Benguela Global SA Capped Swix Composite Equity Portfolio Commentary: Q2 2024

By

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The Benguela Capped Swix Composite Portfolio delivered 9.18% for the quarter while the SA Capped Swix ALSI delivered a return of 8.17% over the same period. The relative performance is 1.02% for the quarter, gross of fees.

For the past year, the Portfolio returned 11.18% versus 9.94% for the Capped Swix ALSI, a positive contribution of 1.24%, gross of fees.

Key drivers of performance in Q2 2024

Notable sector allocation contributors

Communication Services (UW – positive contribution) :

Portfolio Tactical Strategy: We have been increasing our underweight to the communication services sector as the ongoing challenges lead us to believe there is a structural deterioration in quality for the sector as a whole.

As for the industry as a whole, the significant maintenance capex requirements along with the risks of a large geographic footprint and the sustained pressure on margins and revenue growth show no signs of improvement. The large African exposure has added even more uncertainty through the regulatory risk, the currency risk and extremely high inflationary environments. These factors keep us largely on the sidelines, until we have more confidence in the business prospects for the sector or individual companies.

Financials (UW – negative contribution):

Portfolio Tactical Strategy: We have been and remain constructive on the financials sector, in particular the banks, followed by the insurers. Within this larger sector we have been marginally underweight either due to valuation or quality concerns around some of the underlying stocks. This sector has benefitted greatly from the positive election outcome and this marginal underweight has been a drag on performance. Our overweight in Absa relative to Nedbank has also been a drag on performance in this sector.

Consumer Staples (OW – negative contribution):

Portfolio Tactical Strategy: We maintain our overweight in consumer staples. Even within an improving economic environment we expect the wallet share gains to persist for some time as this sector presents a higher quality exposure to what remains a strained consumer.
Sector earnings remain robust and have good prospects as the consumer is driven to seek the value offered by large scale retailers.

We may reduce our overweight to this sector opportunistically should valuations warrant it and should the outlook for discretionary spend improve.

Stock Level Performance Drivers

For the quarter under review, contribution from stock selection was a net positive while the allocation effect was negligible on a net basis.

Issue Name	Active Bet	Effect	Issue Name	Active Bet	Effect
Spar Group	OW	0,30%	Anglo Platinum	OW	-0,24%
Sanlam	OW	0,24%	Gold Fields	OW	-0,18%
Anglo American	OW	0,23%	Foschini Group	UW	-0,16%
Firstrand	OW	0,20%	Nedbank	UW	-0,08%
Capitec	OW	0,16%	Old Mutual	UW	-0,07%

Top 3 contributors

Spar Group (OW)

Spar has presented a significant discount to its long-term valuation multiples, clouded by its Polish troubles and rising debt profile. We have been overweight Spar with a view that there are a number of internal and external catalysts to unlock value. We have expected a sale of the loss-making Polish operation based on our engagement with management and this is now in the advanced stages. The core South African business remains intact and with management focus the technology and market share challenges can be addressed over the next 12-18 months as well as a sharp reduction in debt through better working capital management and dividend restraint. We now see a rights issue as a low probability and the stock has recovered well post the Q1 sell-off as the market finds some confidence in the turnaround strategy. We have been taking some profits into the rally but expect the overall operating environment to improve with the advent of a potential rate-cutting cycle.

Sanlam Limited (OW)

Sanlam remains our highest quality insurance pick. We believe their exposure across the South African insurance categories along with the pan-African Allianz JV and the fast-growing Shriram Group in India provides good diversification and above-peer growth potential. While the share price has performed well from its April lows, we believe it still offers value, especially considering the potential for diversified growth as it should benefit from an improving outlook for South Africa, continued momentum in India and stable execution in Africa.

Anglo American (OW)

We moved to overweight Anglos early in the year on the attractive valuation, improving commodity outlook and high-quality copper assets. Our expectations are for a more supportive commodity environment as China's growth stabilises and the dollar weakens with the advent of rate cuts. This along with the corporate actions and commitments by management have supported a 24% rally in the share price. The value of the diamond and PGM assets have reduced significantly in the sum of the parts calculation for Anlgo American and provide a level of optionality through restructuring, or recovery in the performance of these assets. We continue to see value at current levels given where we are in the economic and commodity cycle and the long-term potential of the high-quality copper portfolio.

Top detractors

Anglo Platinum (OW)

While we are underweight the PGM sector, Amplats is our top overweight in the space due to its higher quality and lower cost of production. While the sector overall faces some long-term structural challenges we believe the supply-demand curve is more or less in balance here as the 6E PGM Basket price of major North American and African mines is below the AISC of the two lowest quartile producers. The demand growth for battery electric vehicles (BEVs) has also slowed somewhat and this should provide something of a floor to the PGM basket supported by the rate cutting cycle which could begin in Q4.

Gold Fields (OW)

While we are close to equal weight the sector, Gold Fields and AngloGold have been our top two picks in the sector based on quality. Gold Fields ramp-up of Salares Norte has been disappointing to say the least with management overpromising. However, the long-term impact on the group cost of production and ounces mined, remains supportive of the improving outlook and quality for Gold Fields. We expect to see improved execution from management going forward while the gold price should be supported by the central bank buying and sustained geopolitical risk seen so far this year.

The Foschini Group (UW)

While we are overweight the retail sector, we are underweight Foschini. This is driven by the relative lack of a focused strategy by management and the inability to deliver incremental returns on invested capital. Being highly geared to the macro-economic environment in SA, Foschini may well continue to deliver strong price returns,

However, we prefer the higher quality and value offered by Mr Price and Truworths in the space until we see better focus on margins and shareholder returns by Foschini.

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Macroeconomic environment and outlook

We expect global inflation to continue on its easing path led by the US and China. China, with low levels of domestic demand, continues to be supportive of goods disinflation while in the US some of the larger and lagged contributors to inflation, namely housing and rentals, will continue to support downward momentum.

The US economy continues to grow but there is clear evidence that the growth is slowing. The US consumer is showing signs of stress while the labour market is also slowing. Unemployment continues to climb and points to further weakening of the economy. The US Federal Reserve has a dual mandate regarding both inflation and employment – for this reason it should be more inclined to cut rates on further easing of inflation.

China still has a number of challenges, but the economy continues to stabilise through multiple interventions. The excess consumer savings presents a potential growth driver should the outlook improve and consumer confidence return.

The outlook for commodities is also improving with the advent of a global rate-cutting cycle. This should support demand led growth from the global economy. An easing of the dollar from lower US interest rates would also be beneficial for commodity prices and EM currencies.

South Africa

We remain optimistic about the outlook for South African equities. While there has been some rerating since the elections, we believe there is still potential for earnings upgrades with several tailwinds moving into the second half of the year.

Longer term, we see the risk of an upside surprise to GDP growth over the next 12-18 months.

Our view is supported by a number of expectations:

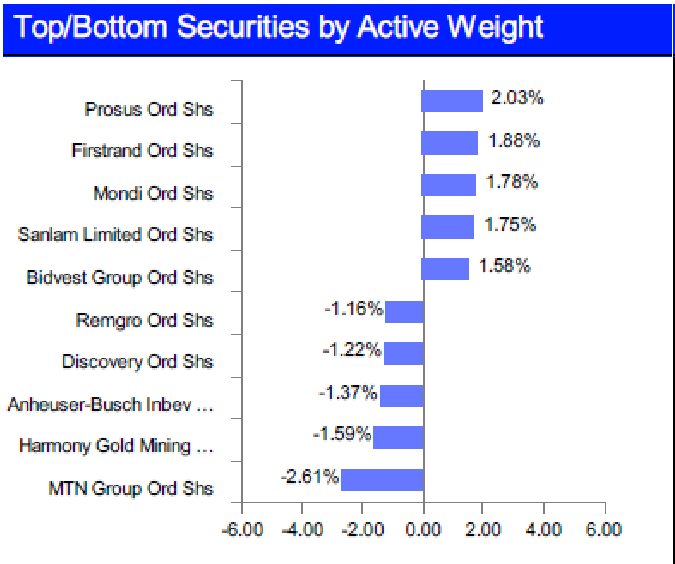
- Continued improvement in loadshedding outcomes will provide margin accretion as companies spend less on diesel and will also free up cash for reinvestment into business opportunities.
- The elimination of election uncertainty and the potential for improved delivery by government should support infrastructure spend and employment.
- The advent of the rate cutting cycle and continued disinflation should improve consumer sentiment, credit stress and ability to spend, further helping corporate earnings.
- The stabilisation of the Chinese economy and easing interest rates will likely support the outlook for commodities and provide support for the rand and the South African economy via employment and terms of trade.

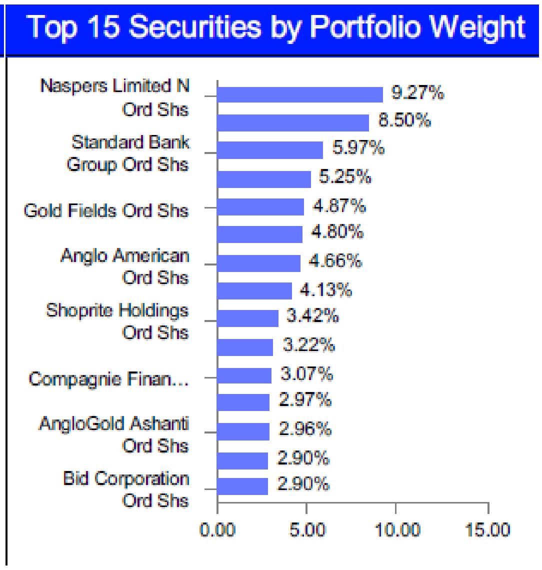
Portfolio outlook and closing remarks

The outlook for SA is somewhat brighter than it has been for some time. We have increased our exposure to SA equities post the election outcomes and are positioning for a continued improvement in the economy over the next 12 months.
While some value has been unlocked with the post-election rally, we believe there is still value to be had in SA and see further scope for upside while also seeing improving prospects for certain parts of the commodity complex.

The caveat to the above remains geopolitics and risks remain elevated. For this reason, we are equal-weight gold and maintain some defensive components within the portfolio.
As at 30 June 2024 our most significant portfolio positions and key portfolio characteristics were as follows:

Significant positions:



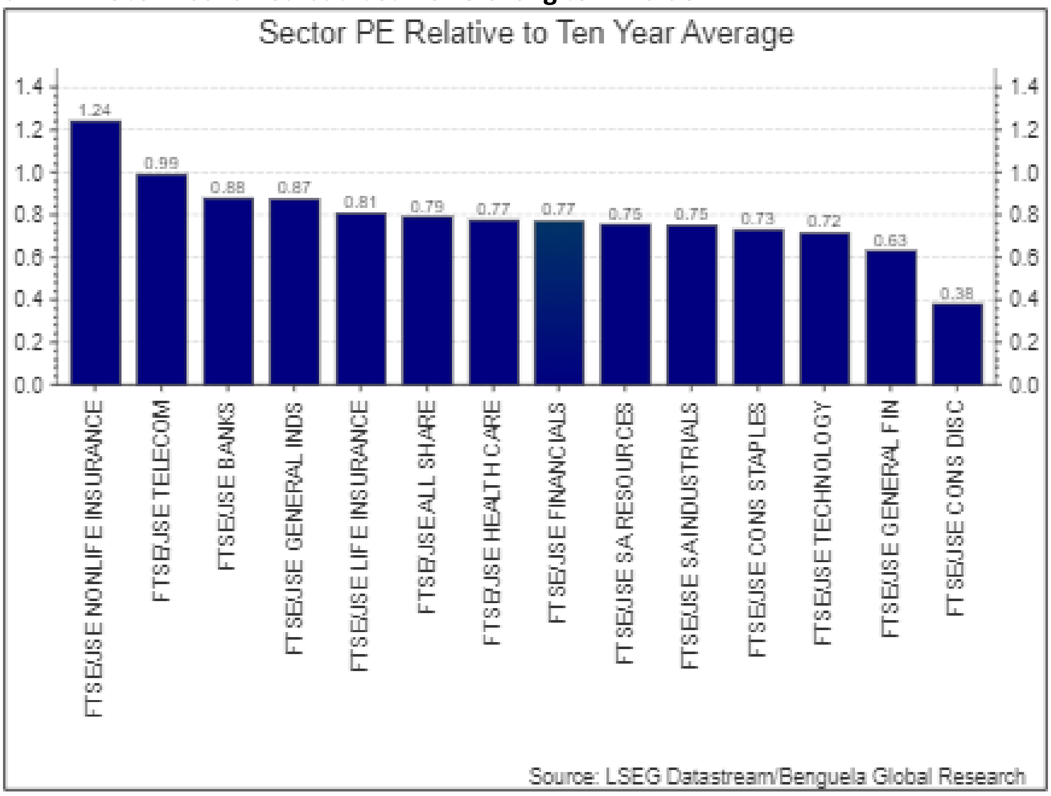


Key characteristics:

Characteristics

	Portfoli	Benchmark	Difference
Dividend Yield	4.00	4.12	-0.13
Price To Cash Flow	9.47	8.02	1.45
Price To Book	2.05	1.61	0.44
Trailing P/E	22.71	21.86	0.86
Forward P/E	12.48	12.03	0.45
EPS Growth - Forecast 12-Month	23.32	25.90	-2.58
EPS Growth - Long Term	8.14	2.24	5.90
Net Profit Margin	22.60%	21.54%	1.06%
Operating Profit Margin	6.25%	3.40%	2.85%
LSEG Style Score (2.0)	17.17	12.15	5.02
LSEG Size Score (2.0)	15.97	8.01	7.96
LSEG Global Size Score (2.0)	12.76	4.98	7.77
StarMine ARM Global Rank	64.45	61.53	2.92
StarMine Relative Value Global Rank	59.62	64.77	-5.15
StarMine Value Momentum Global Rank	72.94	74.07	-1.13
Total Debt-to-Equity (Worldscope)	0.85	0.84	0.01
Return on Equity - Annual (Worldscope)	16.66	12.88	3.78

Appendix 1: The JSE has rallied but it still offers long term value



Appendix 2: The moving average unemployment rate in the US points to further slowing and further unemployment in the absence of interventions