INVESTMENT ENVIRONMENT

DOUGLAS INVESTMENTS

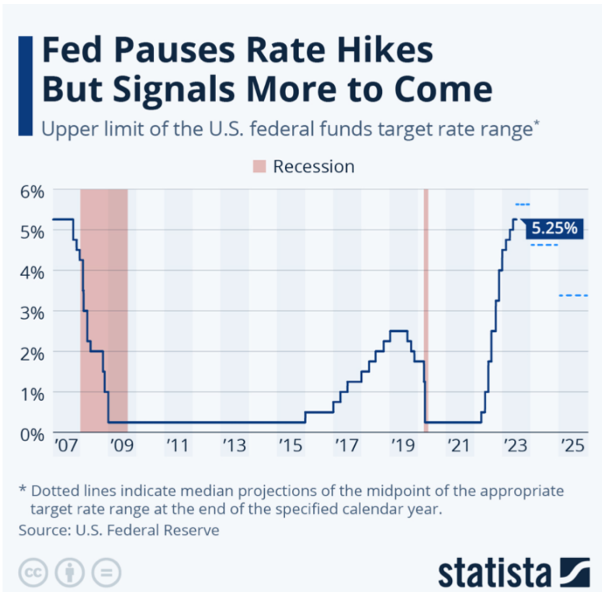
Introduction

June was a good month for US markets as strong equity growth saw a risk on bias but the same can't be said for South Africa. With earnings season behind us, the attention shifted back to the macro environment with the market following macro data releases with the key focus being inflation and in turn the central banks response. The various US, UK, Euro and Japanese central bank heads met in Sintra, Portugal to discuss the work being done to bring down inflation. Saudi Arabia decided to institute a surprise production cut to oil output to try stem the declining oil price and provide a support level. This resulted in them giving up market share as they were the only country to institute production cuts. During the month, geopolitical tensions continued to make headlines with China and US relations appearing to take two steps forward and one step back. US Secretary of State Antony Blinken met with President Xi Jinping in Beijing with both parties reporting on positive talks and progress being made. Shortly following these discussions President Biden made comments likening President Xi Jinping to a dictator. This coupled with additional expectations of semiconductor chip supply to China being restricted by the Biden administration seems to have undone a lot of the progress made during the Beijing discussions. The Ukraine and Russia war continued with Ukraine's Kakhovka Dam being blown up and causing flooding and significant infrastructure damage. Mercenery Yevgeny Prigozhin who heads up the Wagner Group started marching on Moscow before doing an about turn and calling off what many have seen as the start of a coup against Putin. Although things have calmed down in Russia for now it has raised questions around Putin's true power and following and whether his leadership may be under threat. The growth story out of China is not materializing as many would hope with their recent PMI reading below 50 indicating contraction and not the big growth factory expected at the start of the year. This has a knock-on effect to commodity prices with the likes of copper halving from prices seen in January.

South Africa (**SA**) continued to experience headwinds in June although the extreme levels of loadshedding eased which should hopefully assist in improving business and consumer sentiment. The Rand also saw some strength which was fairly short lived as it started to move back towards the R19 to the US Dollar. News broke that the US was looking to remove SA from AGOA (African Growth and Opportunity Act) which provides favorable trade terms for exports to the US. This has largely been seen as a consequence of the Governments neutral stance on the Russia Ukraine war.

Macro Environment

As largely expected, we saw a rate hike pause from the Fed in their June announcement. Despite this, the rhetoric coming from the Fed was still hawkish with Powell alluding to a further 50 bps of hikes before the end of the year. The Statista chart on the right shows the work done to date which the market was largely pricing as sufficient as the peak of rates so this new view of further hikes will be watched with caution. The ECB also hiked rates by 25bps to 3.5% and clearly indicated more work to be done. The BOE hiked by a 50bps as inflation is proving to be more resilient with core inflation increasing and surprising on the upside. South Africa's inflation came in lower than expected which was some welcome relief with hope rate hikes can slow.



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Putin's leadership and in turn power might be under threat after Yevgney Prigozhin through the Wagner Group went on a 'march for justice' following his views on the war in Ukraine being poorly managed. The rebellion was quickly averted with a deal for Yevgney to leave Russia to Belarus resulting in the Wagner group halting their march on Moscow and the anticipated violence avoided. Yevgney was once considered a strong ally of Putin, nicknamed the Chef as his catering company provided food to the Kremlin, so the rebellious act indicated flaws in Putin's power. There are still many questions that need answering such as, who will the remaining Wagner soldiers answer to going forward and will they stop fighting in Ukraine. As can be seen from the chart on the left they have a large presence globally where they are active for Russia. There is no doubt questions around Putins strength are increasing and the coming months will be telling.

At the start of 2023 the view was that the US is likely heading into a recession and global growth's main hope was for China opening up to stimulate the global economy. To date this hasn't happened with China struggling to kick start their economy and the US holding up stronger and to date avoiding a recession. There is no doubt there are risks on the horizon as further work needs to be done to bring inflation down to target levels and due to the lag effect of rate hikes, we could see an over tightening by central banks. There is also a strong view that financial conditions will be tighter as additional regulation takes hold of banks following the crisis that began in March. Having said that economies have shown resilience in a rising rate environment with even South Africa managing to churn out some growth at 0.4% despite excessive load shedding. Should central banks manage to bring inflation into target without over tightening and if the trend of economic data remains resilient then the second half of 2023 going into 2024 could present a more favourable macro environment for companies.

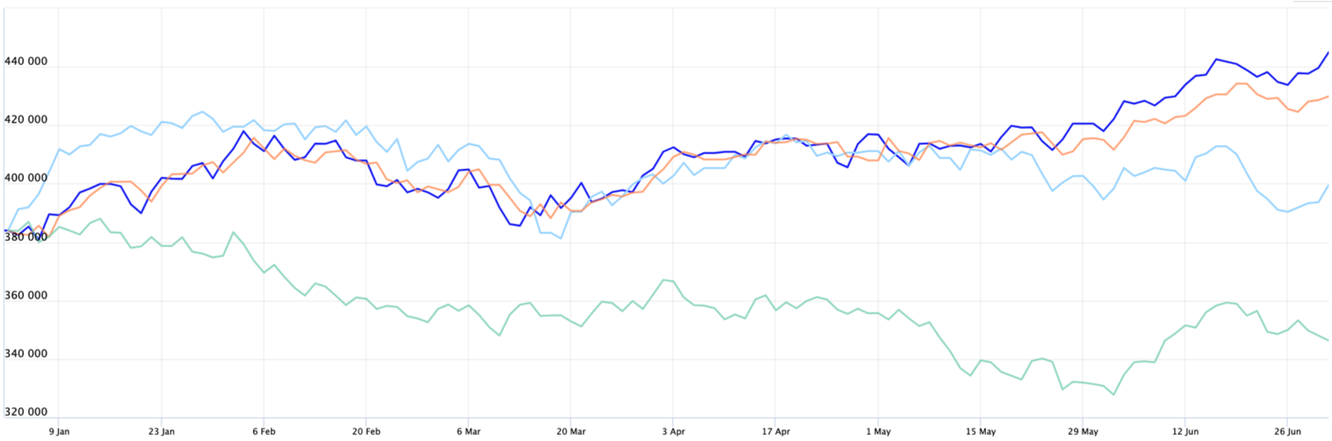
As the macro data continues to evolve, we adjust the asset allocation within portfolios to position our clients for the most attractive risk adjusted returns with a long-term outlook.

Asset Allocation

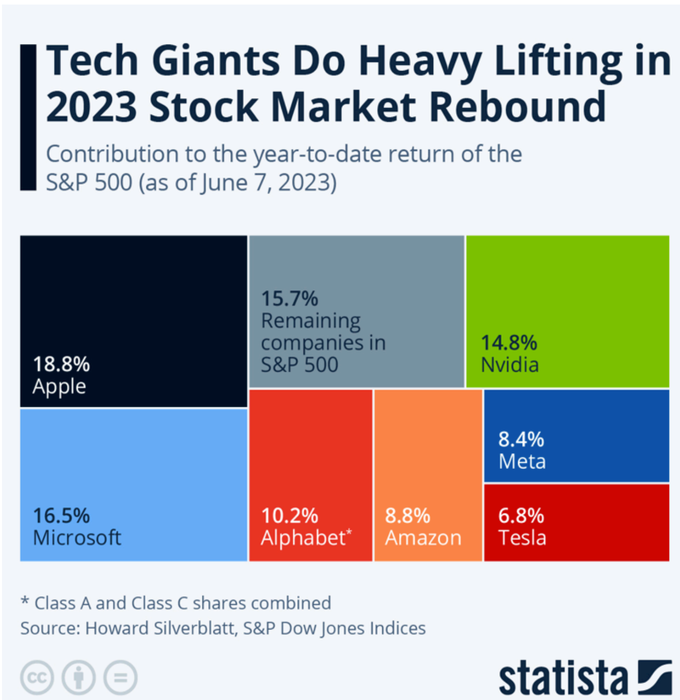
We have kept our asset allocation with a slightly conservative equity weighting following the strong run in US markets driven by the technology sector. Based on recent macroeconomic data there may be a case to increase equity allocation, but we are wanting to monitor earnings season starting in July to gauge how the underlying companies are performing. Our Bond positions and Structured Notes allocations remain unchanged as alongside cash they make up the balance of the portfolios. Locally we remain concerned about growth prospects for SA focused companies and seek to create some diversification by focusing on global players who mitigate SA risk. Our allocation to local bonds remains unchanged despite all the volatility that has been experienced in the last month as we believe a longer-term horizon should see some benefit.

Market Performance

June saw a very strong month for US markets driven by strong economic data. The JSE on the other hand ended largely flat over the month due to a rally towards the end. Globally the MSCI World was up 4.4%. The S&P500 ended the month up 5.43%. The JSE was up 0.32% in June. The chart below depicts the market movements for the year to date with the light blue line showing the JSE all share up 4.08% and the green line showing the ZAR/USD exchange rate declining YTD by 9.81%, the blue line showing the S&P500 up 15.91% and the orange line showing the MSCI World up 11.96%.



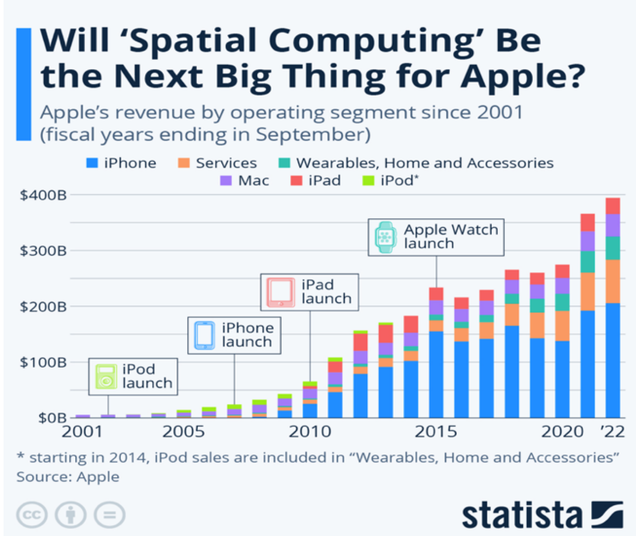
The S&P500 officially entered a bull market in June (increase of more than 20%) from the October 12th low of 3577. This has largely been driven by the tech sector as outlined by the chart on the right. Current strategists in the US are seeing a divergence in views with some saying the bull market will continue while others caution valuations are overdone and, should earnings come under pressure, we could see a quick correction. Our view is that to date the US economy is showing resilience which as markets are forward looking and we reach the peak of the hiking cycle that other sectors could see an uplift which will continue to drive the market forward. Having said that we are cautious around certain stock valuations which have run far ahead of historic averages so should there be any slow down or earnings drop off then the price will come under pressure. This emphasizes the stock picking environment we have spoken about in previous Investment Environments.

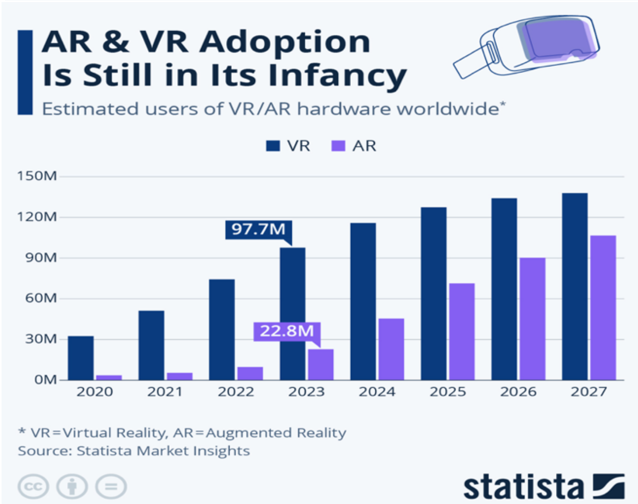


Apple remains one of DI's preferred stocks and continues to perform reaching new highs at the end of June. They also launched their latest new product which is a highly anticipated Virtual Reality headset called the Vision Pro. The launch had mixed reactions from markets with some concerns around the price point which is on the high end at $3499.

The reality is the technology is still new and all the use cases still need to be understood from the Metaverse, to the work environment and entertainment. However, based on Apple's track record of launching new products and learnings from their customers it is an exciting next step in the company's story.

Locally we saw an announcement from Naspers and Prosus that the cross holding that was implemented in 2021 was going to be unwound. This is in an effort to continue with the current share buyback program and assist in reducing complexity within the group. We believe this is a good move to assist with unlocking the discount to NAV which shareholders should see a benefit from. However, it is important to remember it is the same management team who put the structure in place that is now unwinding it and these processes come with significant advisory fees.





Bonds

Offshore bonds saw yields tick up as markets expect further hikes from central banks based on hawkish comments being made by the central bankers. We still prefer focusing on the shorter end of the curve to minimize duration and look to hold to maturity based on attractive rates. Locally the SA bond market has been in a perfect storm with rates going higher than expected, the rand blowing out and views on SA risk increasing. This unfortunately has put pressure on bonds prices, but our view is should sentiment improve and indications of rates peaking come through then we can expect returns to normalize.

Conclusion

June was a good month for the US, but the rest of the world was fairly muted. We hold a strong US bias, which has benefitted portfolios. Although we are wary of certain stock valuations and geopolitical risk is high there is still strong macroeconomic data which indicates a recession could be avoided. As we move into earnings season in July this will give us a view on company performance and how the market is likely to position for the second half of 2023 with both the Bull and Bear camps making a lot of noise. Locally we are concerned about economic growth so are focused on a strong rand hedge bias in portfolios until we can see some positive policy implementation. Please reach out to us should you wish to chat through any portfolio detail.

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