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Quarterly Memorandum
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During the last quarter, market volatility once again escalated, which frightened many investors. What we have tried to explain to our clients is that market volatility is unavoidable because it is a function of uncertainty. Uncertainty, in turn, is at the heart of human progression.

In the past, humans have tried to manage this uncertainty, most recently by using instruments such as monetary policy. But experiments like these usually end up causing more harm than they do good. Consider, for instance, the great monetary experiment that the United States (US) conducted at the turn of the century. During this experiment, interest rates were kept below their long-term trend (natural) rates, which eventually led to the global financial crisis in 2008/2009, one of the worst economic crises faced by humans in modern history.

Today's uncertainty has a similar ring to it. Following the global financial crisis, central banks opened the floodgates of easy money, keeping interest rates lower for longer and ballooning their balance sheets with quantitative easing. In many ways, the actions taken by central banks after the global financial crisis dwarfed the monetary experiment of the early 2000s. How this will play out is anyone's guess and, unfortunately, as research has shown, trying to time the market is futile. Investors who do attempt to time the market get their timing wrong and miss out on gains which they can never recover. Therefore, the best anyone can do is to look through the short-term uncertainty (read volatility) and invest in companies that they believe in. As this report will show, we still believe in the companies that we have invested in, and we are confident that, in the long term, they will deliver returns that are consistently excellent.

But there is something else that prudent investors can do during these times of unavoidable volatility, and that is to use the volatility as a buying opportunity. Corrections and recessions offer the perfect buying opportunities. Prudent investors can use these moments, which often only occur once or twice in a generation, to buy those companies that they believe in at a substantial discount. Please speak to us if you want to make use of this unique opportunity.

Kind regards

Dr. Francois Stofberg
Managing Director

REFLECTING ON THE EVENTS OF THE SECOND QUARTER OF 2022

“Keep calm and carry on.” This was the name of our first memorandum, released exactly two years ago, as investors were dealing with the impact of COVID-19. It seems fitting to us that we once again turn to these words during turbulent times, as was the case in 1939 when the world stepped over the starting line of a second world war.

Some context, however, is important. During the first quarter of 2022, investors experienced a rollercoaster of emotions as they placed their faith in global central banks who acknowledged that they had it completely wrong as they underestimated the severity of inflation. This left the banks in a position where they had to repair the damage that resulted from their indecisiveness. As these repairs started, inflation continued to cut deep into consumer sentiment, their pockets, as well as their investments. Unfortunately, the impact of inflation was exacerbated when Russia decided to invade Ukraine, which, today, feels like forever and a day ago.

In the blink of an eye, we found ourselves in the second quarter of 2022. This quarter was marked by still higher inflation but, as time passed, investors lost most of their interest in the ongoing Russia/Ukraine war and decided to rather dig their teeth into the growing signs of slowing global growth and the possibility of a global recession. Reflecting on these events, the argument shifted from one where central banks had to put their foot on the gas to stem inflation, to one where they will perhaps need to lift or remove their foot so as not to cut off growth completely. But whilst investors are wrestling with these ideas, central banks are still confident that they can navigate a soft landing.

Fortunately for our investors, we do not believe in a “wait-and-see approach” when it comes to managing wealth. We continued to be pro-active in managing the overall integrity of our investment solutions. During the quarter, the investment team continued to improve the quality and overall risk profile of our respective portfolios. We managed to achieve market-beating returns during these difficult times and firmly believe that we are even better positioned to do so going forward.

Offshore markets

The second quarter was lacklustre by most standards for financial assets globally. US markets fell 16.5%, followed by their European counterparts, which fell by 9.9%. Chinese markets bucked the trend by rising 3.3%. On 13 June, US markets entered bear-market territory for the first time in many months. A bear market is characterised by a drop of more than 20% from the most recent peak. Inflation in the US reached its highest level in more than four decades, on the back of surging energy and food prices. This resulted in the US Federal Reserve (Fed) staying the course on rate hikes, as it increased rates by another 75 basis points for the first time since 1994. It is important to remember that, in 1994, the markets were 27% higher 12 months later. During June, the already strong US labour market started to show signs of weakness whilst US banks continued to show that they can weather almost any crisis after all 33 banks passed the annual stress test. The dollar remained strong in the

second quarter as it continued to benefit from aggressive rate increases, as well as its safe-haven qualities.

Across the Atlantic, European markets also did their best to contend with inflationary pressures, in addition to political turmoil. With inflation top of mind, the European Central Bank (ECB) concluded their policy meeting and markets looked for signs of a possible rate hike in July. This is not an easy task for the ECB, as it runs the risk of causing another debt crisis, like the one in 2009/2010. The main surprise in Europe, however, was a move by Switzerland who hiked rates for the first time in 15 years, leaving the Bank of Japan as the only developed nations bank that has not begun to hike rates. On the political front, Boris Johnson survived a no-confidence vote and in France, French voters denied newly re-elected President Emmanuel Macron an absolute majority in parliament, limiting his hand in his second term. On the geopolitical front, as the war drags on in Ukraine, Russia defaulted for the first time on its foreign-currency debt in more than a century. The North Atlantic Treaty Organisation (NATO) allies imposed further sanctions on Russia and the Ukraine was nominated as a European Union (EU) candidate (which is quite a tedious process).

Moving east, in China things looked quite different during the second quarter, as investors bet that the worst of a lockdown-induced economic shock and extended tech sector crackdowns in the country have passed. Markets were further buoyed after China cut its quarantine requirements for international arrivals and China’s central bank confirmed that it will help boost the economy, even as Purchasing Managers’ Index numbers were already expanding.

EFPC Global Portfolio

During the quarter, we continued to increase the quality of our portfolio by introducing a company called Accenture plc. Accenture is an information technology company, which has returned close to 71% on an annualised basis for investors over the last two decades. The company provides information technology and consulting services in fields such as life sciences, cloud, and sustainability. In an ever-changing world where companies are forced to adopt a wide array of technologies, of which they know very little, Accenture’s expertise will remain in high demand for a long time to come.

We also used the momentum in energy stocks to take profit on a US refiner called Valero, which we sold at \$144 per share. We introduced Valero back in March, below \$90 per share, in anticipation of higher energy prices as a result of years of underinvestment in the oil industry, as well as the West’s response towards Russia. Subsequently, Valero rallied 62% and our research showed that markets were pricing in too much given the possibility of a recession and the resulting drop in demand for oil during such an event. Since selling Valero, the stock has pulled back by more than 25% at the time of writing this report. It must be noted that we are still positive about energy over a multi-year period. We are still invested in Shell, owing to the possibility for value unlock, its shareholder-friendly return policies, and free-cashflow generating abilities.

As a result of the Valero sale, our cash position grew in the portfolio, which places us in an ideal position to utilise market volatility over the next few months to further increase the quality of our portfolio over the long term.

Local markets

The second quarter was by no means an exciting one for local investors. The Johannesburg Stock Exchange (JSE) All Share Index bled to close the quarter below 70 000 points. Growth concerns were at the top of the priority list for investors. This was evidenced by the retreat in commodity stocks, as investors shunned the asset class, which was once lauded as an inflation hedge, despite persistently elevated inflation prints. Copper, the macro bellwether metal, closed the quarter below \$8 500 per tonne, while platinum-group metals (PGMs) also struggled, with platinum closing the last day of the quarter below \$900 per ounce. Gold was also not spared as the quarter saw the yellow metal shed 7% to close just above \$1 800.

The JSE All Share Index also felt the impact of tech heavyweight Naspers, which touched a quarterly low of R1 427 per share. The share was volatile during the quarter, spiking 22% in a single session, following the announcement of a share repurchase programme. The Group announced that this will be funded with a reduction of its Tencent stake.

The rand was uncharacteristically strong during the second quarter, maintaining much of its strength even as global markets experienced volatility. The currency finally breached R16 to the dollar as Eskom announced that the country would be going into Stage 6 load shedding. South Africa was not spared from the inflation woes, as the local Consumer Price Index (CPI) breached the South African Reserve Bank's upper limit in May with a 6.5% print.

EFPC Local Portfolio

In light of persisting macro concerns and a local market largely concentrated in commodity stocks, we decided to make some portfolio changes and introduced some defence into the portfolio. During the quarter, we decided to re-introduce British American Tobacco into the local portfolio as a defensive play, which has kept up quite well as the rand lost some ground.

We have also been selective in the property sector and decided to reduce our underweight position in the sector with the introduction of Growthpoint. In addition, we sold out of Telkom at R45 per share, as the investment case started to show signs of deterioration. Finally, our preference for Pick n Pay over Shoprite paid off, with the former lifting 5% while the latter fell 21% during the quarter.

We maintained our slightly underweight position in basic materials in light of growth concerns, but we continue to search for attractive entry opportunities into the sector in anticipation of a longer-term commodity shortfall play, which we remain positive about.

Kind regards

The EFPC Investment Team

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