WARWICK WEALTH

The Investment Specialists

Quarter 1 – 2021

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ASSET MANAGEMENT House View

This Month's Focus

In this issue

Sibanye Stillwater

Sibanye-Stillwater (SSW) is a leading international precious metals producer, which mines and processes platinum group metals (PGMs) and gold.

The PGM basket is largely constituted of platinum, palladium, and rhodium. SSW has a geographically diverse portfolio of operations and projects in the US and South Africa. In 2016, Sibanye embarked on a massive acquisition spree, acquiring several PGM mines which fundamentally changed the company from a 100% gold counter to one of the largest precious metals mining companies, where approximately 90% of their earnings before interest, taxes, depreciation and amortization (EBITDA) now comes from PGM's. The acquisitions were made when the PGM market was at the bottom of the commodity cycle and the assets were acquired cheaply. In retrospect, this represents an astute piece of business by the management of the company. As a result, Sibanye has now emerged as the world's largest primary producer of both platinum and rhodium and second largest primary producer of palladium.

Investment case

The main source of demand for PGMs is motor vehicle auto catalysts which are installed in the vehicle's exhaust line through which it converts pollutants from the combustion of fuel into harmless gases. Despite the demand decrease in automobiles globally over the last couple of years, the increase in carbon emissions standards globally has meant that loadings of these PGMs per car have increased. This, in turn, has led to increased demand for these metals and with the PGM market being in a structural deficit, this has resulted in higher PGM prices.

The PGM basket price is the main factor in the investment case for SSW as the revenues and earnings of the business are largely dependent on the prevailing market prices, with the prices of these PGM commodities having soared since the SSW acquisition. The price of rhodium has surged by 3 000%, palladium has returned over 350% and platinum has also gained 25%.

The increase in the prices of these PGMs has meant that the company has been able to generate solid earnings and has also managed to de-leverage the business into its current cash-flush state. At current spot prices for the PGMs, SSW has a free cash flow yield of over 20%. This means that if the prices of the PGM metals stay where they are, the business will generate significant surplus cash to either reinvest to grow the business or pay cash back to shareholders.

The medium-term outlook for the PGMs is also positive, with expected supply deficits in the rhodium and palladium markets helping to support current prices. Notably too, the current surplus in the platinum market also expected to narrow in the first half of the decade.

Turning to the balance sheet, the financial risk of this business is low, with the business in a net cash position, which means that current cash on hand is greater than outstanding debt. Most of the debt used to make the PGM acquisitions has been paid off and the liquidity profile of the business is not a concern with cash on hand being sufficient to meet its upcoming debt maturities.

The business was also able to reward shareholders with an industry-leading dividend yield of 8.7% on the average share price over the year, declaring a dividend of R3.71 for the full year. The dividend is in addition to strong gains investors would have realised as the counter gained over 50% for the year.

Our position

We are happy to remain invested in SSW as the outlook for the PGM market looks favourable for the medium term as supply deficits continue in rhodium and palladium support higher prices. In addition to the strong fundamentals of the metal markets, the business has low financial risk, is highly cash generative and is expected to return cash to shareholders, with a pay-out ratio of between 25-35% of earnings. From a valuation perspective, at a current forward PE ratio of less than 6 times, we feel that there is still significant upside to the current share price of R70.

International Market Overview

World markets entered the new year on the same positive note they ended the last quarter, on an upward trajectory.

Admittedly the same economic headwinds raised by the Covid-19 pandemic continue to prevail and will be a continued challenge, as seen by the renewed lockdowns in Europe during this quarter. In addition, rising treasury yields in the US as well as continued inflation concerns internationally, continue to weigh on investor sentiment.

United States of America

From an economic perspective, we have seen a significant jump in the March ADP payroll numbers of 517 000, while the Chicago purchasing managers index for March record a 30-month high coming in at 66.3. A reading above 50 indicates expansion, while one below 50 indicates contraction. Furthermore, the fourth quarter 2020 GDP reading released by the Bureau of Economic Analysis was revised upward to 4.3%, from its previous expectation of 4.1%. All of this was mitigated to a degree by poorer than expected pending home sales, with retail sales and personal spending also falling more than anticipated.

The US Federal Reserve, (FED), during its March Federal Open Markets Committee, left the interest rate unchanged, between 0.00% and 0.25%, while economic forecasts were largely improved, as well as indicating no expectations of a rate hike until at least the end of 2023. In addition, they expect to have a tolerance for US inflation above the 2% level, before looking to hike rates.

Late March saw the unveiling of the new $2trln American jobs plan announced by President Biden, which is in addition to the $1.9trln Covid-19 relief package passed by the US Congress in mid-March. The aim of the plan is to focus spending on major infrastructure categories such as highways, bridges, and roads, as well as trying to reign back wealth inequality and facing climate change. The plan is proposed to run over an eight-year period, and is expected to be highly job generative, while being partially funded by a review of corporate taxes, which are set for substantial increases.

On the back of this we have seen the US market end both the month and quarter in the black, with the S&P 500 up 4.2% for the month, and 5.8% for the quarter and year-to-date. The Dow showed a gain of 6.6% for the month and 7.8% for the quarter and year-to-date. The Nasdaq reflected gains of 0.4% for the month and 2.8% for the quarter and year-to-date.

Europe

European markets followed the US markets firmer with the Dax, the primary stock index of Europe's largest economy, Germany, was up 8.9% for the month, and 9.4% for the quarter, whilst the French Cac was up 6.4% for the month and 9.3% for the year-to-date.

With respect to regional economic data, the Eurozone and Germany recorded positive manufacturing PMI numbers as demand increased, with Germany's service sector expanding. This was boosted by the increased vaccinations roll-out which created the hope of an end to the pandemic, as well as anticipation of an economic recovery. However, renewed lockdowns across certain sectors of Europe have economists only expecting an economic bounce during the second half of 2021.

In concert with their neighbours, UK markets also had a positive month, up 3.6%, and by 3.9% for the quarter and year-to-date. Inflation numbers in the UK slowed as we saw significant discounting from clothing retailers as the third lockdown took effect. The inflation number came in at 0.4% for February vs. the 0.7% seen in January.

Asia

Asian markets were mixed during the period with the Hang Seng ending the month lower by 2.1%, and up 4.2% for the quarter. In a similar vein, the Shanghai Composite index was down by 1.9% for the month and 0.9% for the quarter and year-to-date. This has been a difficult time for these markets with the Chinese Government increasing scrutiny and regulation of the country's largest corporations. In addition, the official Chinese manufacturing PMI for March came in at 51.9, vs. the 50.6 in February, while the Caixin/Markit Manufacturing PMI came in at 50.6 vs. 50.9 in February.

In Japan, the Nikkei ended the month up by 0.7%, and for the quarter and year-to-date up 6.3%. The Japanese government cut its views on export for the first time in ten months, while indicating that the economic environment was still showing weakness due to the impact and effect of the coronavirus pandemic.

Analysts generally expect the economy to shrink sharply in the first quarter of 2021 due to the lockdown, which while ending in April, continues to have a significant impact on business activity and consumer spending. We expect the decline to be followed by of an annualised GDP growth rate of 5.3% in the second quarter of 2021 with economic activity expected to pick now that the lockdown restrictions have eased.

SOUTH AFRICAN LOCAL MARKET OVERVIEW

Local Equities

Resources

The resource index had an extremely strong quarter and was the best performing of the indices. The Resi 20 returned 18.8% compared to the JSE ALSI which was up +13.2%. Sasol was the best performing counter over the period, appreciating 58.1%. The Sasol share price was depressed due to concerns around financial risk, but an asset sales program which helped bolster the balance sheet, coupled with an increase in the oil price (+23%) has led to strong returns from the company over the period. The PGM miners also had a great quarter, buoyed by the strong PGM metal prices, as Rhodium and Palladium are at all time highs. The strong metal prices have led to record cash flows and earnings for the PGM counters as Amplats led the way up +51.6%, followed by Impala +40.6%, Northam +22.8% and Sibanye returning +13.5%. The Gold miners were the only counters in the red for the quarter due to the gold price depreciating by 10.0%, with Harmony losing -8.4% and AngloGold down -4.1%.

Industrials

The INDI25 had an excellent start to 2021, gaining 12.4% in the first quarter of the new year. Naspers (+16.97%) and Prosus (+2.29%) both had a strong start to the year, as Tencent jumped 35.9% in the first three and a half weeks of the year. Recent months had seen all three companies' share prices pull back as tech shares valuations have come under some pressure on the back of higher US 10-year yields, and concerns around the regulatory environment in China. Locally, MTN was the top performer for the quarter, gaining 44.3%. The telecoms company released a robust set of results in March and is considering spinning out certain business units to unlock value in its core business. After a tough 2020, apparel retailers enjoyed a solid quarter, with the likes of Truworths (+36.3%), Woolworths (+25.1%) and TFG (+20%) all up double digits in Q1. After losing a third of its value in 2020 as revenue came under pressure due to the deferral of elective surgeries, Netcare recovered some of those losses, gaining 14% for the quarter. By contrast, AB Inbev was the worst performer for the quarter, declining 10.3%, whilst Multichoice and Clicks fell 3.8% and 3.3% respectively.

Financials

The FINI15 index returned +2.3% for the quarter, lagging the JSE ALSI which was up +13.2%. Investec PLC was the best performing stock in the index, strengthening by +20.0%, followed by Nedbank, whose earnings results surprised on the upside, up +8.1%. Absa was the second best performing of the big four local banks, returning +5.2%, benefitting from management guidance ahead of expectations. FirstRand was also positive over the quarter, up +3.3%, with Standard Bank the only one of the big local banks which was negative, returning -1.3%. Looking at the insurers, Discovery was the biggest laggard over in the index, losing -13.7%. Old mutual was the best performing of the insurers, gaining +6.2%, with Sanlam also up 1.3%.

Local currency

The volatility that we have come to expect from the local currency continued in the first quarter of 2021. Starting the year at USDZAR 14.69, the rand quickly depreciated to USDZAR 15.53 in the first two weeks of the year, before slowly appreciating all the way to USDZAR 14.45 in the middle of February. Notable local events that occurred during the quarter included the SARB keeping interest rates unchanged as inflation remains benign, as well as the budget in February which seemed to appease investors and other market participants. At quarter end, the local currency had depreciated by just 0.6% from where it started the year, to USDZAR 14.78, and continues to be supported by a trade surplus. As one of the most liquid emerging market currencies, the rand will continue to be affected by not only what is happening in the local economy, but also by what is happening on the international front, and as such, we expect the volatility to continue.

Local Fixed Income

Market Review

The global economy continued to show a recovery during the first quarter of the year despite renewed Covid-19 restrictions being implemented early in the year. The vaccination rollout provided a positive boost to the global economy, but the uneven pace of implementation across countries hampered its overall effectiveness. The rise in US bond yields remains topical despite the Fed's March meeting statement maintaining a dovish bias. The 10-year generic US yield was up 1.74% by the end of the quarter, while the German 10-year generic yield ended the month at -0.29%. The French 10-year yield closed the quarter at -0.05%, with its UK counterpart ending at 0.84%.

The local bond market maintained an overall negative trend for the quarter, losing 1.74% over the period. Foreigners were also net sellers bringing about further steepness to the yield curve. The 2021 budget prioritised debt stabilisation, however, by reducing government bond and T-Bill issuance over socio-economic priorities such as social grants and public sector wages. This was structurally positive for bonds but failed to keep a lid on yields during the latter part of the quarter. The SARB also voted unanimously to keep the repo rate unchanged during its March meeting thereby supporting the view that inflation will remain relatively contained in the near future.

Inflation-linked bonds had a strong quarter, delivering more than 4.50% for the period as demand for this asset class picked up.

Our fixed income outlook for the coming months is detailed as follows:

- Economic growth is low but is expected to improve from the low levels recorded at the height of the covid-19 pandemic.
- The local currency will be driven by the risk-on/ risk-off trade but remains susceptible to weak economic fundamentals.
- Monetary policy intervention is expected to be minimal as the committee analyses the inflationary impact over the coming months.
- Fiscal metrics remain a concern despite an expectation of improved revenue collection.
- Further ratings downgrades remain a threat.
- Short-term technical trends are negative, while the long-term trend is in neutral territory.
- Local sentiment remains cautious.

We continue to seek value along the yield curve with careful duration risk positioning of our portfolios.