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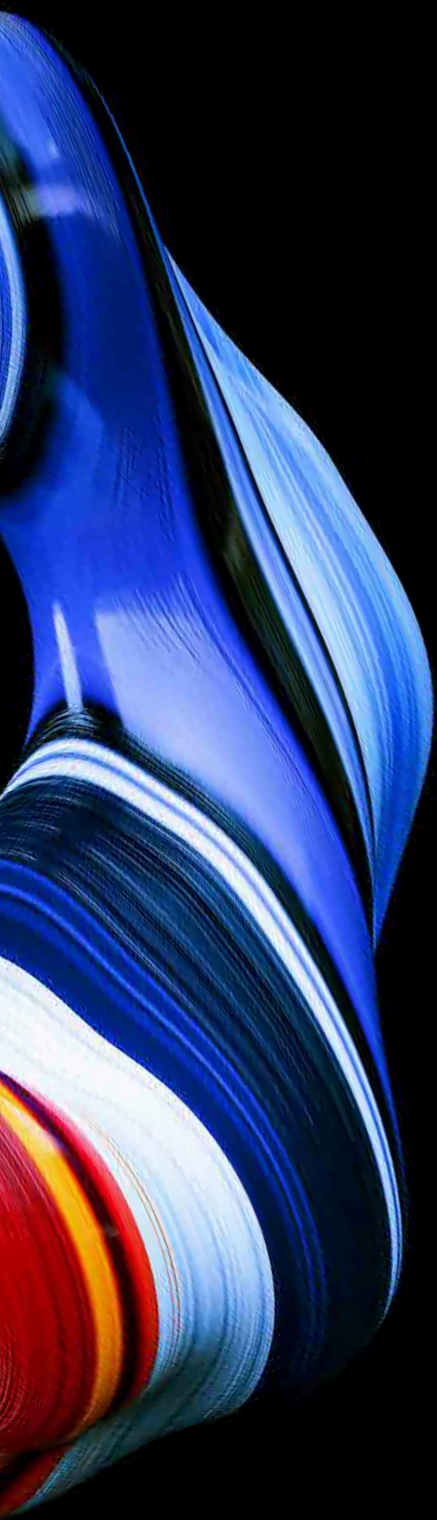


QUARTER 2, 2023 MARKET REPORT

Closer to the truth

Population shifts will be impacting your life experience

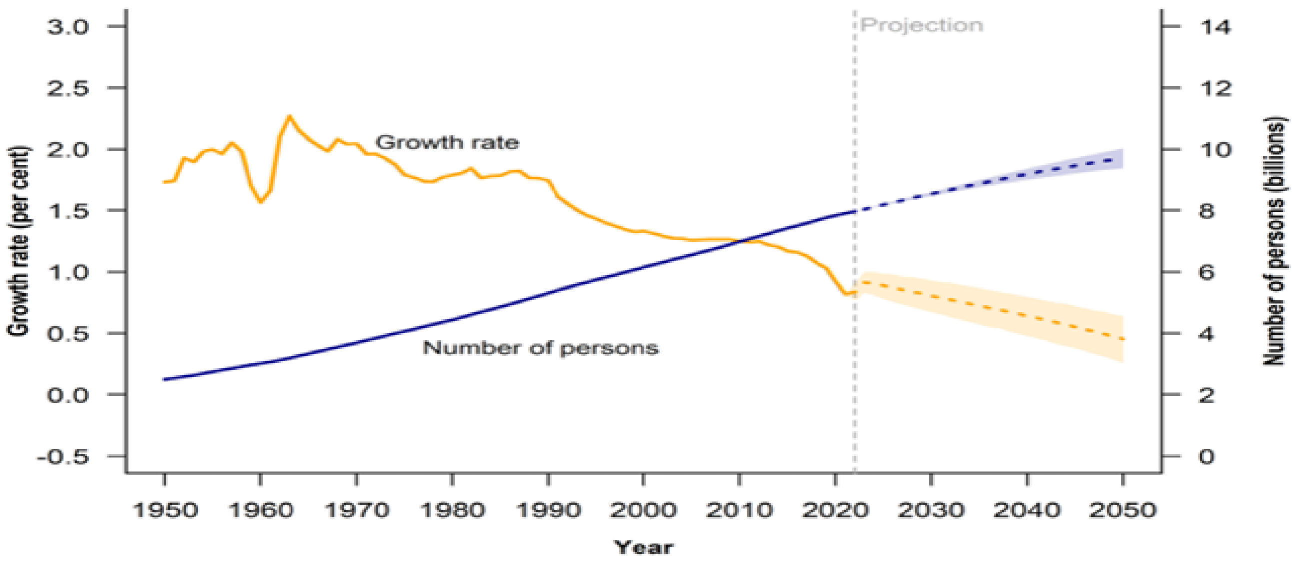
Adrian Clayton, CIO

Global but more important, regional population changes, particular in Africa are going to profoundly affect our lives. How we invest will be impacted, but even more important, is an understanding and preparation for how these will adjust our daily living experience. This is the first article of two follow-up articles which we have written on tectonic demographic shifts.

Global demographics, the changes which happen in a population, matter and the world is beginning to experience some profound differences versus decades past.

Between 1950 and 1987 (37 years), the Earth's population grew from 2.5bn people to 5bn. It is expected to double again by 2059, reaching 10bn, but taking much longer, 72 years. The rate of population growth is slowing down, but more importantly, by 2100, the number of humans that occupy this planet is expected to shrink, this will be the first time since 1346, the onset of the Black Death, that this has happened.

Chart 1: Global population size and annual growth rate: estimates, 1950-2022, and medium scenario with 95 per cent prediction intervals, 2022-2050



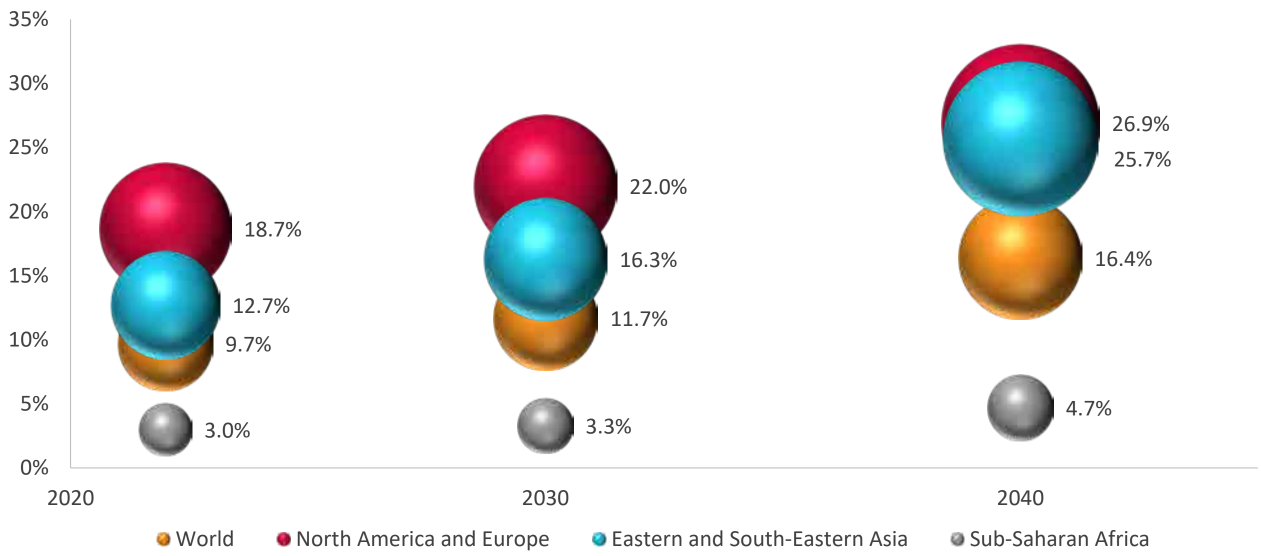
Source: UN Population Division

Changes are already afoot, global fertility rates in 2000 were 2.7 births per woman, they are currently at 2.3 births and to keep the current population numbers stable, a replacement birth rate of 2.1 is required. 15 of the largest countries by GDP already have fertility rates below the replacement rate, these include the USA, China, and India. The Chinese birth rate in 1970 was 6 children per woman, it fell below 2.1 in 1991. Africa, an area that continues to grow in numbers, has also shown a distinct collapse in birth rates. In 1980 the African birth rate was 6.6 kids per mother, in 2023 it is 4.2.

Pro family policies (incentivizing more births) are failing – Singapore has used incentives for years with no positive effect, China has tried the same for the last couple of years. China's National Bureau of Statistics announced that its population shrank by 850 000 people in 2022. The UN predicts that China's population will halve by the year 2100 to 700m.

So, the one demographic change is fewer children, the other is an aging world. By 2050, there are expected to be twice as many 65 years olds walking the planet as 5-year-olds. By 2030, more than 50% of East and Southeast Asians will be over the age of 40.

Chart 2: Percentage of population aged 65 and over



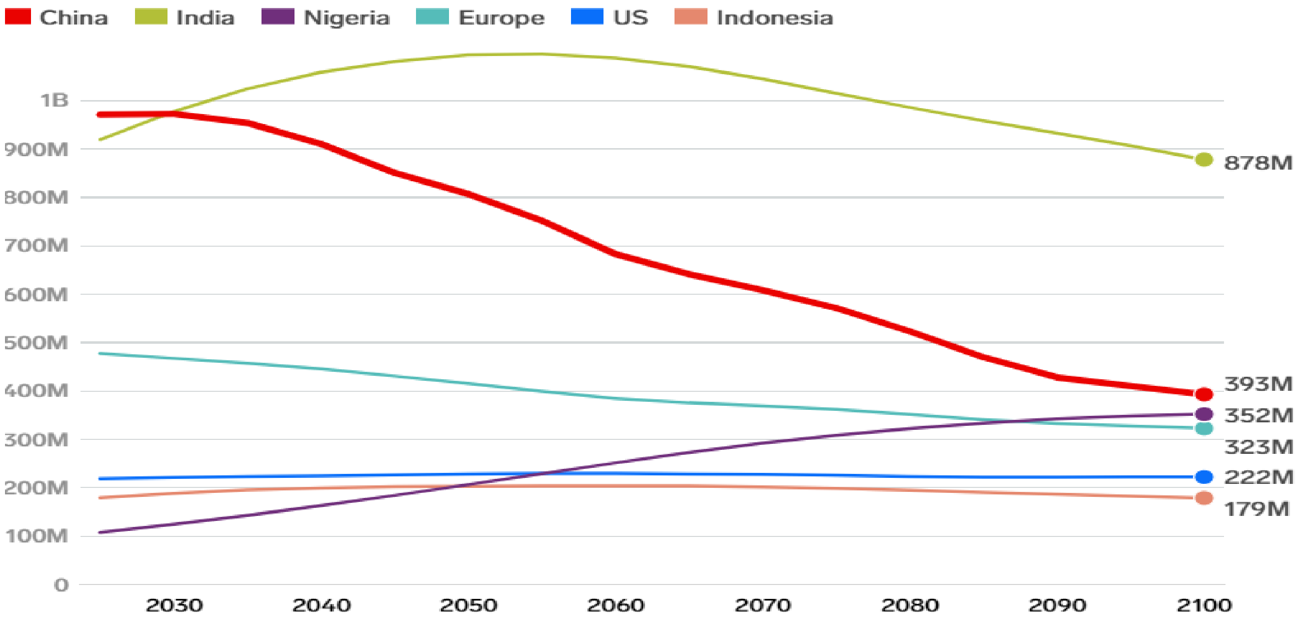
Source: Statista

Clearly though, population numbers continue to rise for the foreseeable future and considering that many developed countries are already deeply into population regression, where is this growth coming from? Well, more than 50% of the world's future population growth comes from Southern Africa. Sub Saharan Africa presently represents 1.152bn people and by 2040, this is expected to reach 2.00bn. A further example of Africa's population growth is Ethiopia, it has a population of 120m, by 2050 this is predicted to reach 205m people and by 2100, 294m. To grasp the gravity of these changes, one needs to understand how important population numbers are for GDP growth, particularly as countries develop and undergo what is know as demographic transition, which is closely aligned to improving wealth. We will cover demographic transition and its impacts in more detail in future Big Picture articles, for this quarter however, we will briefly allude to some of the impacts that shifting population demographics are having on economics.

These include: a future world with less workers and potentially worse educated workers as populations are growing in areas where education is lacking; less tax receipts and thus less fiscal funding as older populations are in retirement; significant slowdowns in GDP growth for countries that have relied on real estate to grow GDP – like

China – lower numbers of home buyers; a potential reduction in creativity and problem solving – young people are known to improve fluid intelligence – most patents are lodged by younger generations as an example; finally, the prospect of social upheaval as these population dynamics place strain on a system we have traditionally become accustomed to.

Chart 3: Forecasted working age populations



Note: Working age includes people aged 20-69

Chart: Shayanne Gal/Insider

Source: United Nations World Population Prospects

Demographic shifts are tectonic and they accelerate in the decades ahead and will have a profound effect on wealth creation in ways that are not intuitive. It is our responsibility to research these, be aware of all their nuances and position your capital to capture the many opportunities which they offer.

SA Equities: Peak pessimism or structural reset?

Marco Barbieri, Director of SA Equities

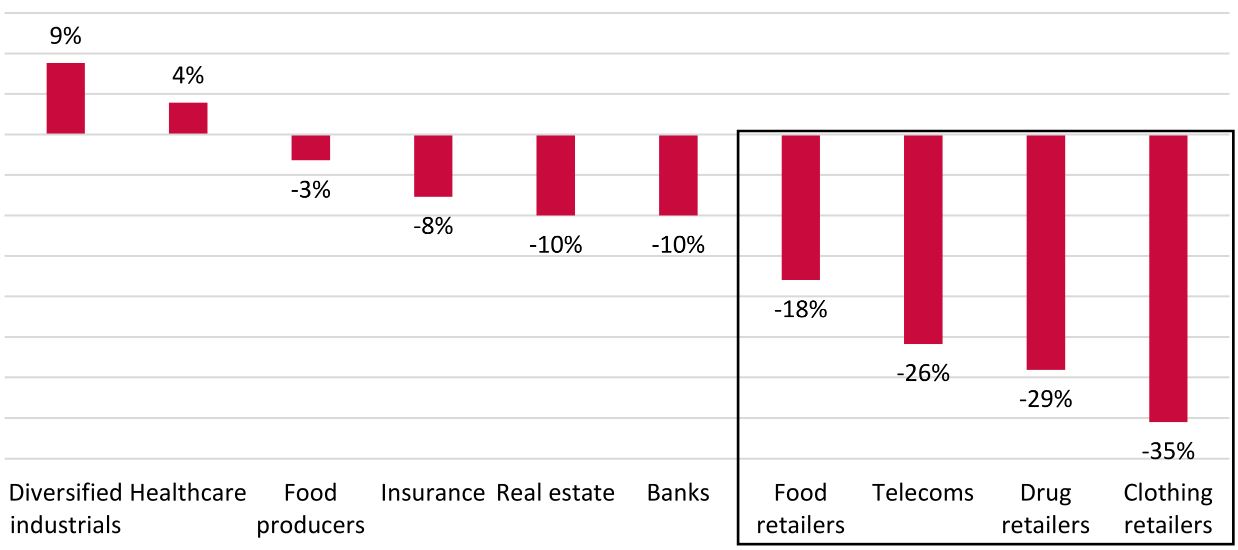
Over the past 12 months, the impact of loadshedding on corporate profitability has been severe. Although the FTSE/JSE All Share index returned 8.5% over this period, South African sensitive stocks have been extremely weak and now trade at deep discounts to their long term valuation multiples. In this article we explore the impact of loadshedding on corporate costs and revenue, assess if these are permanent or temporal in nature and finally consider their valuation impact.

The impact of loadshedding is well documented and is having a profound effect on corporate South Africa.

Although Eskom has implemented various loadshedding programmes over the past decade, there has been a significant ramp-up over the past 12 months as increasing electricity demand following Covid lockdowns has met weak supply. Deteriorating power plant availability, neglected maintenance, poor planning, and the effects of two decades of public sector corruption are the main reasons behind this.

Yet, the JSE All Share Index has returned 8.5% in Rands (31 May 2023) over the past year. A closer analysis of this performance reveals that it is explained by strong contributions from index heavy-weights Naspers/Prosus, BHP, Richemont and local listed gold stocks. All of which have benefitted from a healthy global backdrop together with a weaker Rand, this has masked the impact of extremely weak performances from SA sensitive stocks (Chart 4).

Chart 4: Median sector returns – 12 months (in Rands)



Source: S&P CapitalIQ, Northstar AM, 31 May 2023

Of the inward focused JSE stocks, retailers and telecoms have been the hardest hit but the sell-off has been broad-based, with most financials, local industrials and manufacturers faring poorly over the past year. These hardest hit areas of the markets, as highlighted in chart 4, are also the cheapest on a forward PE basis with discounts of 20% to 40% relative to their respective average 5-year histories and even larger discounts when compared to longer periods of time.

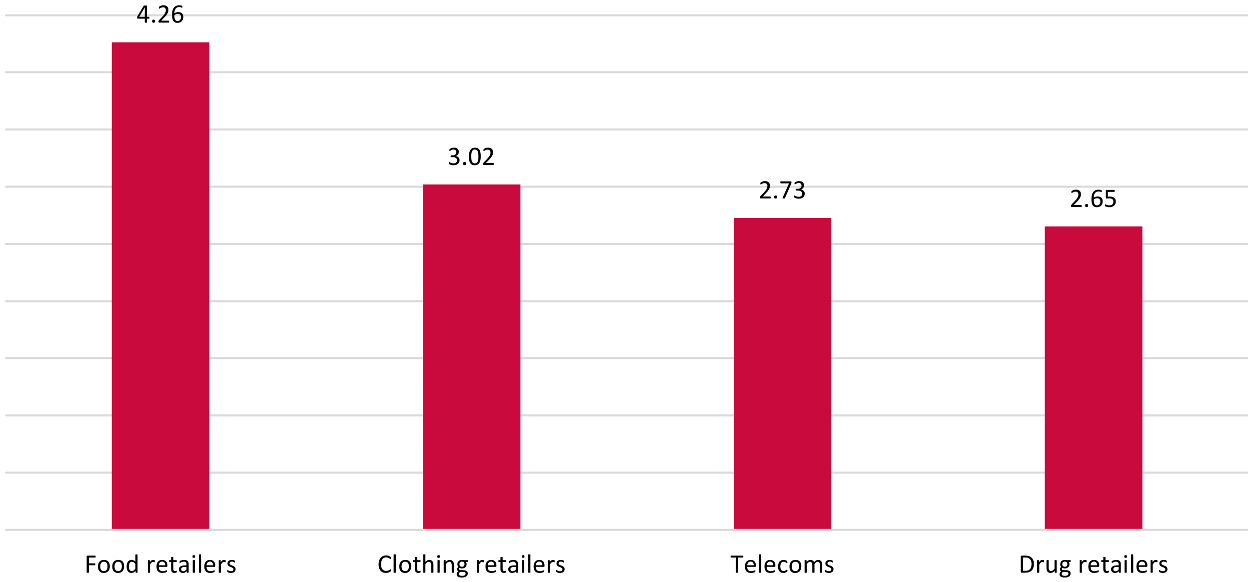
Impact on profitability

From a cost perspective, the impact from loadshedding has been more pronounced for food retailers at about 5.9% of operating profit (EBIT), given their higher energy requirements for refrigeration and their cold supply chain needs. The impact on SA telecoms has also been severe, as MTN and Vodacom, to ensure network operability, absorbed incremental operating expenditure due to diesel consumption. This has been approximately 4% of EBIT.

Costs for clothing and drug retailers, based on our estimates, are lower at 3.8% and 1.9% respectively but are also not homogenous. In general, retailers operating battery infrastructure, such as Clicks and Truworths, have fared significantly better from an operating cost perspective, having already sunk capital, against other businesses operating diesel generators.

While the effects of loadshedding from a cost perspective have been severe, this has not been the main determinant of stock performance. A more significant component of margin and earnings reduction has been caused by product markdowns and sales losses caused by reduced trading hours and a highly strained consumer. Estimating the impact on sales caused by loadshedding alone is difficult but we estimate losses of between 2% to 5%, with clothing retailers and telecoms experiencing higher losses compared to food and drug retailers.

Chart 5: Degree of operating leverage (DOP)



Degree of operating leverage (DOG): Expected change in EBIT / Change In sales

Source: S&P CapitalIQ, Company reports, Northstar AM (31 May 2023)

To fully appreciate the disproportional impact on earnings across these four groups of companies, it is also important to consider their degree of operating leverage (DOP: impact of 1% change in sales on EBIT), which based on our estimates, ranges between 2.6 and 4.2 times.

Although food retailers have the highest DOP (chart 5), they equally have been far more successful in passing a larger proportion of costs onto their consumers. Clothing retailers and telecoms, on the other hand, have not only had to contend with increased costs and revenue loss, but also, given their discretionary nature, struggle to pass costs on. Consequently, they have been the clear losers in this group.

Is the impact temporal or structural?

The market has over-penalised this group of stocks as its collective view is that loadshedding-related pressures will persist in perpetuity. Our valuation work corroborates this; based on a more optimistic medium-term view, which we share, significant valuation uplift for food and clothing retailers, should be in offing.

We are not making a case for a V-shape recovery of these businesses, but we believe these sectors are likely to experience better profitability over the medium-term, this should be accompanied by market valuation support as volume growth and costs normalise.

Northstar launches global income fund

Patrick Cairns, CityWire SA Editor

The fund targets a yield of 4% in US dollars and stable capital returns equating to 1/3 of the risk of the equity market.

Northstar Asset Management has added to its suite of funds with a global portfolio that targets an income yield in US dollars at low volatility.

The Northstar Global Income fund, which is domiciled in Mauritius, will be benchmarked against the EAA USD Cautious Allocation sector, with a real return target of 2% over rolling three-year periods.

‘We’ve always said that we want a limited fund range, rather than managing a huge number of different products,’ portfolio manager Mark Seymour told Citywire South Africa in an interview. ‘But we believed there was a gap in our range in that we only had one offshore offering, being the Northstar Global Flexible fund.

‘We believe there is a gap for a fund that is lower risk, and that meets the requirement of an investor looking for something with a more stable profile.’

Seymour said that in order to meet its yield and volatility targets, the fund is likely to hold around 70% in fixed income instruments, 25% in equity, and 5% in commodities over time. This is based on Northstar’s three-year risk and return expectations from these asset classes.

‘We analysed funds across the cautious allocation sector and discovered that they cover a wide spectrum of risk,’ Seymour said. ‘There are funds that operate with a standard deviation of as low as 3%, and some as high as 10% to 11%.

‘We wanted to create something that fulfils the need of a global investor that is looking for stable returns in US dollars. A large number of investors are looking for an offshore solution, but may not necessarily have the risk appetite for either a high equity flexible fund or a pure global equity fund. If you are close to or even in retirement, and you want a permanent offshore holding, you are probably looking for a 3% to 4% yield, with some capital growth.’

He added that ‘we will be optimising for the best risk-adjusted returns and limiting the overall risk profile for the fund to not exceed one third of the equity market’.

Seymour said that ‘an exciting problem to solve’ has been identifying the kinds of assets to include in a portfolio of this nature.

‘The characteristics of the equities we hold have to be different to a high growth portfolio,’ Seymour said. ‘We want to find companies with a high dividend yield, but also the fundamentals that lend themselves to stable capital appreciation over time.’

‘But if you screen just on dividend yield, you might find energy companies on massive yields, but you have no idea whether their balance sheets are going to hold up over the next five years. Other companies might have good fundamentals and good growth profiles, but they are not preoccupied with paying out dividends. As you start looking for higher yield, the profile of the company in terms of quality starts dropping off, generally speaking.

‘We don’t want to compromise on quality, but we want the high yield, so you have to do some smart screening. We have to look for interesting opportunities where companies have potentially been unfairly priced down.’ Specifically, Seymour is looking for companies trading on a 4% dividend yield – or 2% above the market – showing top-line growth, stable margins, steady free cash flow growth and robust balance sheets at valuations that meet the required rate of return.

At the moment, he is finding these opportunities in tobacco stocks, certain healthcare stocks ‘that have been priced for negative outcomes’, and a range of financials including Morgan Stanley, T. Rowe Price and Northern Trust.

‘There is not a lot of overlap between what we hold in this fund and in the Northstar Global Flexible fund,’ Seymour said. ‘British American Tobacco and some healthcare stocks do appear in both portfolios.

‘But we are stretching ourselves to think more broadly, which I think has been very healthy. We have been very focused on a certain segment of stocks that have high quality characteristics. We won’t drop that measure, but it’s been a challenge to find great quality companies, at a reasonable price, at attractive yields.’

The bulk of the portfolio is however currently in short-dated US Treasuries, where Seymour is able to pick up yields of around 5% on an average duration of just a few months. He will continue to recycle these holdings while these kinds of yields are on offer at the short-end of the curve, but anticipates that in time he will shift some of that into longer-dated bonds and equities.

‘At some point we will also look at corporate bonds, but at the moment I just think, from a risk-adjusted perspective, there are more interesting opportunities in the equity space.’

Original article published in CityWire on 26 June 2023
https://citywire.com/za/news/northstar-launches-global-income-fund/a2420150?utm_medium=website&utm_source=citywire_za&utm_campaign=home-content-list-1&utm_content=international-south-africa-latest-news-list&utm_pos=1

Meet the team

Shannon Hendricks
Operations Associate

When did your interest in financial markets start?
As a recent entrant to the industry, I am deeply fascinated by the financial markets and have dedicated significant time to studying and monitoring them independently. I am eager to immerse myself in this dynamic industry and acquire extensive knowledge.

What did you study and why?
I pursued a law degree (LLB) and completed two years of study before financial constraints hindered my progress. However, those two years equipped me with a solid foundation in legal principles, honed my critical thinking abilities and developed my analytical skills. Despite that setback, I remain determined to eventually complete my law degree when the circumstances allow.

What do you think equips you to do this job properly?
My relevant experience, strong communication skills, meticulous attention to detail, problem-solving abilities, and technical proficiency equip me to excel in this role.

What do you love about investing?
Ultimately, while my role may be indirect in the investment process, my interest lies in understanding and supporting our clients' investment goals. I find great joy in contributing to their financial well-being and being part of their journey towards long-term success. Witnessing the positive impact of successful investments on clients' lives reinforces my passion for the industry.

What do you find the most challenging part of your role to be?
The most challenging aspect of my role as an operations associate in a financial institution is navigating the complexities inherent in financial operations. This includes managing high volumes of data and transactions with precision, solving problems in a fast-paced environment, ensuring effective communication, and staying updated with software systems. However, I embrace these challenges as opportunities for growth, leveraging my attention to detail, problem-solving skills, adaptability, and commitment to continuous learning to overcome them effectively.

Why do you think clients will do well at Northstar?
Clients will thrive at Northstar due to our exceptional team of experienced professionals. With extensive knowledge and expertise in the financial industry, our team provides valuable insights and guidance tailored to each client's unique needs. Trust, transparency, proactivity, and open communication are essential to building strong client relationships. By choosing Northstar, clients can be confident that they have a dedicated team committed to helping them achieve their financial goals.

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Prospective applicants for shares should inform themselves as to the legal requirements and consequences of applying for, holding and disposing of shares and any applicable exchange control regulations and taxes in the countries of their respective citizenship, residence or domicile. Independent professional financial advice should always be sought before making an investment decision as not all investments are suitable for all investors. If you choose to appoint an adviser, advice fees are contracted directly between you and the adviser.

Collective Investment Schemes (CISs) are generally medium to long term investments. The value of participatory interests or the investment may go down as well as up, and therefore the CIS Manager does not make guarantees with respect to the protection of capital or returns of the investment. Past performance is not necessarily a guide to future performance. CISs are traded at ruling process and can engage in borrowing and scrip lending. The portfolio may include underlying foreign investments, and may as a result be expose to macroeconomic, political, foreign exchange, tax, settlement, reporting or illiquidity risk factors that may be different to similar investments in the South African markets. The underlying foreign investments may also be adversely affected by foreign investment policies, restrictions on repatriation of investments and other restrictions and controls that may be imposed by the relevant authorities of the relevant countries. The CIS Manager reserves the right to close the Fund to new investors if it is necessary to limit further inflows for it to be managed in accordance with its mandate.

Investors in the Fund are not protected by any statutory compensation arrangements in Mauritius in the event of the Fund's failure. The Mauritius Financial Services Commission does not vouch for the financial soundness of the fund nor for the correctness of any statements made or opinions expressed regarding it. In certain circumstances, a participant's right to redeem his shares may be suspended.

Applicants are assumed to have read and understood the Prospectus and accept the risks of an investment in PIM Capital Ltd PCC. It is understood that they are aware that the portfolio of securities is subject to market fluctuations and to the risks inherent in all investments, and that the price of shares and any income from the shares may go down as well as up, and that the fund may be subject to volatile price movements which may result in capital loss.

No guarantee is provided, either with respect to the capital or the return of the Fund. Excessive withdrawals from the Fund may place the Fund under liquidity pressure and in such circumstances, a process of ring-fencing withdrawal instructions and managed pay-outs may be followed. Commission and incentives may be paid and if so, will be included in overall costs. Actual investment performance will differ based on the initial fees applicable, the actual investment date and the date of reinvestment of income.

Fund valuations take place at approximately 12h00 (MUT) each business day and forward pricing is used. Instructions must reach the CIS Manager before 16h00 (MUT) on the Dealing Date. You can expect to receive withdrawal pay-outs five business days after the dealing day. Large investments or redemptions (exceeding 5% of fund value) may be subject to an anti-dilution levy to defray dealing costs and expenses. This levy, where applicable, is applied fully for the benefit of the fund. A schedule of fees and charges and maximum commissions is available on request from the CIS Manager.

Additional information such as daily fund prices, brochures, applicable forms and a schedule of fund fees and charges is available on request from the CIS manager.

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