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WEEKLY REPORT

OVERBERG MARKET REPORT

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Global Report

Nick Downing

Finding growth in an unsynchronised world

It is tempting to be pessimistic about the outlook for global equity markets in the current environment. The threat of recession looms in the US, the world's largest economy, as surging inflation, and the fastest increase in interest rates in 40 years take their toll. Global markets have struggled since hitting a peak in late 2021. The MSCI All Country World index is down 14% from its peak reached on 12th November 2021. Yet, opportunities abound, helped by the fact that GDP growth of various geographic regions has seldom been less synchronised. Differing responses to the Covid pandemic and the uneven impact of the Ukraine War have caused economies to grow and retreat at different times, very different from the norm of relatively synchronised growth. While the US is slowing, being the first major economy to start hiking interest rates, growth in the Eurozone is accelerating due to war-related fiscal support and the unexpectedly large retreat in energy prices.

China is exhibiting the most significant acceleration in GDP growth as her economy awakens from hibernation. The lifting of severe Covid restrictions has unlocked pent-up consumer demand for goods and services. At the same time, government has put a temporary halt to its meddling with private sector business. China's GDP grew by only 3% in 2022 during its year of hibernation, the slowest growth since the 1980s but is expected to grow by around 6% in 2023. Meanwhile, consumer price inflation is only 0.7% in China.

First quarter (Q1) GDP beat already elevated expectations, helped by rising consumer confidence and expenditure of accumulated savings, especially in the services sector. GDP growth accelerated to 4.5% year-on-year in Q1, up from 2.9% in Q4 last year, and well above the consensus forecast of 4.0%. GDP output is now 6.8% above its recent low point in Q2 2022. Property sector investment continued to decline but housing demand began to recover, helping house prices to increase at their strongest pace in 21 months. Monthly economic data since quarter-end point to further gains in economic momentum, including upbeat purchasing managers' indices (PMIs), strengthening consumer confidence and rising credit growth. Services and construction PMIs hit decade highs in April.

Encouragingly, China's current growth rate is more organic than usual. The massive stimulus programmes of past economic cycles are missing. This is good news, as it is likely that imbalances from excessive credit expansion and over-investment in housing, infrastructure, and industrial capacity, will be avoided. It means, of course that economic growth will be slower, unlike the heady days of 8%-plus growth, but it also points to greater sustainability. Moreover, current GDP growth is occurring in the absence of any export recovery. The traditional drivers of China's GDP growth: housing, exports, and investment spending, are all relatively subdued, which means the economy is maturing and relying more on consumer spending and the demand for services.

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China pessimists cite geopolitical risks and the decoupling of China from the West, and the impact this may have on economic activity. Others cite the country's demographics and the rapidly shrinking and ageing population. The two trends are intertwined. A rapidly ageing population will increase the dependency ratio (children and retirees divided by the working age population) and lead to a drop in the savings rate, which according to Independent research firm, MRB Partners, means: "Regardless of geopolitical tensions and increasing deglobalisation, demographics dictate that China will continue opening its economy and capital markets to foreign investors…… Policymakers have been preparing the ground for a more open capital account, because in future China will need to borrow capital from the rest of the world."

Regarding demographics, MRB Partners make the following observation: "That China's demographic structure will cause the trend of its GDP growth to decline is a given…. However, the fact that the share of its service sector in GDP will continue to increase as incomes rise and the population ages is a strong tailwind for Chinese corporate earnings growth." Another interesting point is that despite China's ageing population, the country is not yet fully urbanised. The United Nations forecasts that people living in cities with populations exceeding five million will increase from 208 million in 2020 to 280 million in 2030, bringing numerous economic spin-offs and considerable relief to the over-extended property sector.

In an article we wrote in October 2022, titled "Is China becoming un-investable?", prompted by government crackdowns on the internet sector and a persistent Covid-zero policy, we concluded that "China is unlikely to ever become un-investable. Its economy is too dependent on trade and integral to the world economy for either its own or for foreign governments to render it so…. Current valuations almost guarantee superior returns." MRB Partners, in their "Long-Term Returns" report, dated 17th November 2022, forecast China's GDP growth will achieve 3.8% per annum in the decade from 2022-2032, much lower than the 6.7% annual growth in the prior decade, but enough according to their forecasts to generate the world's strongest equity market returns.

There will be positive spin-offs for the entire Pacific region, benefitting Japan, developed Far Eastern and emerging Far Eastern markets, which like China are all cheap compared to their long-term averages and at multi-decade lows compared with the relatively expensive US market. Overberg Asset Management has significant weighting to China and the Asia-Pacific region in its privately managed global share portfolios including holdings in: Fidelity China Special Situations, VinaCapital Vietnam Opportunity, Schroder Asia Pacific, Schroder Oriental Income and Baillie Gifford Japan, all investment companies listed on the London Stock Exchange.

Local Report

Gielie Fourie

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Five things investors should avoid.

INTRODUCTION: Phil Fisher (1907 – 2004) was an American stock investor – he retired when he was 91 and died at age 96. He is best known as the author of the book Common Stocks and Uncommon Profits, a guide to investing that has remained in print since it was first published in 1958. He started investing in a time when value investing was popular. Fisher was contrarian, he was one of the early proponents of the growth investing strategy. Warren Buffett called Fisher's 'Common stocks and uncommon profits' a "very, very good book." Buffett added: "I am an eager reader of whatever Phil has to say, and I recommend him to you." Buffett describes himself today as 85% Benjamin Graham, who followed a value strategy, and 15% Phil Fisher, who followed a growth strategy.

Fisher mentions in his book "Five Don'ts for Investors." These five tenets have nothing to do with financial ratios at all. They are qualitative, rather than quantitative. They refer to five "don'ts" that the investor should be aware of.

1. DO NOT INVEST IN PROMOTIONAL COMPANIES: Fisher defined promotional companies as companies with less than three years of commercial operation. His advice is to invest in established companies. We have seen this so often. Companies would list on a stock exchange with a lot of hype. After a few years, the hype is gone and reality sets in.

2. DO NOT BUY STOCKS WITH BORROWED MONEY: Buying on the margin (with borrowed funds) is risky. It was the accepted method of trade in the 1920's. Buying on the margin is now limited to a fraction of what it was. Today an exceptionally large percentage of all trading is done on a cash basis. Cash trading today is done by a new class of investors, called institutional investors, like investment trusts and pension funds overseeing the collective savings of millions of small investors.

3. DO NOT BUY A STOCK JUST BECAUSE YOU LIKE THE "TONE" OF ITS ANNUAL REPORT: The annual report may often be too optimistic. Annual reports are designed to build goodwill. It may not even be written by the chairperson but by the marketing team. They are prone to put the best foot forward. They seldom present balanced and complete discussions of the real problems and difficulties of the business.

4. DO NOT QUIBBLE OVER EIGHTS AND QUARTERS: By quibbling over small amounts to save say R50.00, investors can fail to make big profits. For example, an investor can insist on buying a share only when it is below R10.00. The price may fall to R10.50 but our investor is adamant – he will only buy below R10.00. The share may then run to R100.00, a ten bagger, and the investor loses out.

5. DO NOT INVEST WITHOUT A PLAN: It is important to have a well-thought-out investment plan that aligns with your financial goals and risk tolerance. Investing without a plan can lead to making impulsive decisions and not achieving your financial objectives. Investing should be viewed as a long-term strategy, and investors should avoid being swayed by short-term market movements. Making impulsive decisions based on short-term gains can result in significant losses. Do not try to time the market or chase after short-term gains. Instead, focus on long-term investment goals and stay invested for the long haul. Be a patient investor. Investing is not a sprint; it is a marathon. Since 1926 the stock market has increased on average around 10% each year, or 1,330,000% over 96 years. Do not allow short-term fears control long-term decisions. Time in the market is more important than timing the market.

In addition to the above, beware of becoming overconfident in your investment decisions. Remain humble and objective when evaluating investment opportunities. Overconfidence can lead to taking on too much risk or ignoring red flags. Investing in only one asset class or sector can expose you to unnecessary risks. Diversifying across multiple asset classes and sectors can help to mitigate risk and

improve overall portfolio performance. Do not put all your money into a single investment. Instead, spread your money across different asset classes, such as stocks, bonds, real estate, and commodities.

BOTTOM LINE: If you are unsure about how to invest, or need help developing an investment strategy, consider seeking the advice of a financial professional such as a financial advisor or a certified financial planner. They can help you to construct a diversified portfolio of both growth and value shares. You should not invest without a plan. Do not try this at home and do not follow the herd. Contact one of our consultants to help you with a roadmap for your financial future. They will help you to make uncommon profits from common stocks.

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