OVERBERG MARKET REPORT

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Global Report

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Big tech mania

In last week's market report, we wrote about the potential for Artificial Intelligence to transform the global economy, with similar effect to the introduction of steam power during the 1700s and electricity in the early 1900s. As AI technology moves across the spectrum from specific AI (designed to complete a specific task), to generative AI (such as ChatGPT) and eventually to general AI (capable of fully simulating human intelligence), there will be significant implications for the economy and financial markets. GDP growth will rise, tax receipts will increase, there will be a boost to productivity growth resulting in higher margins and stronger earnings, while inflation should come down resulting in higher price earnings multiples.

The transformative impact on the economy will be positive for equity markets, especially for the technology sector in the initial years and more specifically for the US technology sector where the AI giants reside. Investor imagination has already perked up, since OpenAI's launch of ChatGPT in November 2022 and the subsequent announcement in January this year that Microsoft had acquired a significant holding in the company.

The benefits of AI may take many years to filter through, but equity markets are forward-looking, and investors will tend to front load the prospects of higher productivity and faster earnings growth. Since the start of the year, the US Big Tech shares have risen collectively by almost 60%. They comprise over 25% of the S&P 500 index and around 18% of the MSCI All World index. If these shares were excluded, the S&P 500 index would be more or less flat for the year but because of their strong performance and massive weighting, the index is up 18% YTD.

The AI tech giants have the deep pockets and user bases that make them significant beneficiaries. The development of AI Large Language Models (such as ChatGPT) and the computer chips to power them currently cost hundreds of millions of dollars. For the time being, the giants have an almost monopolistic hold on the AI transformation, although as the technology progresses, smaller firms will be involved in workflow integration and development of applications. The rising share prices of the tech giants are supported by solid fundamentals. The graph below prepared by independent research company, Alpine Macro, shows the dramatic increase in their operating margins over the past three years, and their increased weighting in the S&P 500 index.

Big Tech Margins Advantage Has Become Even Bigger Since The Pandemic Began					
	Market Cap Weighting		Operating Margins		
	Current (%)	2014-2019 Average (%)	Current (%)	2014-2019 Average (%)	March 2020 (%)
FAAMG*	25.4	13.7	28.9	24.5	24.2
S&P500 ex. FAAMG	74.6	86.3	8.5	10.6	10.5

*Facebook, Amazon, Apple, Microsoft, and Google,
Source: Alpine Macro.

The share prices of the tech giants are expensive, but nowhere near the bubble proportions of the Dot.com boom or the "Nifty Fifty" leaders in 1972. The table below shows current forward price-earnings multiples versus previous bubble peaks. The technology sector, given the transformational potential of AI, could rise considerably further. In the mid-1990s, Federal Reserve chairman Alan Greenspan warned that the stock market was showing signs of "irrational exuberance", but the Nadaq surged for 5 more years before the dot.com bubble burst. There has been no such warning yet in today's technology market, which has risen for just 12 months.

Big Tech Valuation High, But Not At Previous Bubble Peaks					
Big Tech	**Forward P/E**	**Tech's Four Horsemen**	**March 2000 P/E**	**Nifty Fifty**	**1972 P/E**
Facebook	19	Intel	41	Coca-Cola	46
Amazon	34	Cisco	100	McDonalds	71
Apple	29	Dell	57	Texas Instruments	40
Google	19	Microsoft	51	IBM	36
Microsoft	33			Xerox	46
Nvidia	32			Polaroid	95
S&P 500	**21**	**S&P 500**	**28**	**S&P 500**	**19**
10-Year Treasury Yield	**4.4%**	**10-Year Treasury Yield**	**6.2%**	**10-Year Treasury Yield**	**6.5%**

Source: Alpine Macro.

Some economists believe a tech share mania could develop. Alpine Macro references the Kindleberger Framework, which lists four preconditions for an asset price mania to develop. The tech giants qualify on three of them. (1) Fundamental displacement: They dominate their technology segments and have the potential to take advantage of AI-driven innovation. As shown, they have increased margins in absolute terms and relative to the broader market. (2) Difficult to value: Difficulties quantifying the benefits that will immediately accrue from AI will create the conditions for extrapolation and ignoring standard valuation metrics.

(3) Broadening investor participation: Their performance over the past year will strengthen the investor following, especially as they show both "growth" and "defensive" characteristics. Their huge cash balances made them impervious to the regional banking crisis earlier in the year. There is also the potential for forced buying due to their large market weighting. (4) Liquidity: This precondition has not yet been met. The fastest increase in central bank interest rates since 1979 and surge in bond

yields has choked off liquidity, but interest rates are expected to fall in 2024 in line with declining inflation. Liquidity expansion may provide the catalyst.

The largest holding in Overberg Asset Management's global private share portfolios is well positioned to benefit from upside in the tech giants and the broader technology sector. Allianz Technology Trust plc (ATT) has a long and successful track record of investing in quoted technology companies on a worldwide basis. ATT has the competencies to sift through the winners and losers of the AI transformation. It has won several awards and has the highest rating available from Morningstar. ATT is an investment company listed on the London Stock Exchange with a market capitalisation of £1.1 billion and the shares trade at an attractive 13% discount to net asset value. Voya Investment Management, which manages ATT's underlying investment portfolio, is based in Silicon Valley where the tech giants and the world's key technology companies are headquartered.

Local Report

Francois Louw

The Competitive Food Retail Sector

Introduction: In the South African food retail landscape, Shoprite Holdings Ltd, Pick n Pay Stores Ltd, Woolworths Holdings Ltd, and SPAR Group Ltd are the four major players. In the face of a changing consumer landscape, success hinges on innovation and strong leadership. Managing an inflationary environment and a price-conscious consumer, retail companies grapple with the challenge of not passing the entire impact of price hikes onto customers. Striking a balance between stabilising profit margins, coping with rising costs, and handling unforeseen expenditures has turned the local retail sector into a dynamic and forward-thinking environment. Below is a short summary of the performance and strategies of the four leading food retailers.

Pick n Pay: Pick n Pay is facing a challenging 2024 financial year, reporting its first pre-tax net loss of R873 million in the interim financial year results for the period ended 27 August, a stark contrast to the previous year's profit of R588 million. Newly re-appointed CEO Sean Summers attributed a significant portion of the loss to one-off unforeseen expenses related to retrenchment, load shedding, and a distribution centre transition (from 60% ownership to renting). The group's debt increased by 171%, reaching R3.8 billion for the half year, and interest payable has become a point of concern. Returning after Pieter Boone's tenure, Summers, with a proven track record, aims to revitalise Pick n Pay, acknowledging the opportunity to honour the legacy of founder Raymond Ackerman.

Shoprite: In the first quarter of its 2024 financial year, Shoprite exhibited notable growth, launching 81 new stores as part of its strategic plan to open a total of 314 new stores by June 2024. The company's capital expenditure (capex) is particularly noteworthy. Capex rose from R5.4 billion to R6.8 billion in 2023, and projections anticipate a peak of R8.5 billion in 2024, reflecting a 25% anticipated increase. This underscores Shoprite's commitment to maintaining its market dominance. Since Pieter Engelbrecht assumed the role of CEO in 2017, his leadership has been characterized by strategic execution and innovation, with Shoprite now the largest retailer in the country.

Woolworths: Woolworths produced a robust financial performance for the 52 weeks ended 25 June 2023, with a 29.5% increase in pre-tax profit to R6.7 billion from a 7% rise in total turnover to R85.7 billion. The core food business was the driving force behind its success. Shareholders benefited from a noteworthy 36.4% dividend increase to R3.13 per share. However, Woolworths has struggled to adapt to the New Zealand and Australian markets, with its clothing business Country Road experiencing an 8.1% decline in sales. Appointed as new CEO in 2020, Roy Bagattini initiated strategic moves, including selling David Jones clothing company, addressing minimum wage concerns, and elevating transparency by disclosing hourly wage levels.

Spar: In the 6 months ended 31 March 2023, SPAR saw a 5.6% growth in total turnover, primarily driven by a 7.9% increase in the grocery wholesale business. However, TOPS at SPAR experienced a 1.9% decline in liquor sales due to high previous period sales during eased lockdown restrictions. Challenges also emerged in KZN during the implementation of a new SAP software system, resulting in distribution issues and an estimated loss of R1.42 billion for the 47 weeks ended 30 August 2023. Angelo Swartz, with 16 years of Spar experience, assumed the role of CEO on October 1 of this year, succeeding Brett Botten. The group also appointed a new COO to help increase profitability. The new COO, Megan Pydigadu, is well-known for her anti-corruption efforts at her previous employer (IT company EOH).

Delivery Wars: There has been a noticeable shift toward online shopping among local consumers. Shoprite witnessed an impressive 82% surge in Sixty60 deliveries in the first half its 2023 financial year, expanding services to 466 locations. Pick n Pay responded by improving its asap! application, now offering 25,000 products. With a robust 76% growth in online sales, Pick n Pay now provides delivery services to 400 locations. In its 2023 financial year, Woolworths experienced a 28.5% increase in online sales due to its online shopping service - Woolies Dash. Spar joined the trend in 2022 with the launch of Spar2U, now delivering parcels with eco-friendly vehicles.

In a market where budget-conscious consumers prioritise price, a recent case study by BusinessTech compared the pricing of four delivery platforms across 15 everyday consumables, including 10 food items and 5 non-food items of house brand goods (Table 1). The case study revealed that, overall, Checkers Sixty60 emerged as the most cost-effective option (R641.85) compared to its counterparts. Specifically, when examining two distinct baskets, Checkers Sixty60 proved to be the cheapest for 5 non-food items (R228.95), while Spar2U offered the best prices for the 10 food items (R396.90). Conversely, Woolies Dash ranked as the most expensive across both categories (and in total), although it did provide the most competitive pricing for a 2kg bag of white sugar (R57.99). This study supports the notion that most consumers prioritise price, with Checkers Sixty60 being the biggest platform amongst its peers.

Table 1

Case Study: Prices for a basket of goods on delivery platforms

Items	Checkers Sixty60	Pick n Pay Asap!	Woolies Dash	Spar2U
Baked Beans	R10.99	R13.99	R14.99	R11.99
Tuna in brine	R21.99	R21.99	R27.99	R23.99
Tomato sauce	R24.99	R32.99	R44.99	R28.99
Mixed Veg (frozen)	R34.99	R32.99	R54.99	R29.99
Cooking Oil	R84.99	R79.99	R79.99	R74.99

Chutney	R24.99	R24.99	R53.99	R30.99
White Sugar	R59.99	R59.99	R57.99	R59.99
Apples	R32.99	R26.99	R37.99	R14.99
Cabbage	R16.99	R19.99	R21.99	R21.99
Long life milk	R99.99	R99.99	R109.99	R104.99
FOOD TOTAL	R412.90	R413.90	R504.90	R396.90
Dishwash Liquid	R24.99	R24.99	R34.99	R22.99
Refuse Bag	R34.99	R41.99	R52.99	R40.90
Bleach	R16.99	R16.99	R34.99	R16.99
Toilet Paper	R129.99	R134.99	R174.99	R147.99
A Purpose Cleaner	R21.99	R22.99	R34.99	R25.99
NON-FOOD TOTAL	R228.95	R241.95	R332.95	R254.86
TOTAL	R641.85	R655.85	R837.85	R651.76

Source: BusinessTech

Bottom Line: South Africa's major retailers have recently undergone significant leadership changes, with some bringing back experienced leaders and others introducing new faces to influence operational strategies. Consumer loyalty varies, with some exclusively favouring one retailer, while others choose based on factors like location, convenience, and promotions. The retail sector is directly impacted by key economic factors such as inflation, unemployment, and low GDP growth and success lies in the ability to rise above these. Those who introduce new ideas, whilst staying true to their brand identity, are likely to thrive amid economic challenges and changing consumer preferences.

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