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WEEKLY REPORT

OVERBERG MARKET REPORT

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Global Report

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PMIs and the Trajectory for Interest Rates

The Purchasing Managers' Index (PMI) is a widely used economic indicator that provides crucial insights into the health of a country's manufacturing and services sectors. The PMI is based on a monthly survey of purchasing managers showing the level of activity and sentiment in each sector. A PMI reading above 50 indicates expansion, while a reading below 50 indicates contraction. Changes in the PMI can provide early signals of changes in the overall economy, making it a valuable tool for investors to assess the direction of the economy and to adjust investment strategies accordingly. Central bankers also use it to guide their decisions on interest rates and other monetary policy measures.

The PMI is calculated separately for the manufacturing and services sectors, and the results can be compared to gain a better understanding of the overall economy. The Manufacturing PMI measures the level of activity in the manufacturing sector, including output, new orders, new export orders, backlogs of work, output prices, input prices, suppliers' delivery times, stocks of finished goods, quantity of purchases, stocks of purchases, employment, and future output. Furthermore, the manufacturing PMI provides insight into the demand for manufactured goods and the level of production.

The Services PMI measures the performance of the services sector. It includes survey respondents from various service industries, including consumer (excluding retail), transport, information, communication, finance, insurance, real estate and business services. The headline figure is the Services Business Activity Index and covers economic variables such as new business, new export business, outstanding business, prices charged, input prices, employment, future activity.

The Composite PMI with its headline figure. The Composite Output Index is comprised of a weighted average of the Manufacturing Output Index and the Services Business Activity Index, where the weights mirror the relative size of manufacturing and services according to official economic data. Developed nations typically have a much larger weight to services, as high as 80%.

The most recent PMI data for February from the Eurozone would have been encouraging in a pre-Covid era, showing marked improvements in most developed regions since the end of last year. The Eurozone posted the highest Services and Composite PMI in 8 months of 52.7, showing that private sector services are in expansionary territory. This despite manufacturing easing since the start of the year, coming in at 48.5. The expansion in February allayed fears of a recession in the first quarter and the optimism also spurred firms into hiring, suggesting an appetite to invest into further expansion. While this is great news for the economy, it is bad news for inflation. It could spell further and more aggressive monetary policy tightening from the European Central Bank which could stymie the recovery of European stocks over the last two months.

The US saw a similar "good news is bad news" survey result. The US Composite PMI Output Index rose to 50.1 in February from 46.8 in January, indicating stable levels of business activity at private sector firms and an end to a seven-month contraction. Input prices rose at the second-slowest pace since October 2020, leading to a softer cost pressure, but firms passed on higher costs to customers as output charges increased. Employment saw faster expansion, with the rate of job creation at its highest since September 2022. The US job numbers for January caught the markets off guard, surprising on the upside and saw financial markets quickly recalibrating their inflation outlook and interest rate expectations. Given the strong PMI numbers for February the end to tightening monetary policy by the Federal Reserve Bank is being pushed into next year, causing bond yields to rise and stock markets to trade sideways.

The latest Chinese Manufacturing PMI data shows that the manufacturing sector returned to growth in February, with the headline figure increasing to 51.6, up from 49.2 in January. This improvement in overall business conditions is attributed to the recent roll back of pandemic restrictions, leading to renewed and solid upturns in both production and new orders, as well as increased employment and purchasing activity. Pressure on supply chains also eased, with lead times improving to the greatest extent in eight years. Additionally, business confidence regarding the year ahead reached a 23-month high due to the return to more normal business conditions and expectations of further increases in client demand. This corroborates the outlook of improved domestic demand and the likelihood that China will beat the recently announced 5% GDP growth target which economists have described as a "floor" that should be easily beaten. This is good news for the easing in global supply chains which will relieve input price pressures in developed nations. Global demand for Chinese exports has cooled, in line with an easing in consumer spending on goods in the west. However, Chinese demand for commodities, as their economy accelerates, poses a new threat to global inflation.

In the coming months PMI figures will be lighting up the runways for hard or soft economic landings, while the no-landing, where inflation remains stubbornly above the target as interest rates keep rising, is still a very likely outcome. Central bankers would have taken note of recent developments and there is no doubt that they will remain firmly hawkish for the time being.

Local Report

Gielie Fourie

Lessons from Warren Buffett's Annual Report

INTRODUCTION: Last week Warren Buffett released his 2022 letter to Berkshire Hathaway shareholders. The letter contains little financial information, but there are lots of financial advice for his shareholders. The annual general meeting (AGM) will be hosted by Buffett (92) and Charlie Munger (99) in Omaha, Nebraska) on May 5-6. Buffett bought Berkshire Hathaway, a failing textile company in 1964, and then began using it as a platform to invest in other companies and industries. When it comes to investing, Buffett is still a genius.

PERFORMANCE: The performance of Berkshire Hathaway since 1965 to 2022 (58 years) is remarkable. The compounded annual gain since 1965 is 19.8%, exactly double the annual gain of 9.9% of the S&P 500. This may seem petty, but the overall gain over 58 years was 3,787,464% (3.7 million percent), compared to the 24,707% (24.7 thousand percent) of the S&P 500. The price of a single Berkshire Hathaway share today is $473 256.12, around R8.5 million per share.

INVESTMENT STRATEGY: Warren Buffett once said in a letter to his shareholders, "It is far better to buy a wonderful company at a fair price than a fair company at a wonderful price." This has not always been his strategy. Buffett's investment strategy has changed since he met his business partner, Charlie Munger, in 1958. Buffett used to be a deep value investor, a strategy he learned from Benjamin Graham, the father of value investing. Munger convinced Buffett to also consider growth, a strategy he, Munger, adopted after reading the book, Common Stocks and Uncommon Profits, by Phil Fisher. Fisher is one of the early proponents of the growth investing strategy. Today Buffett describes his investment style as 85% Benjamin Graham (value) and 15% Phil Fisher (growth). Buffett invests in companies with sound balance sheets, sound management and have moats around them.

BUY-AND-HOLD STRATEGY: Buffett is also a buy-and-hold investor, hanging on to stocks for years and even decades. However, there are notable exceptions. In 2022, Buffett dumped Bristol Myers and Royalty Pharma, not long after buying them for the first time. The prior year, he sold Biogen, Merck, Teva Pharmaceuticals and Merck spinoff Organon, not long after opening stakes in those companies. In 2020 he bought and quickly sold Pfizer. He clearly decided to exit drug stocks. In 2020 he bought Barrick Gold and sold it in February 2021. He bought (in 2016) and sold all his airline stocks in 2020 when the coronavirus hit global air travel.

CURRENT PORTFOLIO AND CASH: In Warren Buffett's current portfolio as of 31 December 2022, the top 5 holdings are: Apple: Value $116 billion, Bank of America: Value $33 billion, Chevron: Value $30 billion, Coca-Cola: Value $25 billion, and American Express: Value $22 billion. Cash on hand, available within one year, amounted to $36 billion, a decline of 60% relative to the previous year.

REPORT CARD: Buffett writes: "A report card from me is appropriate: In 58 years of Berkshire management, most of my capital-allocation decisions have been no better than so-so. Our satisfactory results have been the product of about a dozen truly good decisions – that would be about one every five years – and a sometimes-forgotten advantage that favours long-term investors such as Berkshire." He adds: "It is crucial to understand that stocks often trade at truly foolish prices, both high and low. Efficient markets exist only in textbooks."

DIVIDENDS - THE SECRET SAUCE: In 1994 Buffett completed his seven-year purchase of 400 million Coca-Cola shares for $1.3 billion. In 2022 the dividend received amounted to $704 million, and the value of the shares increased to $25 billion. American Express is much the same story. The purchases of Amex were completed in 1995. The cost was the same as that of Coca-Cola, $1.3 billion. Annual dividends have grown to $302 million. The value of the shares has increased to $22 billion.

DIVIDENDS INCOME: While Berkshire Hathaway does not pay dividends, Buffett prefers to invest in companies that do pay dividends. The annual dividends collected are around $6.1 billion. Just five holdings account for 71% of dividends received. They are Chevron ($908 million), Bank of America ($909 million), Occidental Petroleum ($898 million), Apple ($840 million) and Coca-Cola ($704 million).

Buffett says: "Assume, for a moment, I had made a similarly sized investment mistake in the 1990s, one that flat-lined and simply retained its $1.3 billion value in 2022. (An example would be a high-grade 30-year bond.) That disappointing investment would now represent an insignificant 0.3% of Berkshire's net worth and would be delivering to us an unchanged $80 million or so of annual income."

SHARE BUYBACKS: One of Buffett's strategies is to buy back shares. It is a great strategy if the shares are bought back at prices below its intrinsic value. The result will be that the intrinsic value of the outstanding shares will increase a little bit. Apple and Amex also bought back shares, also increasing their intrinsic values. This benefitted Berkshire indirectly without costing it a cent. When you have idle cash on your balance sheet you have two options, pay dividends, or buy back shares. Buffett does not pay dividends; he prefers to buy back shares.

BOTTOM LINE: Buffett's eleven page 2022 letter is a must read. How does Buffett explain his success? He wrote: "I insist on a lot of time being spent, almost every day, to just sit and think. That is very uncommon in American business. I read and think. So, I do more reading and thinking and make fewer impulse decisions than most people in business." He adds: "Over time, it takes just a few winners to work wonders. And, yes, it helps to start early and live into your 90s as well." Finally he says that nothing beats having a great partner like Charlie Munger. Investing is not for everyone. If you want to invest, contact one of our consultants. They will take the sting out of investing.