500 up 19.52% and the green line showing the MSCI World up 16.36%.

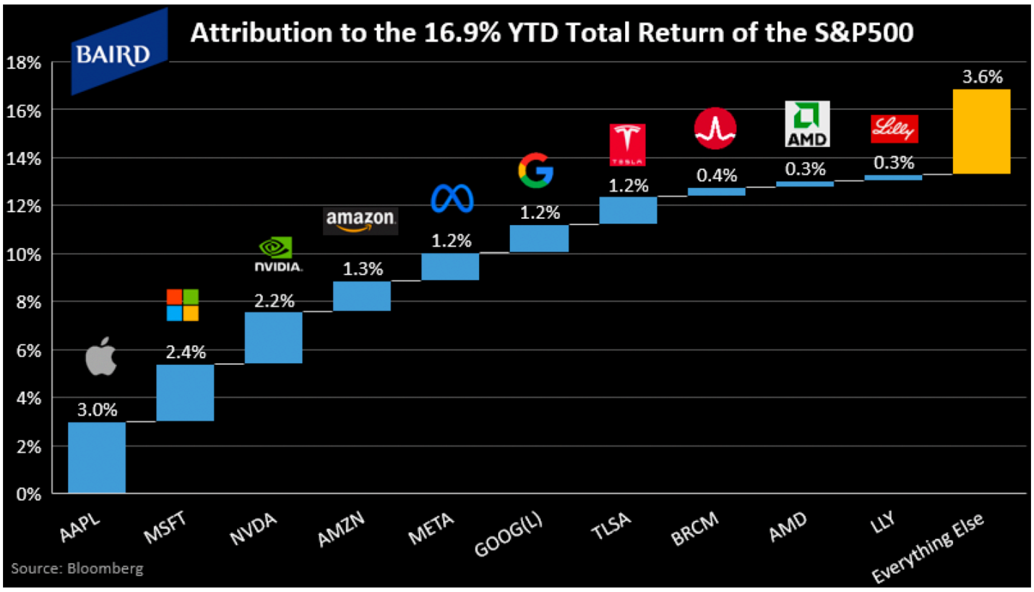


Equities

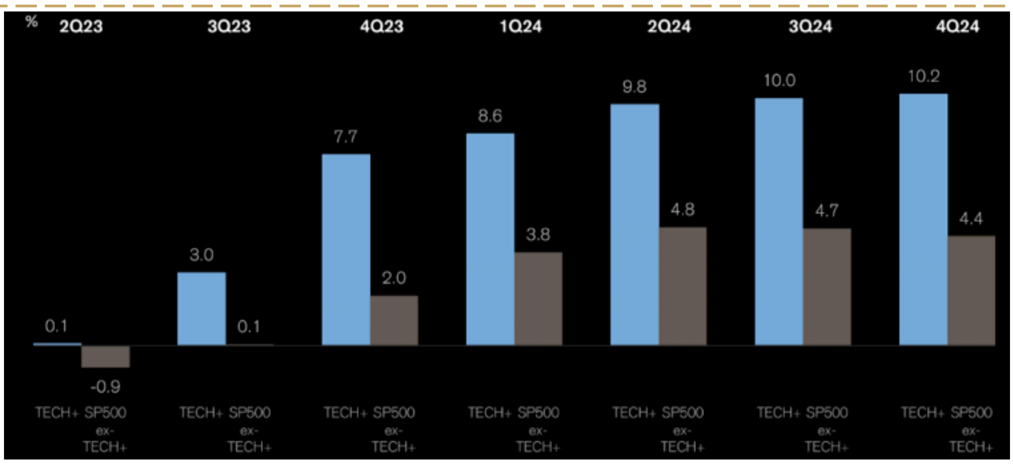
We are at the midpoint of earnings season in the US and to date results have been good. According to Factset 80% of companies are reporting EPS above estimate which is above both the 5-year and 10-year averages. Although earnings are definitely beating estimates the pressures of rate hikes are being felt with a blended earnings decline for the second quarter of 7.3%. This is not surprising based on the extreme hiking cycles over the last 18 months having an effect of companies as well as the high inflation they have had to contend with. Looking at the sectors as outlined by the chart on the right, it is clear that Information Technology continues to surprise the most on the upside while financials have provided the most below consensus results so far. This is likely a result of the banking crisis that took place earlier in the year putting pressure on the sector as a whole. The big banks results were still very positive and largely beat expectations.



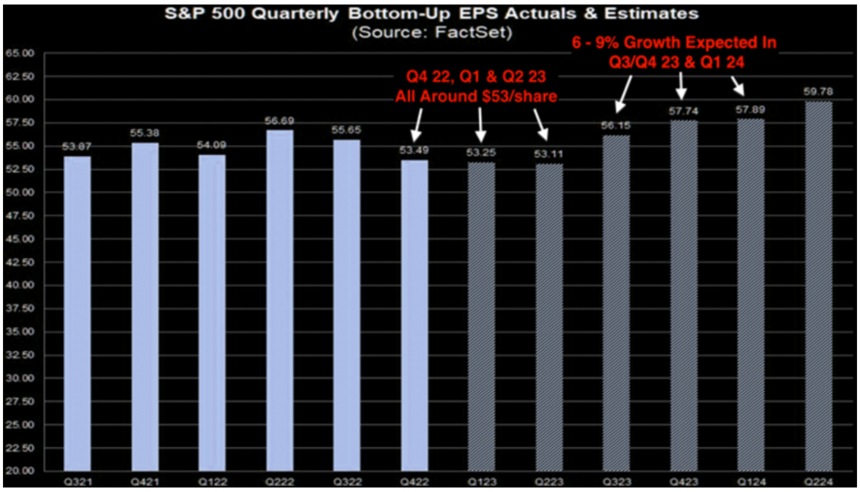
The strong returns seen to date in the US have not been about the market as a whole. As outlined by the graphic below, 10 companies have driven 13.3% of the return while the other 493 companies have only contributed a return of 3.6%. This is a fairly unusual scenario which a number of market commentators have been highlighting. The good news is that our clients hold a number of the companies shown below which have been driving this growth and it further means there is still a lot of opportunity in the rest of the market should the rally broaden to the other 493 companies. This chart reinforces our thesis of a few months back that stock selection in an uncertain market is important. Based on recent results there are a number of companies that haven't run hard to date but still producing good results. As a team we are spending time looking at these opportunities as a way to put some profits to work from the Technology sector. As a house we will always hold technology but there is no doubt should performance broaden outside of tech there are lots of opportunities beyond this sector.



It is important to understand why the market is so excited about tech and it all comes down to future earnings. Tech is seen as the earnings growth engine of the market and in turn the market is happy to pay up. This is outlined by the chart below from Credit Suisse showing revenue growth estimates for the S&P500 excluding tech versus tech. It is clear to see where the market is expecting growth and why we are seeing multiple expansion currently.



Markets are forward looking and so despite earnings coming under pressure this year the outlook into 2024 is a lot more positive as outlined by the chart on the right. Ultimately earnings season is all about expectations and guidance and to date expectations are being beaten and the forward-looking picture is a lot better. Investors are willing to pay up which drives price to earnings expansion and strong returns. Obviously, the risk to this outlook is if earnings should disappoint then the market can quickly rerate from a valuation perspective. None of this is new but it reinforces the need to stay in the market and then manage allocation and positions depending on our outlook.



Bonds

Offshore bonds have seen a bit of consolidation as the peak of the hiking cycle appears close. Japan's shift in yield-curve control caused some volatility as market concerns around shifts away from US Treasuries were raised. The bond market still provides an attractive offering as part of the offshore portfolio and to date has worked well. In the local market we have seen a recovery in the bond market as the Rand recovered and SA saw more favour from international investors following the BRICS Summit outcome with Putin not attending physically.

Conclusion

July has been another good month for portfolios and sentiment appears to be shifting towards a soft-landing scenario. We still think there are risks on the horizon and the inflation battle is not over. We believe geographic positioning is important as there is a clear divergence amongst regions. However, we are happy with our current portfolio positioning and believe some equity opportunities outside of technology are starting to present themselves which could make a case for deploying some cash. The portion of portfolios outside of equities are also performing well and both fixed income and structured notes are generating a very attractive yield. We continue to be available should our clients want to go through their portfolio in detail and discuss positioning for the remainder of the year.