INTUITION
22 SEPTEMBER 2023

Stats vs Facts. How to solve the investment equation.

"Stats versus Facts" was the topic of our recent Insight seminar. We tried to draw attention to the way statistics are sometimes used to drive fear into the minds of investors. Statistics is all about interpretation and are often supported by anecdotal facts that might just add a fresh perspective to the economy and financial markets. Searching for facts or interpreting numbers from outside the normal data sphere usually brings new investment insights. This new data makes the investment world more exciting and can be applied to optimizing future portfolio structure.

Willie Pelser

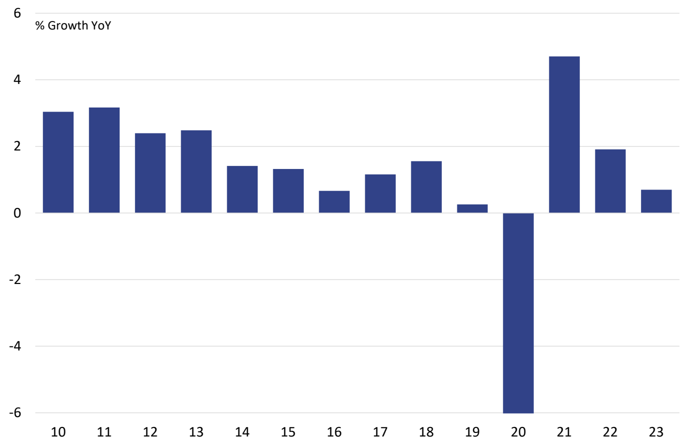
"Stats versus Facts" was the topic of our latest Insight seminar. We chose this topic for two reasons. Firstly, to delve into the concept of how headline news can periodically use statistics to sell a very negative story. Although the statistics are factual, it all comes down to interpretation by the author. Invariably, there are other statistics that are often overlooked, and we are of the opinion that they often tell another story which is useful when it comes to markets. Secondly, we have tried to give some insight into our decision making around the listed companies included in our clients' portfolios. How do we solve these equations?

SPEED READ

- **Globally economic growth is measured by the equation: GDP = C + I + G + X -M. Due to our dismal economic performance, investors often want nothing to do with SA or the JSE. They argue that the economy is so bad that our market is uninvestable.**
- **Some consumer-related companies are performing well despite the pressure facing households. (This is the "C" component of the GDP equation). We ask a few questions around consumer income and spending patterns.**
- **Fixed Investment is critical in all economies. South Africa enjoyed an investment boom leading into the 2010 World Cup. By nature, investment projects take years to come to fruition. Albeit slow, the project pipeline is growing again, despite the loadshedding impact, and is expected to accelerate our current weak growth rate.**

Globally, economic growth is measured by gross domestic product (GDP). The equation is fairly simple: GDP = C + I + G + X-M. By adding Consumer (or household) spending (C), Fixed Investment (I), Government spending (G), Exports (X) and subtracting Imports (M), we get to a value that represents the size of the economy. The performance of each individual component over a period (normally measured quarterly), determines whether the economy is growing or shrinking. The chart below shows South Africa's economic growth rate since 2010. Undoubtedly it looks dire for a country that needs at least double to triple that growth rate to create jobs and increase per capita income. News headlines can also be unhelpful during times of GDP statistical releases when they read something like "South Africa is staring an economic cliff in the face", or "economic growth has faltered", or "the economy is grinding to a halt". I sometimes have to bite my tongue when I read these headlines. I do understand the interpretation but factually one can argue that it is not one hundred percent correct. Somewhere, someone is doing something that generates economic activity, even if they are just flagging you down at a Stop/Go sign. That person is earning income that will be spent, whether on food, shelter, or cosmetics! The economy is ticking over, just slowly.

SA GDP GROWTH

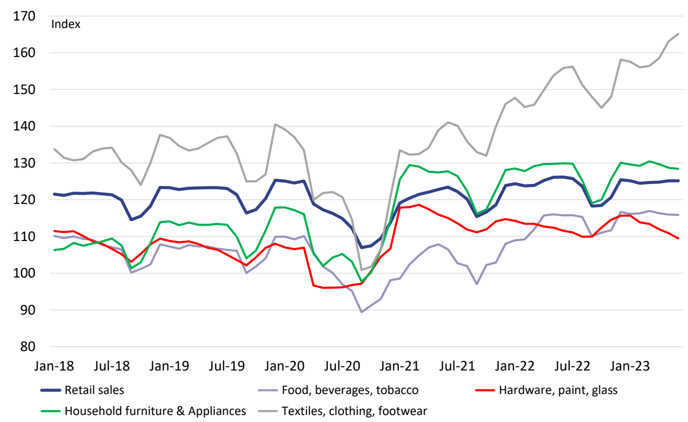


Over the past 10 years, SA's growth rate has stagnated below 2% p.a, well below what is required to generate jobs and reduce unemployment.

How many times have we all heard someone asking why to invest on the Johannesburg Stock Exchange when the economy is in such a bad state? Nothing works and the list of complaints is expanding faster than the economy can grow. Despite these circumstances, the JSE All Share Index managed to grow on average by 10.7% since 2010 relative to an economy that struggled to eke out not even 2% growth. The seminar delved into the "Consumer" and "Investment" components of the economic equation to highlight some factual evidence that influences (both good and bad) the performance of listed companies.

Elaborating on the point of how negative interpretation drives the financial press, we analysed the growth rates for household consumption expenditure and retail sales, both of which reflect negative rates over the last couple of months and quarters. However, when looking at actual spending trends, what is noticeable is how the trend has been upwards in the semi-durable (for example, clothing) and non-durable (food) categories. At the end it comes down to interpretation and further investigation. Faced with news of a consumer under strain due to higher interest rates and increasing use of credit to maintain a standard of living, we investigated why it appears that the consumer wallet might be under less pressure than the general consensus. A number that blew my mind came from left field. Some of our female readers might have heard of Shein - or they may have used it. I know my daughter did! On a global fashion app with 230 million active users and with anywhere between 2,000 and 10,000 individual styles, you can order either custom-made clothing or from thousands of trending designers. Your product is then made to your specific measurements and delivered to your door. What took me by surprise was Shein's statement that they are already earning revenues of R5 billion from South Africa. My conclusion is that South Africans appear to have more disposable income than previously assumed and/or alternative sources of income.

CONSUMER SPENDING TRENDS



Expressing spending trends in terms of volume rather than percentage change as often quoted, drives home a different consumer story.

Who remembers the days when lay-bys were the norm? I remember how my mom did some of her shopping this way. That trend is back, but in a much more advanced way. The new generation of shoppers fear credit. They want that nice pair of sneakers now, but don't want the interest added by using a credit card. Solving this problem came in the form of “Buy Now, Pay Later” services, such as Payflex and Mobicred, to name a few. These applications allow the merchant to sell to a customer who has already gone through a scoring system that allows him to buy the sneakers now but pay for it over 3 months interest free! The benefit of having the product immediately, paying for it without credit and simultaneously building up a credit record has seen an alternative way of consumer spending growing exponentially since mid-2021. Although consumers are under pressure, this is an alternative way of getting maximum bang for your buck. The conclusion is that analysing traditional metrics may not accurately capture modern trends.

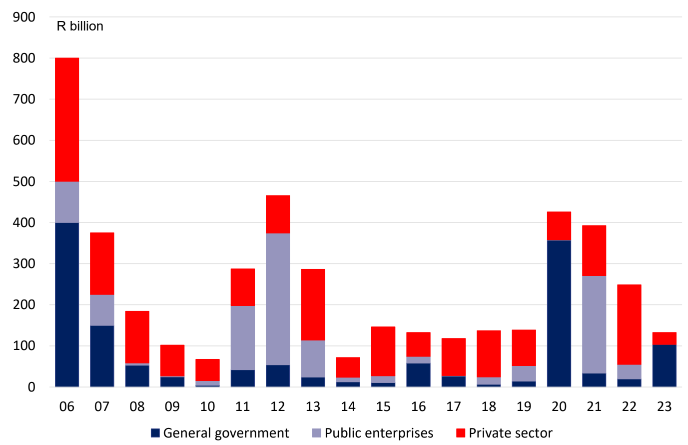
> “Investment to reduce the detrimental impact of loadshedding has seen a sharp acceleration of solar and battery imports since the end of 2021. ”

The earning and spending capacity of the informal sector has for many years drawn the attention of GG Alcock, author of Kazinomics. His research suggests that there is a component of consumer spending that is vastly underestimated. Perhaps this is why some of the local retail shares are faring better than expected. Let me highlight a few examples. A fascinating trend that is developing is backroom rentals. Alcock estimates that they generate about R20 billion p.a. in income for landlords. R50 billion is changing pockets across the fast-food stands in informal settlements and rural towns. Shebeens and taverns generate a further R110 billion. Stop and think about this one for a second: there are 7 million goats in rural areas. 2 million of which are sold each year for an average of R1,100 each. A glimpse into these figures makes one realise that disposable income has various pockets of origin. Our argument rests on the fact that this income is ultimately spent somewhere in the formal sector, either to buy stock for the little spaza shop or to have a branded t-shirt from Mr Price or Foschini.

Turning the focus to the much-needed fixed investment that South Africa requires to address growth and unemployment, the seminar highlighted how we must not lose sight of the longer time frames involved when it comes to bigger ticket spending. Similarities can be drawn from how in 2006 SA faced a boom of formally announced projects, including new stadiums, new airports, the Gautrain project and the Gauteng Freeway Improvement Project, which only really came to fruition from 2010 onwards. I realised last week again that the multiplier effect of convenience is still evident when I used the Gautrain between the airport and Sandton.

We are of the opinion that despite current data showing we are well behind on getting capital investment to reach a level of 20% of GDP (current about 15%), the pipeline is reason for hope. Investment to reduce the detrimental impact of loadshedding has seen a sharp acceleration of solar and battery imports since the end of 2021. The multiplier effect of companies being able to run their production lines when they want to and not be faced with stop-start as Eskom changes loadshedding stages will be felt in years to come. To some extent, we need patience. We ask, for

LARGE INVESTMENT PROJECTS ANNOUNCED

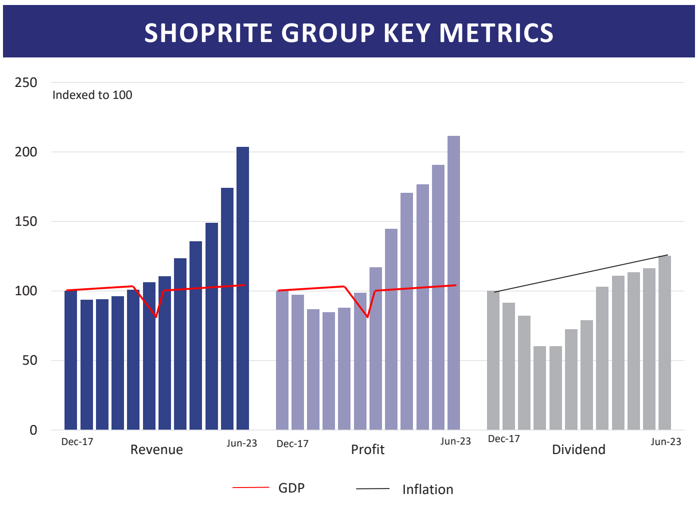


There has been a dearth of new projects over the past ten years, but momentum is picking up in the pace of new projects being announced. These will be executed in the years ahead.”

example, why car manufacturers (Stellantis being the latest example) are investing billions of rands in a South Africa that locals easily write off as a country facing a sheer cliff. The pipeline of investment activity is building. Over the past few years, South Africa has hosted an Investment Summit where more than R1 trillion has been promised. Some of these promises have already been added to a list of announced projects compiled frequently by Nedbank. 2023 has seen a slow start to projects being announced, but all the major banks are upbeat about the proposals they are processing for approval.

We analysed 2 companies (although in the interest of space we will only reflect on one in this article) to illustrate why we do not take headlines at face value, but rather dig a little deeper to understand the underlying facts. Using Shoprite as an example, we reflect on how management, despite the numerous pressures they are facing, are not only fighting against the impact of loadshedding on the bottom-line but also attracting new customers from all walks of life. They have even grown their market share - from 28.6% to 33.9% over the past three years - despite the fiercely competitive business environment.

The company surpassed R200 billion in sales for the first time in their most recent financial year.



Shoprite has managed to overcome the tough economy and loadshedding pressures to consistently improve its key metrics, thanks in part to the buoyant informal economy.

Stellantis, better known for its brands Peugeot and Chrysler is investing South Africa.

Notwithstanding capital expenditure of R6,8 billion in 2023, they have announced further investment of R8.5 billion to continue making inroads across the economy. After opening 340 stores in the previous year, 314 new stores are in the pipeline for 2024 across all their brands. The CEO commented that 425 new stores were planned but economic constraints (such as municipal service delivery) are hampering their expansion. Despite spending R1.3 billion on diesel to run generators over the past 12 months, they have still managed to increase their revenues, profits and dividends. If our thesis regarding a reduction in loadshedding in 2024 comes to pass, Shoprite, and dozens of other companies, stand to benefit enormously as diesel costs reduce

Hopefully we have illustrated (with this example) that for people to say you cannot invest in consumer-related stocks because the consumer wallet is under pressure is perhaps rather short sighted. However, by using some well-known words from an ex-president, we are saying “listen carefully”. We are not saying that South Africa (or the World) is firing on all cylinders! There are certainly pitfalls. Nonetheless, we believe that this is what makes the investment world so intriguing. Sifting through the stats to find the real facts and then putting it through our investment “equations” helps us to construct portfolios for clients’ long term needs and benefits.

The copy of the presentation is available on request. Please email **marketing@hhgroup.co.za**

Our next Insight seminar will take place in December in Cape Town, Johannesburg and Howick. After an eventful 2023 which has delivered its fair share of surprises, our next seminar will take stock of the year and focus on the outlook for 2024.

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Topic:	**Outlook for 2024**
Natal Midlands	
Date:	4th of December
Venue:	Oasis Conference Centre, 72 Main Road, Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm
Johannesburg	
Date:	6th of December
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am
Cape Town	
Date:	7th of December
Venue:	ABRU Motor Studio, Lourensford Wine Estate, Somerset West
Time:	5.30pm for 6pm

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Performance figures quoted for the portfolio is from Morningstar, as at the date of this document for a lump sum investment, using NAV-NAV with income reinvested and do not take any upfront manager's charge into account. Income distributions are declared on the ex-dividend date. Actual investment performance will differ based on the initial fees charge applicable, the actual investment date, the date of reinvestment and dividend withholding tax. Performance fees do not apply to any funds managed by Harvard House. The manager does not provide any guarantee either with respect to the capital or return of the portfolio. A schedule of fees, charges, and maximum commissions are available on request from the manager.
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