Newsletter

Q1 2024

PERSPECTIVES

The Trading Conundrum

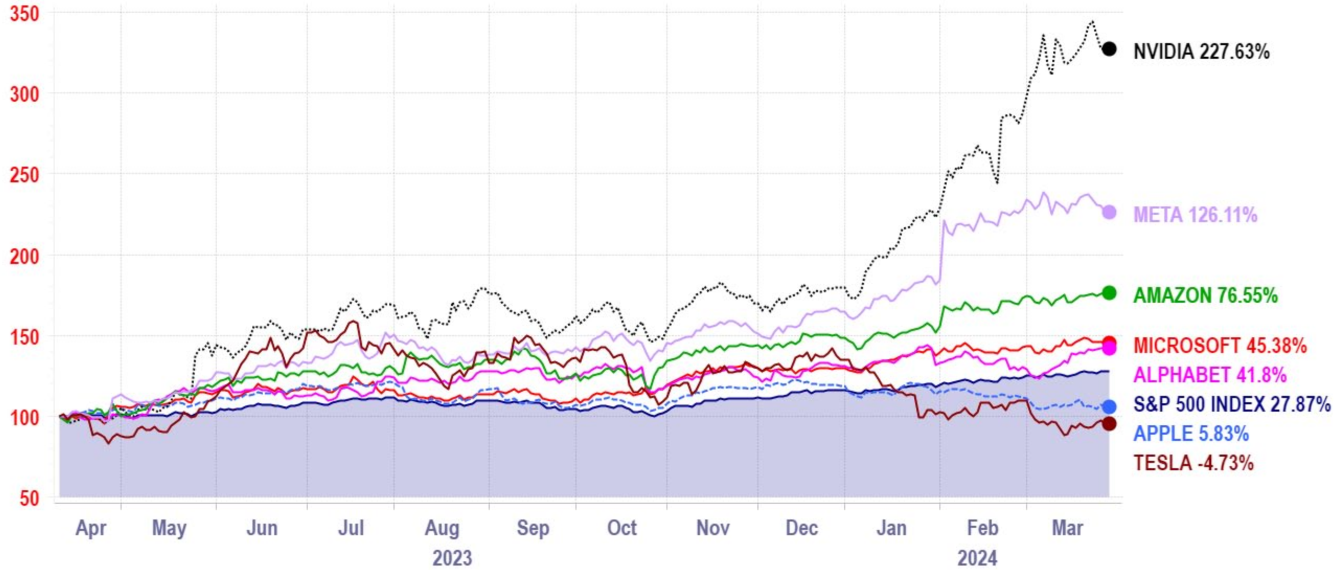
The average investment holding period in the US stock market today is 10 months. In the 1970's it was five years.

Investors increasingly seem to be forsaking the Warren Buffet style of long term investing for short term trading opportunities, despite evidence indicating that long term investing is a more rewarding strategy.

So why trade?

Perhaps the answer is that more and more people are encouraged to do so. The media is obsessed with the large-returns-in-a-short-period-of-time stories at the expense of all else. After all, why should you stay invested in a very good company A, that grew by 5% in six months when you could have bought company B, which grew by 50% in the same time period (a question we ask ourselves from time to time).

Research houses are increasingly focussed on the trader rather than the long-term investor and those who promise to find you the 50% growth company and avoid the rest, sell more products.

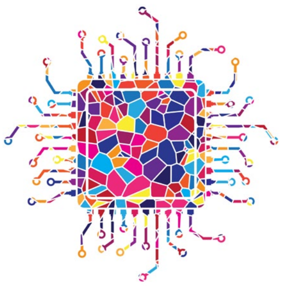


This chart illustrates the one year performance of the "Magnificent Seven" large cap technology stocks in the US, who make up 30% of the S&P 500 index (the other 493 companies make up the rest). In the last 12 months, if you did not own most of these companies in your portfolio you were left behind **- hello traders.**

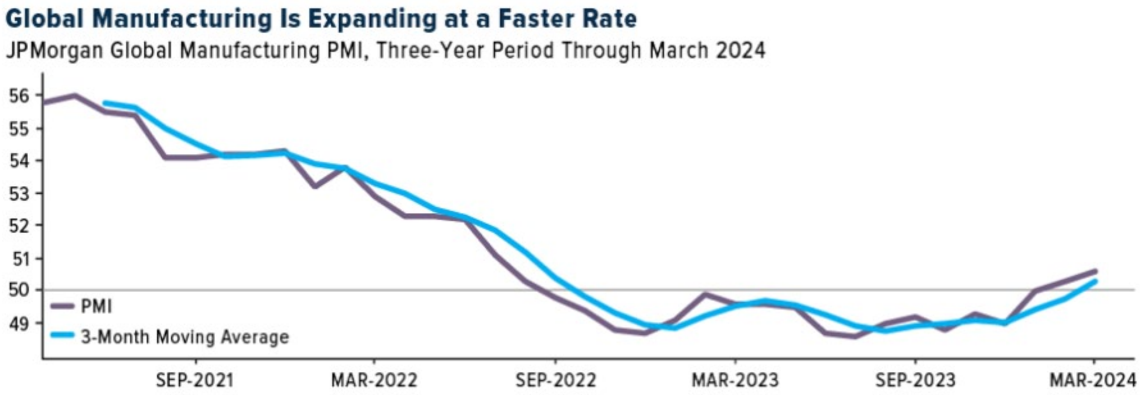
We think that Microsoft, Alphabet, Meta and Amazon are great companies that we would like to own over the long term, yet we are less enthusiastic about Apple and Tesla, partly on valuations and partly on competitive moats. Nvidia is very expensive yet attractive, provided the lofty expectations for earnings growth materializes **– hello investors.**

Trading leads to herd behaviour - a behavioural bias that leverages off the "fear of missing out" where you simply cannot afford not to own Nvidia irrespective of the actual merits of the company. This makes sense to the average investor so, how well do traders do? My short answer involves a friend who was an ex-air force pilot who then left, became an accountant, moved to America, made a lot of money quickly, became a day trader, lost it all in 18 months and eventually went and got a real job. This convinces me that careful, long term investing is a whole lot better than short term trading **in the end.** Yet, it's tough to sit with your very good long-term idea that's going nowhere when the hot stock idea is up 50% in six months.

For this reason, we are becoming increasingly wary of all the money chasing the AI/ semiconductor/ IT security/ other tech themes to the exclusion of the rest of the market.



The Global Manufacturing Engine has Re-Started



S&P Global, which produces the JPMorgan Global Manufacturing PMI, literally surveys purchasing managers from around 13,500 companies in as many as 40 countries, representing 95% of the world's manufacturing output. It's a remarkably thorough, comprehensive and reliable gauge of whether factories are expanding production, and by how much.

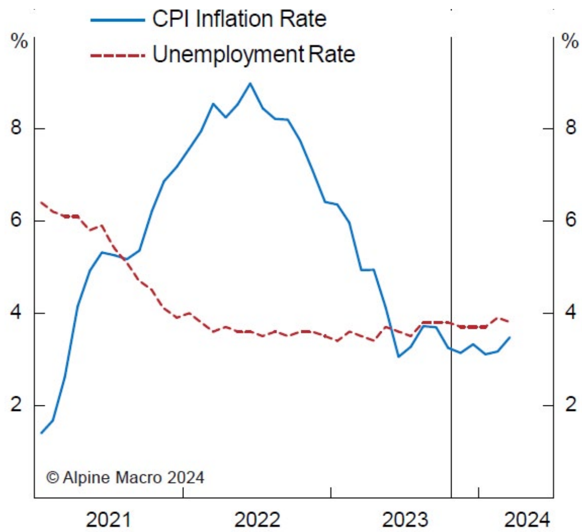
The global manufacturing engine is starting up again which suggests that we may be at an inflection point between economic slowdown and re-acceleration – a period where it is VERY important to be invested into markets.

Manufacturing in the US has turned positive for the first time in 16 months; manufacturing indices in Europe and China have turned higher and emerging market manufacturing indices are surging. This has led to a sharp improvement in mining company share prices as industrial metals prices respond to increased demand. Chinese shares have also turned higher on the growing expectation of an improvement in the months to come.

Inflation Should Keep Falling

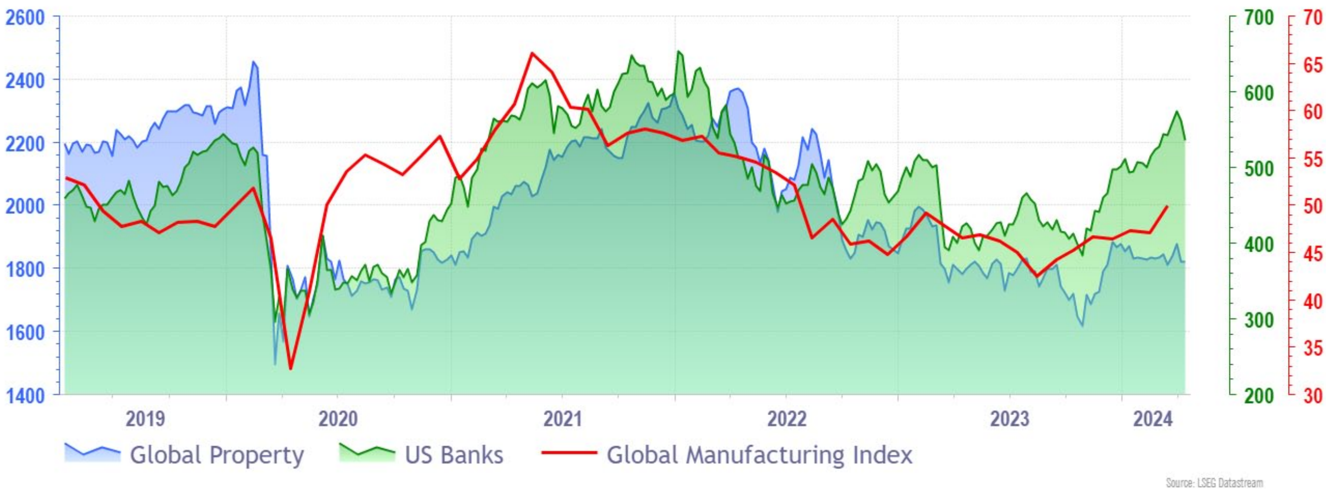
Hiking interest rates to slow an economy leads to falling inflation as demand for goods and services falls away. Not this time around, it seems. Economic growth in the US is steady to accelerating yet all the components of inflation continue to trend lower.

One explanation is that inflation rose on the scarcity of supplied goods dating back to COVID times, which is only now dissipating. This type of inflation does not react to rising interest rates and it's falling despite the higher rates currently in place. Should this be true, inflation will continue to recede at a time of falling interest rates and accelerating economic growth – **ideal conditions for a super cycle in stock markets.**



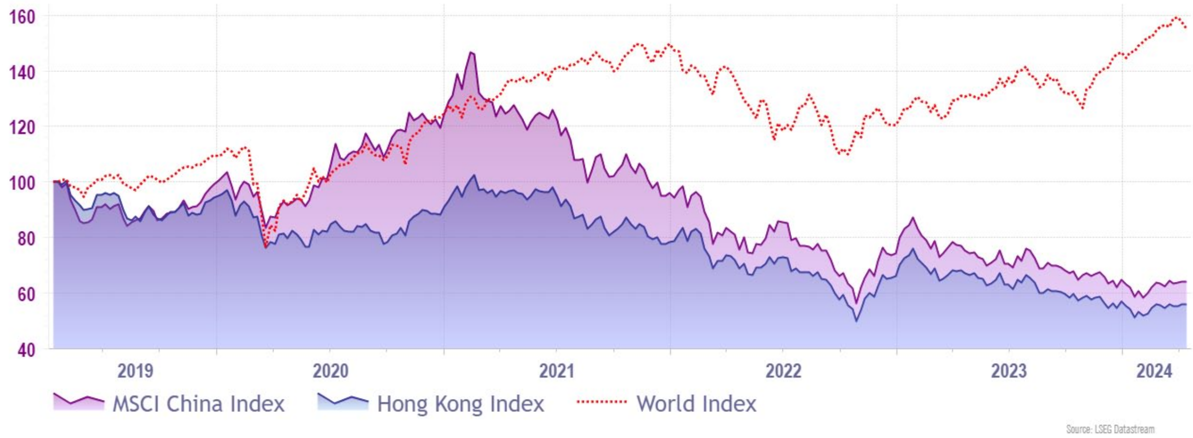
The implications of a re-acceleration in the global economy create opportunities in the following sectors of the global stock market:

Interest rate cyclicals e.g. real estate, banks

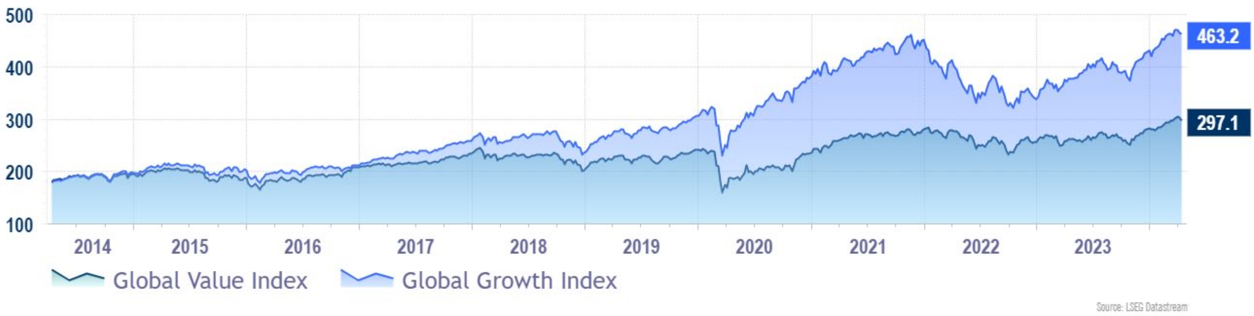


Commodity shares and commodity countries e.g. global mining companies, South Africa, South American commodity producers, Australia.

Chinese shares – Stock markets are deeply oversold, exports are recovering, local sentiment should improve and the property sector should stabilize.



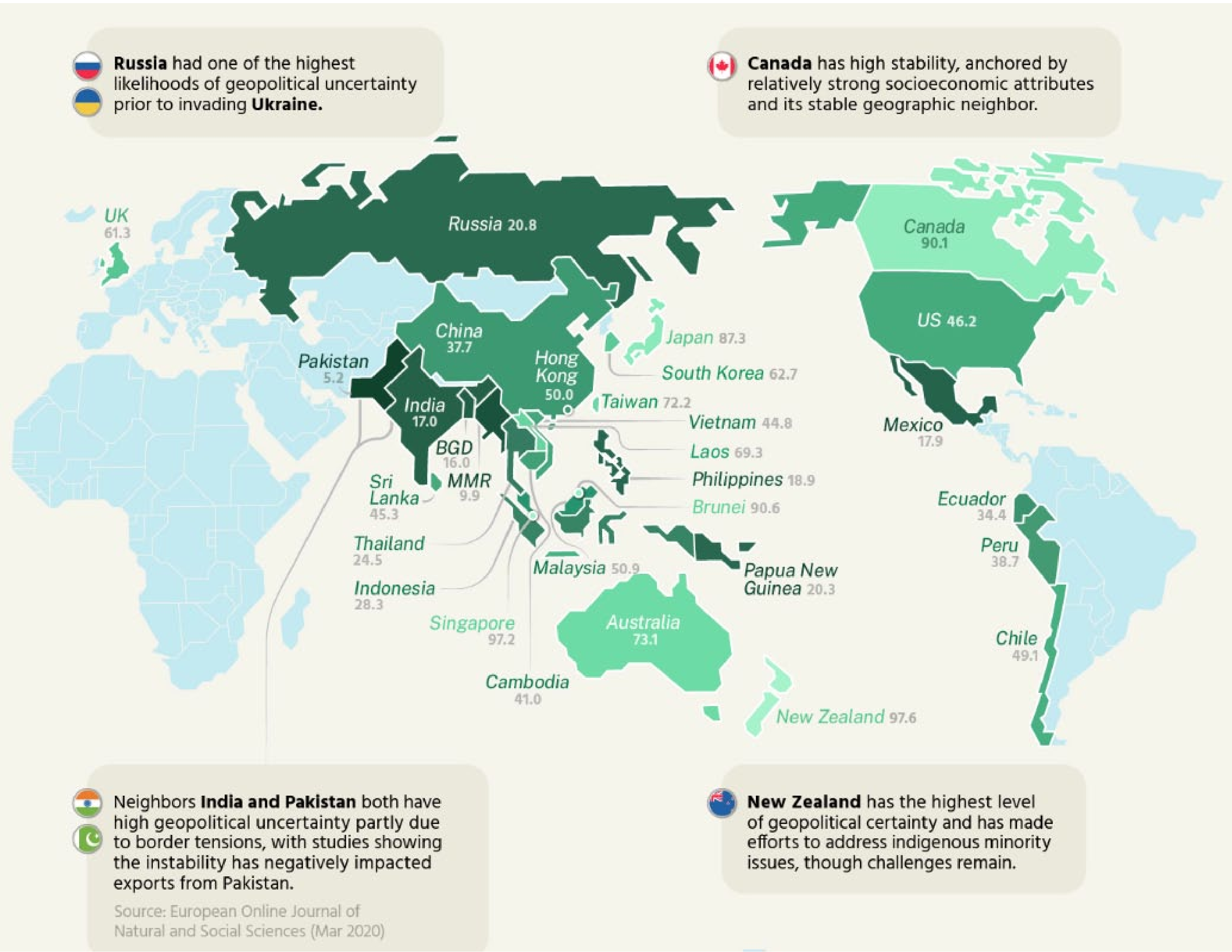
Other value stocks – a broad economic recovery is like an income tide that lifts all boats in the harbour. Value is cheap relative to growth and could recover more strongly.



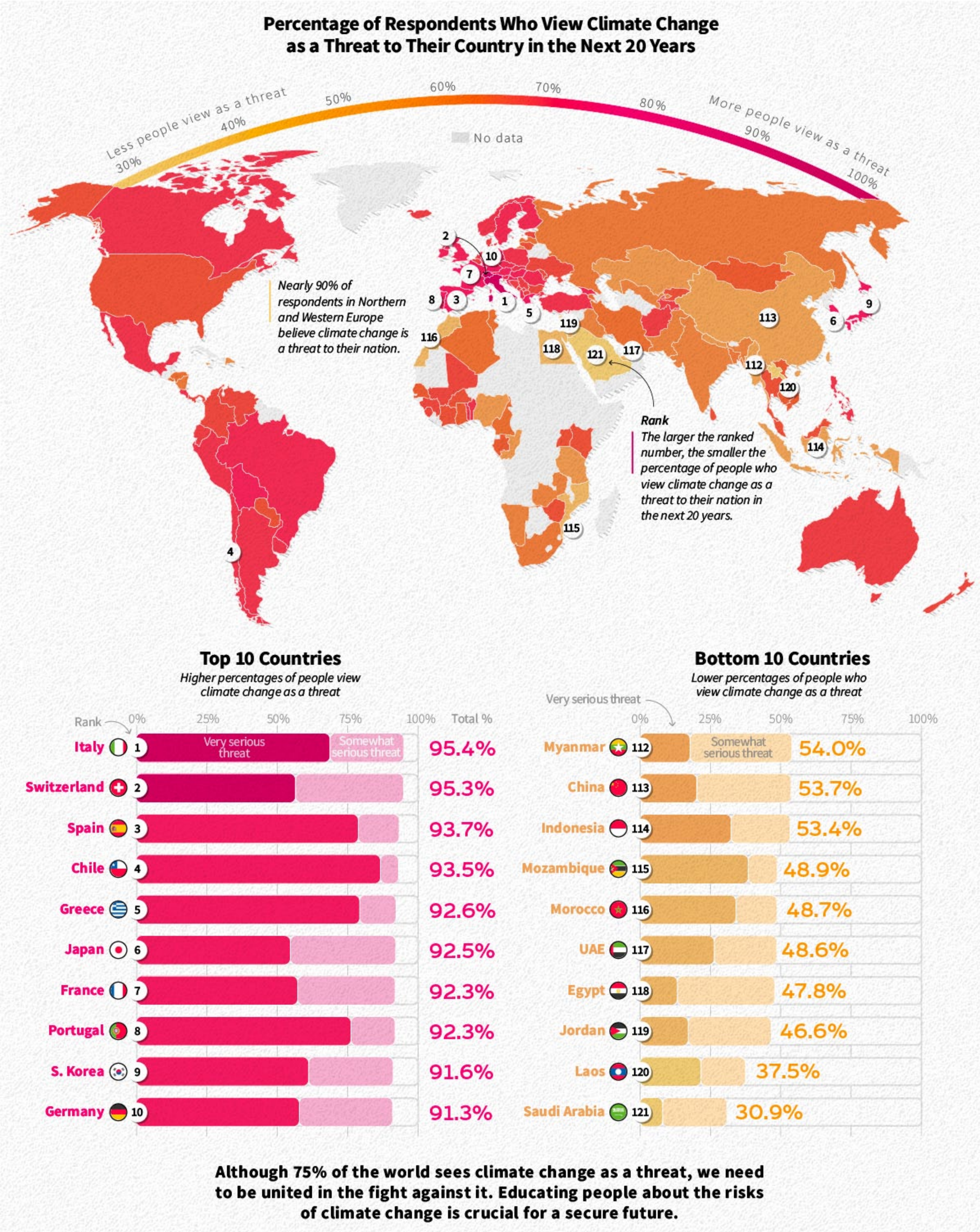
The highest risks to markets this year are likely to be rising geopolitical risks and the effects of climate change.

The European economy has largely adjusted to the economic implications of the Russia Ukraine war. A wider middle east war pitting Israel against Iran and its proxies will push oil higher - our geopolitical strategists expect as much as $120 per barrel should war break out in Iran.

Geopolitical Hotspots in the World Today



Climate change is increasingly affecting the global economic cycle. We are not yet at the stage where climate change is a serious consideration in stock selection yet, we expect it to become more so in the years to come.



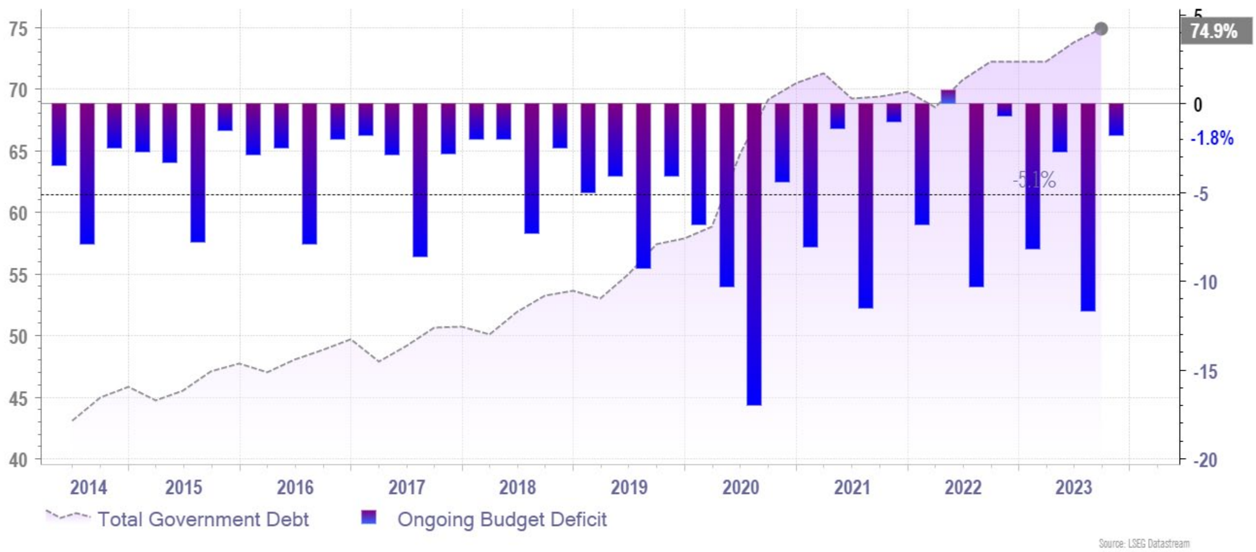
SA Should Experience a Stock Market and Rand Recovery

The JSE should benefit from a recovery in global metal prices, which leads to a recovery in resources and the top 40 index. Unfortunately, SA focused companies continue to struggle in tough operating conditions where consumers are cash strapped, power and water cuts affect production, and deteriorating infrastructure is a problem to all.

It's probable that foreigners will be attracted to the JSE to buy our miners and government bonds as interest rates fall and the global economy accelerate again. This should benefit the Rand for a season, after which domestic ills could put pressure on the currency again.

A future political coalition where the ANC holds on to the reigns of economic power is ominous for our future. Demands from labour on the government to keep the bloated public sector fully employed at future inflation plus increases, together with the need to maintain and increase grant payments to society, dysfunctional municipalities and SOE's will put increasing pressure on the fiscus to borrow more money.

In the face of further economic mis-management and the resultant lower tax collections, debt accelerates.



More debt leads to higher interest rates, lower economic growth, a weakening Rand and the resultant inflation that comes from it. In these conditions, investors would be well advised to invest more money directly offshore.

In summary, the global outlook is improving and economic conditions are creating an environment for risky assets to perform well.

Happy Investing,

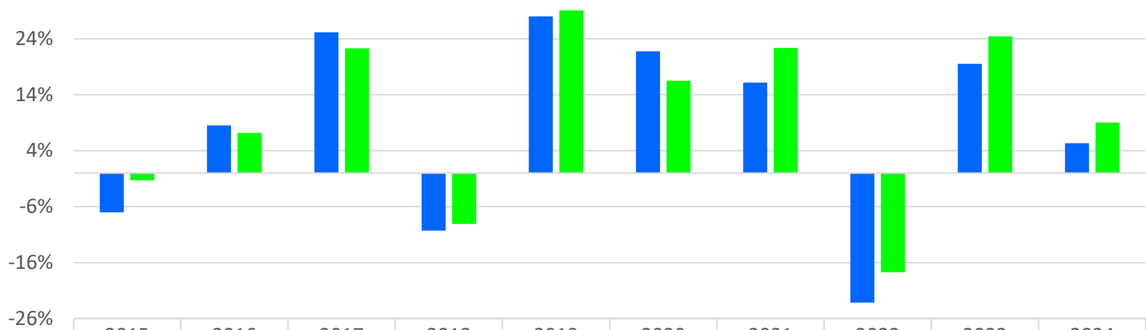
Wayne Smith

Investment Update

The Offshore Growth Model

We are mindful of the profile of the average investor into our Offshore Growth Model and we have positioned the portfolio accordingly. We currently have ±13% in Chinese companies which are very cheap and have the highest upside potential in the portfolio; we have increased our interest rate sensitive companies to 21,6% of total holdings and we have an 8,3% exposure to oil and copper. This makes up a total of ±43% in lower risk and defensive equity positions in the event of a tech heavy market pullback.

We are betting on a recovery in the global economy, led by a pickup in global manufacturing, and interest rate cuts in western economies as inflation falls back to acceptable levels.



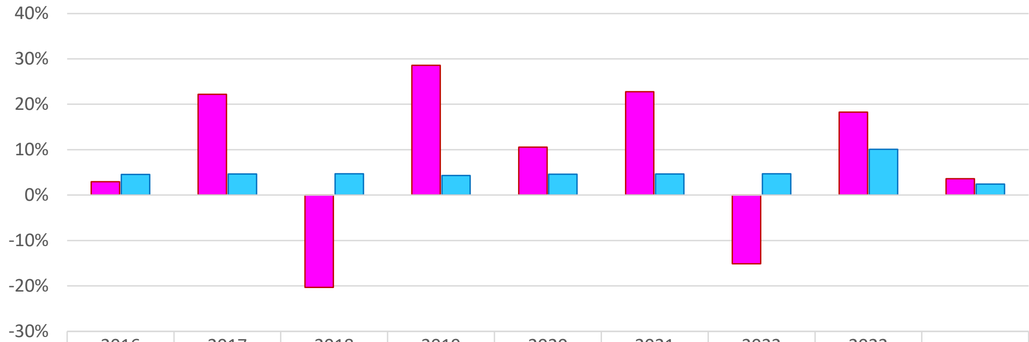
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Portfolio in USD	-7,03%	8,52%	25,16%	-10,27%	27,99%	21,73%	16,16%	-23,13%	19,50%	5,31%
Benchmark in USD	-1,32%	7,18%	22,25%	-9,09%	29,04%	16,50%	22,35%	-17,73%	24,42%	9,01%

The Offshore High Dividend Model

The goal of the portfolio is to provide investors with an above average dividend and capital growth from a well-diversified portfolio of shares across geographies and industries. Our benchmark is USD cash plus 4%.

The portfolio is made up of a 62% exposure to interest rate sensitive shares including banks, property and insurance companies. These shares typically do well in a falling interest rate environment. The portfolio has a 7% exposure to Chinese companies and the balance of the portfolio is made up of a number of healthcare and industrial counters. Since growth shares rarely pay dividends, the portfolio only has a small investment of 13% into typical growth companies.

The portfolio should do very well in a falling interest rate environment.



	2016	2017	2018	2019	2020	2021	2022	2023	
Portfolio in USD	3,0%	22,2%	-20,3%	28,6%	10,6%	22,7%	-15,1%	18,3%	3,6%
Benchmark in USD	4,6%	4,7%	4,7%	4,3%	4,6%	4,6%	4,7%	10,1%	2,4%

The Local High Dividend Model

This model is made up of local shares that pay a high dividend and are expected to generate capital growth over time and is suitable for income dependent investors looking for additional capital growth.

The portfolio has 28% exposure to financial shares including banks, bank preference shares and an insurance company. The portfolio maintains a 25% exposure to fixed income funds/ ETF's due to the scarcity of high quality, high dividend paying companies on the JSE and a 32,5% rand hedge exposure. The current dividend yield is an attractive 7.3%.

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Portfolio	-7,1%	6,6%	9,7%	-13,4%	16,2%	-4,2%	20,2%	6,7%	5,8%	1,1%
Benchmark	7,9%	8,9%	9,0%	8,0%	8,7%	6,7%	5,6%	7,0%	9,9%	2,5%

COMPANY NEWS

We are moving!

Our current offices have been sold to a developer who will be converting them into residential apartments. This has prompted us to move to well established office park where we have taken space in a quiet, leafy parkland environment. From the 2nd May 2024, our new office address will be Willowbrooke House, Constantia Park, cnr 14th Avenue & Hendrik Potgieter Road, Weltevreden Park, 1709.

We are constantly on the lookout for ways to improve our investment performance. After a successful trial of a risk management software system, we will be starting a longer term trial this quarter with the goal of using the software to assist us in making better investment decisions. If successful, the system has the potential to significantly improve performance in time to come.

Aside from some near term turbulence, we expect that 2024 to be a good year for investments and we hope to grow your assets by a meaningful percentage above inflation.

Regards,

The Capstone Team

"The magical hour at the waterhole"

Sources - Alpine Macro, Refinitiv, The Visual Capitalist

Contributors: Wayne Smith, Hanneke Ferreira

For further information on the articles that appear in this publication kindly contact wayne Smith at wayne@cstone.co.za.

Capstone 293 (Pty) Ltd

Reg. No. 2001/023109/07

Director: W. Smith
Ground Floor, Unit 2
Constantia View Office Park
2 Hogsback Avenue
Quellerina, Gauteng
PO Box 6098
Weltevreden Park 1715
Tel +27(0) 11 477 0062
Fax +27 (0) 86 608 5417
www.cstone.co.za

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