INTUITION
10 JANUARY 2024

Are there signs of green shoots?

Many people are still easing into the new year so have yet to give much thought to the year ahead and what it might mean for the JSE and local investments. Clients might remember that in July last year we wrote an article that acknowledged that higher growth was at least eighteen months away, but that six statistics were worth monitoring for signs that the GNU was delivering on its promises. This week, our focus will be on the JSE, whilst also revisiting a few of those statistics to see whether there has been any improvement.

Michael
Porter

Investment markets revolve around indices. It makes sense, as indices are designed to offer a holistic and comprehensive view of an asset class or investment. Without indices, it would be impossible to compare asset classes against each other or derive long term statistics to illustrate trends. Last week, I commented on total returns for the major SA asset classes and various global indices. On balance, SA equities performed well, led by property. This week, I thought we should delve a little deeper into the composition of those returns.

Much has been written over the past ten years about the shrinking JSE, and the reduction in the number of listed companies. By implication, that means that the bigger companies have become more and more dominant in the overall indices and tend to "set the tone." Furthermore, those bigger companies all tend to have global elements to their operations, so performance can be influenced heavily by the exchange rate, or events in foreign economies and markets.

Are the green shoots of recovery upon us? As always, the picture is a little mixed.

SPEED READ

- **Markets revolve around indices. It is an easy way to capture trends and it allows for comparison.**
- **Yet equity returns tend to be measured by a single, key index in each country. If we delve deeper into the JSE, there is a huge disparity of performance between sectors.**
- **Valuations are not as expensive as they might appear. Higher valuations are partly due to the collapse in profits from the mining sector.**
- **We re-examine four stats that give insight as to whether the GNU is delivering. Generally, trends are moving in the right direction, but we need to keep an eye on Eskom.**

There has not been much to crow about in recent years in SA. Our economy has been on life support. To repeat, we haven't grown our economy at more than 1% per annum since 2013 (apart from Covid distortions). That hasn't provided fertile ground for local companies. Many have ventured offshore, only to be burnt. Consequently, the popular mantra has been to flee offshore or have a local portfolio dominated by the big "rand hedges". Diversifying offshore has been a sound decision yet investing in some of the large rand hedges hasn't necessarily delivered the promised benefits.

Overleaf, we break down the JSE further, and comment briefly on the various underlying sectors. Then we will revisit a few of the key indicators to see whether there are any signs of green shoots from the GNU.

JSE Sectoral Performance

The table alongside shows the disparity of returns from different sectors of the market. Large caps significantly underperformed (partly due to the mining sector), whereas investors did far better in mid and small cap companies, which are much more aligned to the good news story in SA and where there was significant value, having been overlooked for many years. Sectorally, mining was weak – but financial and industrial shares performed far better. Yet even within the broad industrials category, healthcare and telecoms performed poorly – telecoms due to challenges across various African countries. On the other hand, consumer services (retailers) and technology performed well. If the SA story continues to unfold, the value will lie in finding hidden gems that stand to benefit from improving conditions, and not necessarily in tracking the Top 40 Index.

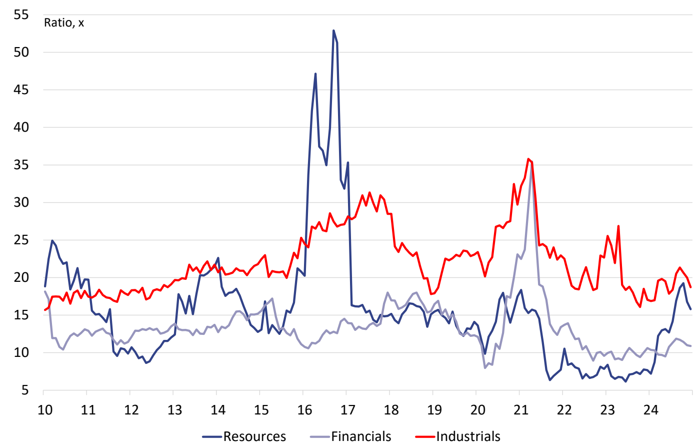
JSE Returns (Price Only) for 2024

By Size		By Sector		By Industrial Sector	
Top 40	6.9%	Resources	-11.0%	General	2.6%
Midcap	11.2%	Financials	15.9%	Consumer Goods	10.9%
Small Cap	28.8%	Industrials	15.5%	Healthcare	-6.8%
		Property	21.4%	Consumer Services	25.1%
				Telecomms	-11.5%
				Technology	33.2%

JSE Sector Valuations

Last week we showed a chart of the broad PE Ratio for the market as a whole. From the trough of under 10x in late 2023, it currently stands between 14x and 15x – a significant improvement. Analysed in isolation, one might conclude that local shares are reasonably priced with limited further upside. If one digs a little deeper, one of the major reasons for the rise in overall valuations has been the collapse in mining profits, which has pushed up overall valuations. Of course, there has been a rise in valuations elsewhere too – both the financial and industrial sector ratios are off their lows – but they are far from stretched. Importantly, earnings growth for local shares (excl. mining) is positive and expected to accelerate as the year unfolds. The market is expecting mid-teens profit growth from this set of companies, so even allowing for unchanged valuations, that implies mid teen returns, which should be enhanced further by dividends.

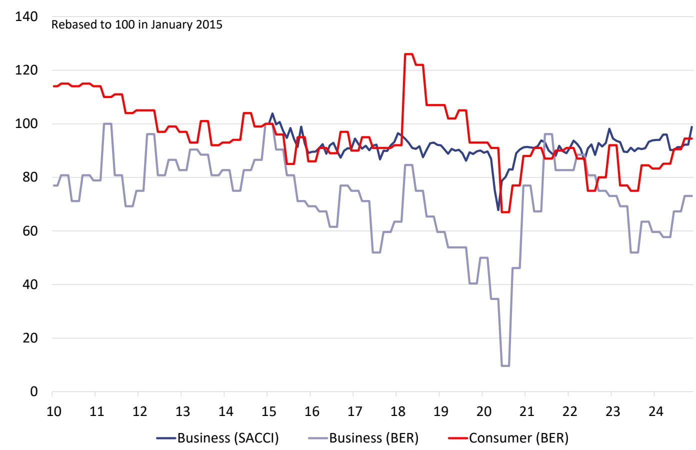
JSE SECTOR PE RATIOS



Confidence

Humans are emotional beings, so we make vastly different decisions depending on whether we are optimistic or pessimistic. We highlighted confidence last year as one of the key indicators to watch for any signs that the national mood is improving. Consequently, it is very encouraging to see an improvement in all three confidence indicators. Business confidence (as calculated by SACCI) is at the highest since 2015. Those calculated by the BER have also shown steady improvement – and should move higher still when the next data point is released in the new year as these indices are only calculated quarterly. Furthermore, it is very encouraging to see consumer confidence back at pre-covid levels. A sustained improvement in confidence would be a great omen for the years ahead.

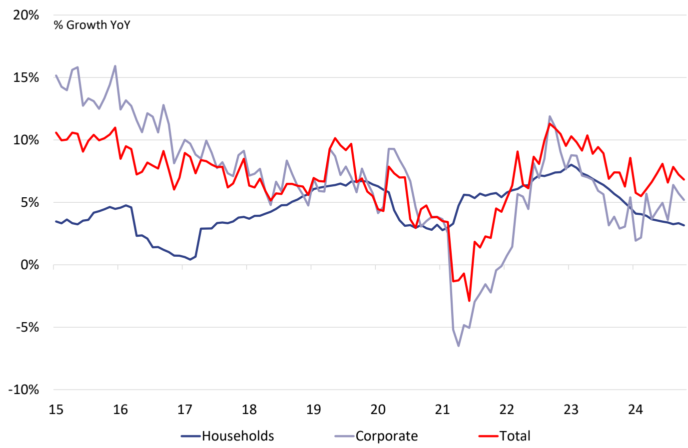
SA BUSINESS & CONSUMER CONFIDENCE



Credit Growth

Allied to the above indicators is credit growth. One is hardly going to borrow money – whether it be for a new car, alterations to your house, or a new factory – if confidence is low. Over the past few months, household demand for credit has stabilised, after having slowed considerably in the wake of higher rates. Corporate credit demand is ticking steadily higher, a good sign for future economic growth, although we would like to see the trend strengthening over the next few months to get more comfortable. There is a general rule of thumb that it takes at least 6 months for a change in interest rates to reflect in changed behaviour. Over the next month or two, we should see rising demand for credit as the rate cutting cycle becomes more entrenched. Allied to the signal that credit demand sends about future growth, it is also an important driver of banking profit growth, an additional reason to follow it.

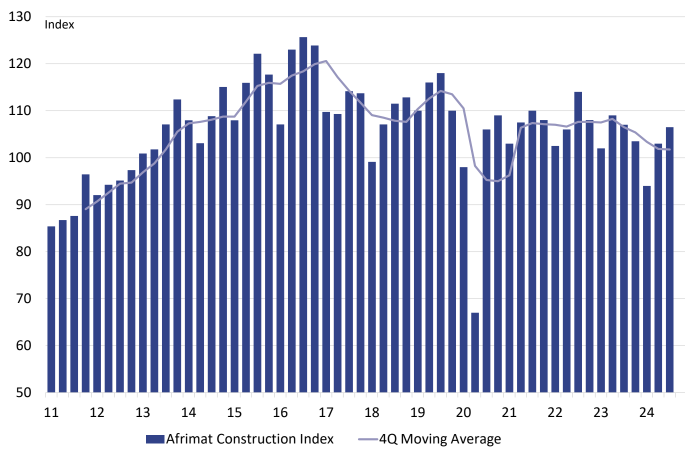
SA PRIVATE SECTOR CREDIT GROWTH



Construction Industry

The enthusiasm from the above few charts might be tempered slightly by a cursory glance at the Afrimat Construction index. Admittedly, this Index is only released quarterly, so the latest reading is up to the end of September. The past two quarters have shown significant improvement, but the 4-quarter average has trended down for the past two years and is only now showing signs of flattening out. Digging deeper into the detail, employment in the construction industry is at a six-year high, while investment by public corporations is rising again and plans passed (a signal of work to come) has also increased for a few quarters in a row. Results from the construction sector point to far healthier times, yet this Index bears watching for broader industry trends.

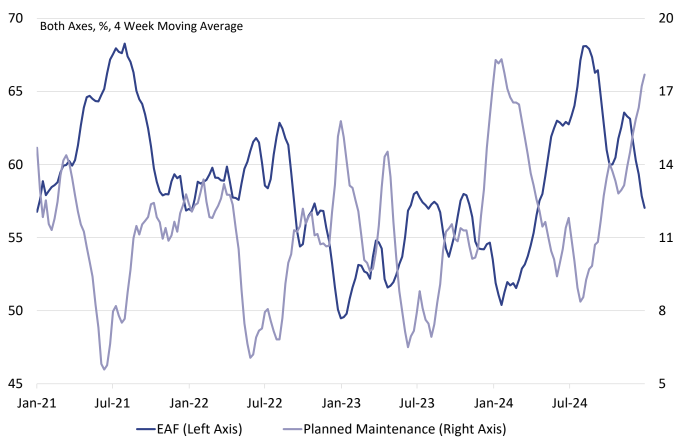
AFRIMAT CONSTRUCTION INDEX



Eskom

A media article in December quoted a new report that suggested we would be subject to loadshedding again this January. So let me finish with Eskom. The Energy Availability Factor (EAF) has declined sharply since the middle of last year – from a rolling 4-week average of 68% to the present value of 57%. In fact, the latest weekly reading is 54%, a far cry from the 70% reached last year. Is Eskom falling apart again? It is hard to tell at this juncture, because Eskom does use the lull in the holiday season to increase maintenance. Maintenance stands at almost 18%, up from just 8% when the EAF peaked in August. Added together, the EAF and planed maintenance amount to 74% of the fleet, down from a peak of 77%. So yes, unplanned breakdowns have risen slightly, but we are not at crisis levels – provided Eskom can bring its planned maintenance stations back on line, on time! We will be watching this closely.

ESKOM: ENERGY AVAILABILITY FACTOR



Thank you to all clients who have supported our Insight presentations last year. Our schedule for 2025 and the topic for our next seminar in March will be published shortly.

Topic: TBC

Natal Midlands	
Date:	TBC
Venue:	Christ Church Howick, 23 Mare Street, Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

Johannesburg	
Date:	TBC
Venue:	Rosebank Union Church, Cnr Winne Mandela Drive and St Andrews Road, Hurlingham
Time:	7am for 7.30am

Cape Town	
Date:	TBC
Venue:	SSISA Conference Centre, Boundary Road, Newlands, Classroom 1, 3rd Floor
Time:	7.30am
Venue:	ABRU Motor Studio, Lourensford Wine Estate, Somerset West
Time:	5.30pm for 6pm

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