INVESTMENT ENVIRONMENT

DOUGLAS INVESTMENTS

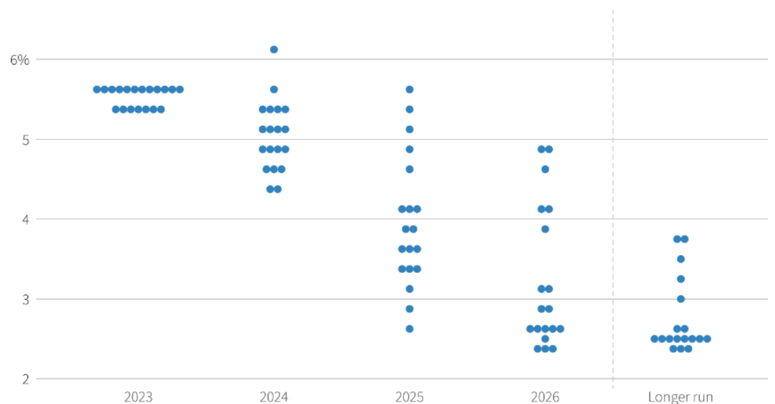
Introduction

September was generally a poor month for markets as risk assets across the globe sold off following strong higher for longer rhetoric on interest rates coming out of most central banks. China continued to experience pressure in the property sector with Evergrande's founder Hui Ka Yan being investigated over suspected crimes. Eurozone inflation came in better than expected at 4.3% versus the expected 4.5%. The ECB has remained fairly hawkish and emphasized that they remain data dependent following a 25bps hike in September. The UK also saw their inflation come in lower than expected which allowed the BOE to keep rates on hold at 5.25% at their September meeting. The Fed was the market mover as they kept rates on hold at 5.5% which was what the market expected but the updated dot plot showed an expectation of 50bps of cutting in 2024 versus the market expectations of 100bps of cuts. This was the main driver of the higher for longer discussion and saw the 10-year US Treasury experience a fairly significant shift higher to levels last seen in 2007. Adding to some concerns of sticky inflation has been the recent rally in the oil price with both Brent Crude and WTI sitting comfortably above the $90 a barrel mark. The US also experienced some labour pressure with the United Automobile Workers (UAW) union going on strike due to a significant gap between their demands and what the major OEMs are offering. The strike is ongoing and is driving debate as to what is sustainable for traditional ICE vehicle manufacturers. Finally, the US nearly went into a Government Shutdown with a deal only being struck at the final hour to avoid it. Markets were not overly concerned but there were questions of added uncertainty as depending how long the shutdown went on for there could be a gap in government data.

From a South African perspective inflation came in at 4.8% which was slightly higher than prior month at 4.7% but was sufficient for the MPC to keep rates flat at 8.25%. Unemployment also came in a bit better than expected although largely driven by some seasonal workers. Load shedding continues to remain erratic which consistently hampers growth although some positive reports that with private sector involvement we should see lower levels of load shedding in 2024. A key macro concern that is coming into focus is the current fiscal position of South Africa with worse than expected tax collections putting pressure on the fiscus and driving a ramp up the country's debt to GDP. South Africa's structural economic problems remain a significant hurdle for companies and create a difficult Investment Environment.

Macro Environment

The biggest news in September was the shift in the Fed's projections as outlined by the Dot Plot on the right. The majority of policymakers still indicate one more hike in 2023 and the updated dot plot reflects 50bps and fewer cuts in 2024. The market didn't like this and reacted with a steep sell off in the remainder of September. The Fed officials also don't see inflation getting back to 2.0% until 2026 which is driving the higher for longer discussion amongst the bears. This was viewed as hawkish, and despite other economic projections seeing an upgrade, general sentiment took a negative shift.



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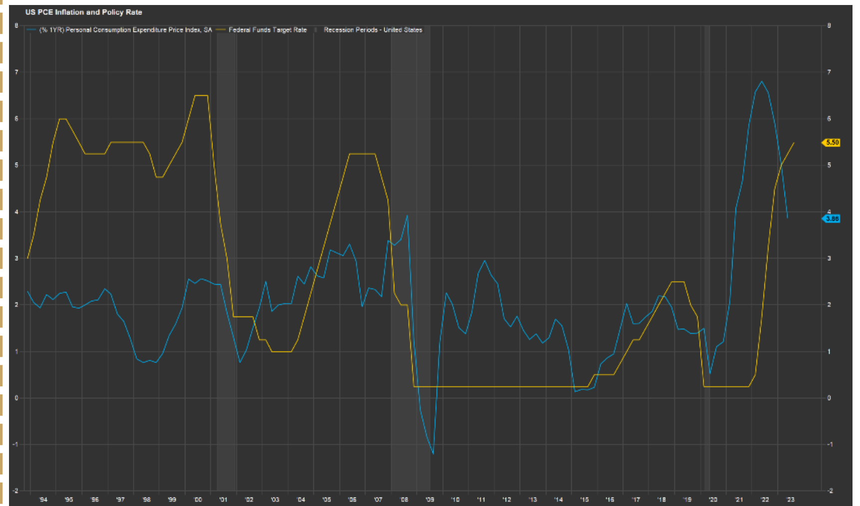
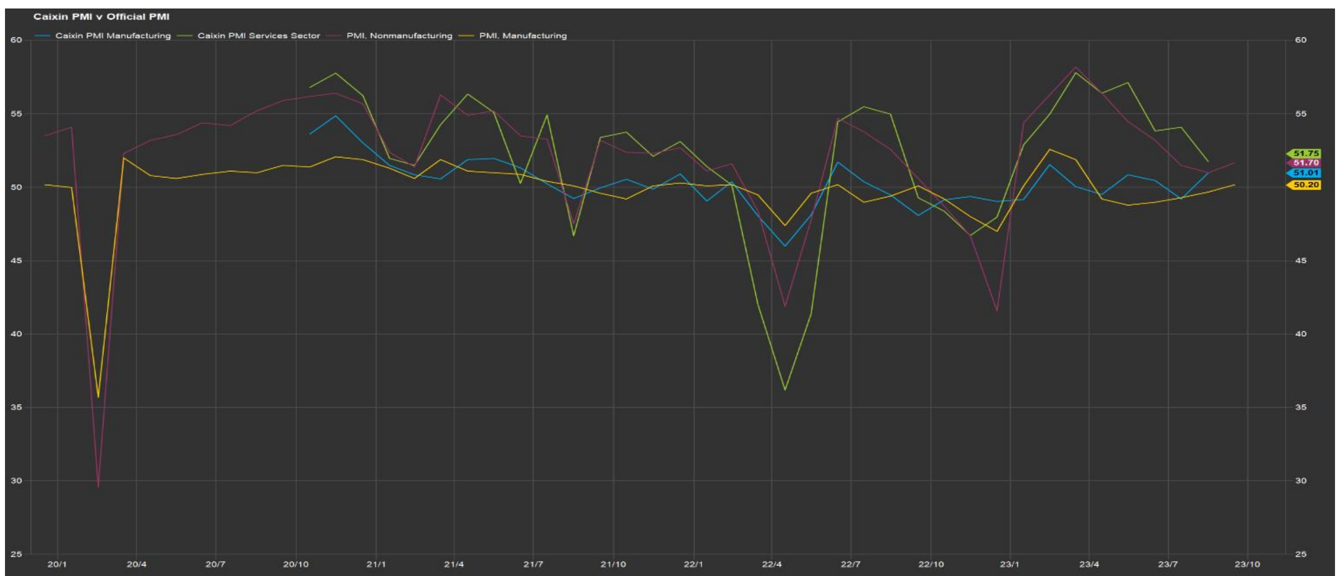
The chart on the right reflects the Fed's preferred measure of inflation (PCE) for which they have a 2% target as well at the Fed's target rate. What is clear is that the Fed has implemented very aggressive hiking which is driving inflation down. The trajectory from here on might be a bit bumpier but provided PCE continues on a downward trend then the Fed shouldn't require any further hikes. Current Fed projections are for one more hike in 2023 whereas most market participants think they are done hiking. The next meeting is in November so the data coming out between now and then will be critical to determine the next rates move.



China has not been the growth story everybody expected this year as their property crisis is running deeper and creating a real drag on the economy. This coupled with a slower growth environment coming out of Covid has made for a difficult year for what many see as the factory of the global economy. This coupled with the ongoing geopolitical tensions with the US has made the Chinese investment case more challenging. As outlined by their PMIs in the chart below there has been a clear slow-down in 2023. On a positive front recent PMI data did beat expectations so the economy might be turning around, and this would be good for general growth. The chip war between the US and China has been interesting with the latest Huawei model showing technology only about 4 years behind the US, compared to the US restrictions in place to keep Chinese chips 8-10 years behind their technology.



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Asset Allocation

Our asset allocation remains in line with August although we do view the recent pull back in equities as an opportunity to put new money to work and top up underweight positions. From a bond perspective we remain with our view that holding to maturity to benefit from current yields on offer between the 3-5 years is the best positioning as volatility in the bond market is high. Finally, as volatility picks up our structured note strategy continues to play an important role in portfolios by bringing income into the portfolio with some downside protection.

Market Performance

September was a poor month for markets with pain felt across regions. The S&P500 was down 5.04% for the month while the MSCI World and JSE were down 4.04% and 3.21% respectively. Despite the poor performance in September the S&P500 is still up 11.68% YTD and the MSCI World is up 10.60%. Unfortunately, the JSE has struggled this year and to date their performance is down 0.91%.

Equities

Equities saw a rapid sell off in the last two weeks of September following the Fed meeting on the 20th. The S&P500 suffered its biggest pullback since December of 2022. The Magnificent Seven which has been the main driver of markets to date saw pressure in September with all but Meta showing a negative return for the month. The upward pressure on rates was a key talking point and a significant headwind for risky assets. Hawkish commentary coupled with seasonality as a further headwind meant there was nowhere to hide in equities with the only positive sector being Energy largely driven by the higher oil price producing favourable returns for energy companies.

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Share	September Return	YTD Return
Nvidia	-11,9%	197,7%
Apple	-8,9%	31,8%
Amazon	-7,9%	51,3%
Google	-3,9%	48,3%
Microsoft	-3,7%	31,7%
Tesla	-3,1%	103,1%
Meta (Facebook)	1,5%	149,5%

The Magnificent Seven as outlined on the left have had an incredible year and the been the main driver of market returns in the US, however September saw some pressure especially by the likes of Nvidia and Apple. This was in line with more risk off sentiment and these stocks are also more sensitive to interest rate changes due to their high growth nature so the higher for longer rhetoric will have hurt their performance. From a DI perspective we still like the fundamentals of a number of these companies and view the recent pull back as an opportunity.

An interesting talking point amongst market participants has been the seasonality that is experienced in markets. As outlined by the table below from FactSet which depicts the monthly returns of the S&P500 for the past 10 years, the stand out worst performing month is September with an average negative return of 1.5%. The only other negative month over the 10-year period is December. If seasonality is to be believed October and November has historically been very good months for the market.

Change (MoM%)

-12.51 … 12.68

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
11 Year Avg	**0.7**	**0.2**	**0.6**	**1.8**	**0.8**	**0.8**	**3.3**	**-0.1**	**-1.8**	**2.1**		
10 Year Avg	**0.2**	**0.4**	**0.4**	**1.8**	**0.9**	**0.2**	**3.3**	**0.1**	**-1.5**	**2.3**	**3.2**	**-0.1**
2023	6.2	-2.6	3.5	1.5	0.2	6.5	3.1	-1.8	-4.9	0.0		
2022	-5.3	-3.1	3.6	-8.8	0.0	-8.4	9.1	-4.2	-9.3	8.0	5.4	-5.9
2021	-1.1	2.6	4.2	5.2	0.5	2.2	2.3	2.9	-4.8	6.9	-0.8	4.4
2020	-0.2	-8.4	-12.5	12.7	4.5	1.8	5.5	7.0	-3.9	-2.8	10.8	3.7
2019	7.9	3.0	1.8	3.9	-6.6	6.9	1.3	-1.8	1.7	2.0	3.4	2.9
2018	5.6	-3.9	-2.7	0.3	2.2	0.5	3.6	3.0	0.4	-6.9	1.8	-9.2
2017	1.8	3.7	-0.0	0.9	1.2	0.5	1.9	0.1	1.9	2.2	2.8	1.0
2016	-5.1	-0.4	6.6	0.3	1.5	0.1	3.6	-0.1	-0.1	-1.9	3.4	1.8
2015	-3.1	5.5	-1.7	0.9	1.0	-2.1	2.0	-6.3	-2.6	8.3	0.1	-1.8
2014	-3.6	4.3	0.7	0.6	2.1	1.9	-1.5	3.8	-1.6	2.3	2.5	-0.4
2013	5.0	1.1	3.6	1.8	2.1	-1.5	4.9	-3.1	3.0	4.5	2.8	2.4

There is no doubt September was a tough month for equities driven by a number of factors. It seems market participants have been waiting for a pull back with a significant amount of hedging and portfolio protection being put in place from July. The tipping point was the Fed's updated view for fewer cuts in 2024 coupled with the hawkish tone of higher for longer. While we do not expect inflation to continue its aggressive downward trajectory based on the data and significant hikes to date, we still believe inflation will trend downwards which in the longer term will be good for risky assets as it will provide scope for rate cuts. Despite September poor returns there is still a positive outlook as corporate updates as analyst investor days are pointing to the soft-landing discussion and analyst revisions for earnings reflect a rebound in 2024. This coupled with a resilient consumer and macro data, that is still strong, could still indicate a good time for markets ahead in the US. Globally the growth story is definitely weaker and other regions such as Europe and China are presenting a more difficult investment case.

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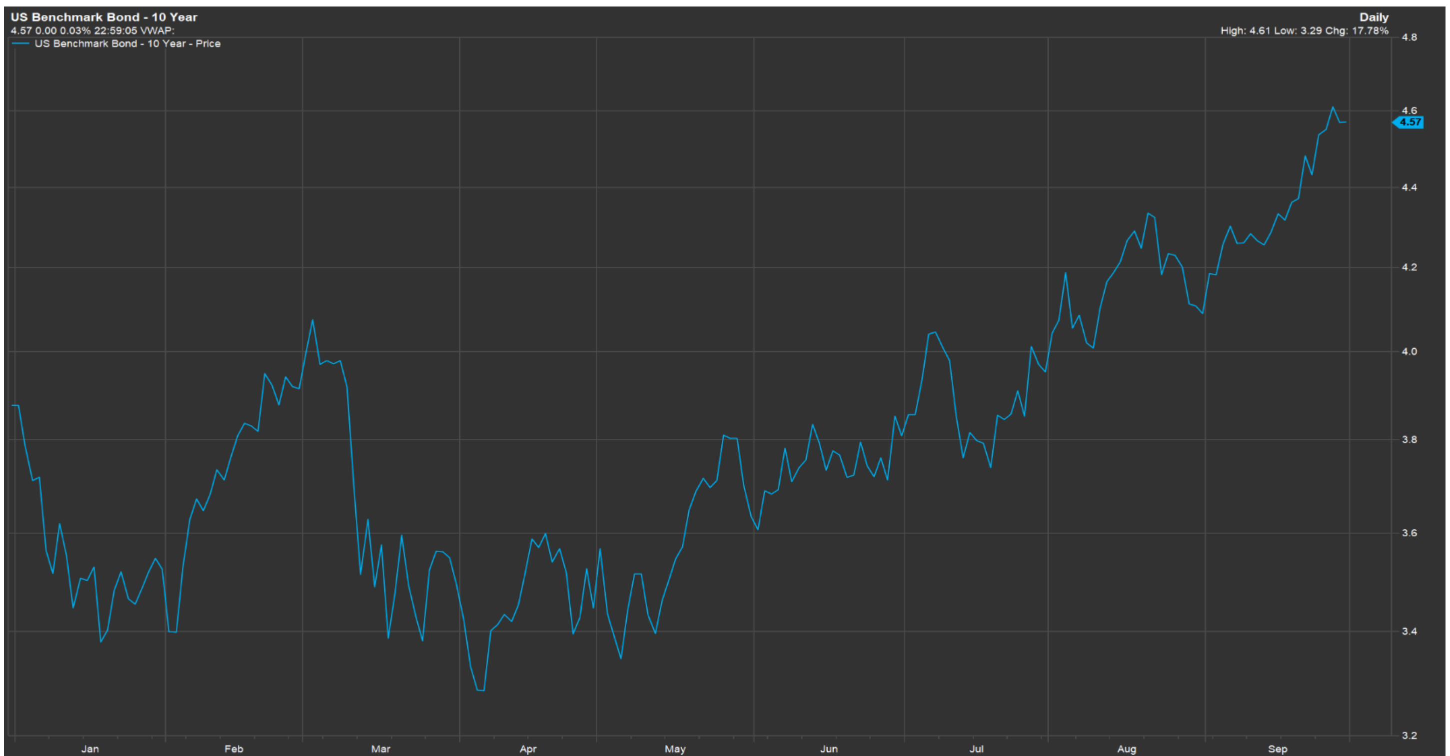
Bonds

The bond market continues to be a volatile space with significant moves in yield as the market looks to project the rates outlook. In September this was largely driven by the US Treasury 10 year which as outlined by the chart below saw a significant move up in yield from 4.19% to close the month 4.57%. This is a large move for what is widely regarded as a risk-free asset and is part of the reason other risk assets have seen an uptick in volatility. The current levels of the 10 year were last see all the way back in 2007.



Conclusion

Unfortunately, September has been a poor month for markets and in turn portfolios; however, we still think longer term fundamentals are encouraging. Should the downward trajectory of inflation continue then a path to rate cuts lies ahead which risky assets will benefit from. The timing is unknown but that is always the case with markets so we remain focused on good quality companies that can be held for the long term and asset class positioning that makes sense based on the macroeconomic environment. We anticipate continued volatility as we sit in a bit of a data vacuum until mid-October when the next CPI reading comes out and we also get to the beginning of Q3 earnings season. As the final quarter of 2023 is upon us, we are focused on positioning for a strong end to this year and looking forward to what lies ahead in 2024. As always please feel free to reach out to us should you wish to discuss the general investment environment or any specifics in relation to your portfolio.

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