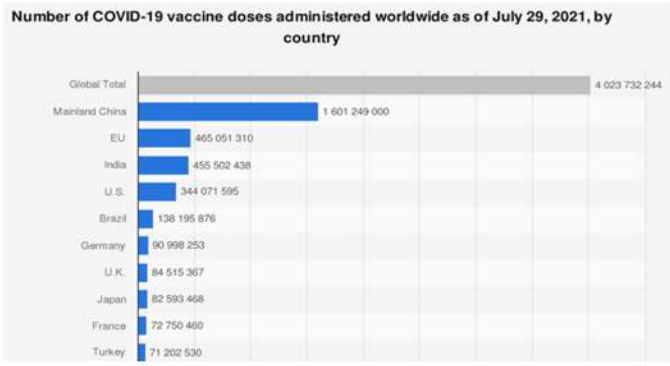
Douglas Investments
Investment Environment

July 2021

COVID-19 VACCINATION PROGRESS

The number of vaccines administered worldwide continues to gather pace. 86 mil doses were administered at the end of January, 241 mil at the end of February, 574 mil at the end of March 1.2 bil at the end of April, 1.7 bil at the end of May, 2.7 bil at the end of June and 4 bil at the end of July. Significant progress has been made in the developed markets with undeveloped markets having to play catchup.



SOURCE: STATISTA

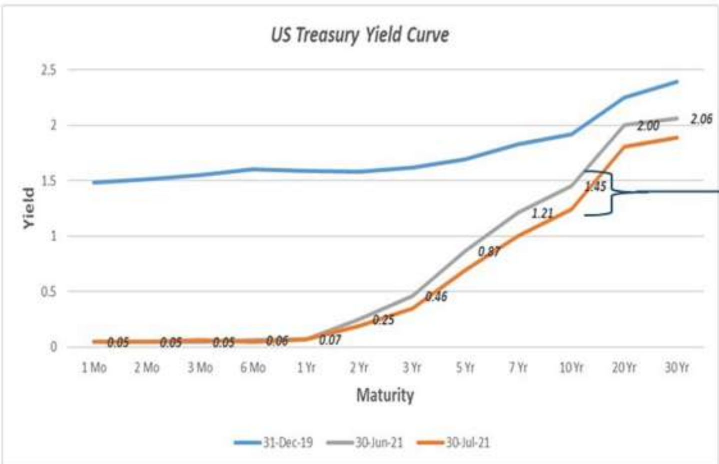
The various variants of COVID 19 (most notably the Delta variant) are providing challenges to governments and health officials aroud the world. Whilst the vaccine seems to provide good protection against death (given the reduction in death statistics) it doesn't necessarily provide full immunity from contraction. This remains the primary driver of governments lifting restrictions on economies and social engagement. On balance we remain favourably disposed to a "risk on" environment.

FISCAL STIMULUS, INTEREST RATES AND RISK-FREE RATE

On 28 July the Federal Reserve issued the following statement:

"The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. With inflation having run persistently below this longer-run goal, the Committee will aim to achieve inflation moderately above 2 percent for some time so that inflation averages 2 percent over time and longer term inflation expectations remain well anchored at 2 percent. The Committee expects to maintain an accommodative stance of monetary policy until these outcomes are achieved. The Committee decided to keep the target range for the federal funds rate at 0 to 1/4 percent and expects it will be appropriate to maintain this target range until labour market conditions have reached levels consistent with the Committee's assessments of maximum employment and inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time. Last December, the Committee indicated that it would continue to increase its holdings of Treasury securities by at least $80 billion per month and of agency mortgage backed securities by at least $40 billion per month until substantial further progress has been made toward its maximum employment and price stability goals. Since then, the economy has made progress toward these goals, and the Committee will continue to assess progress in coming meetings. These asset purchases help foster smooth market functioning and accommodative financial conditions, thereby supporting the flow of credit to households and businesses."

It can be seen below that the US Treasury curve for July moved lower across all maturities from 1 year out. In addition the US Dollar also weakened against major developed market currencies. The accommodative monetary and fiscal policy by the Fed together with lower inflationary pressures continue to support a "risk on" environment and asset classes like equities.



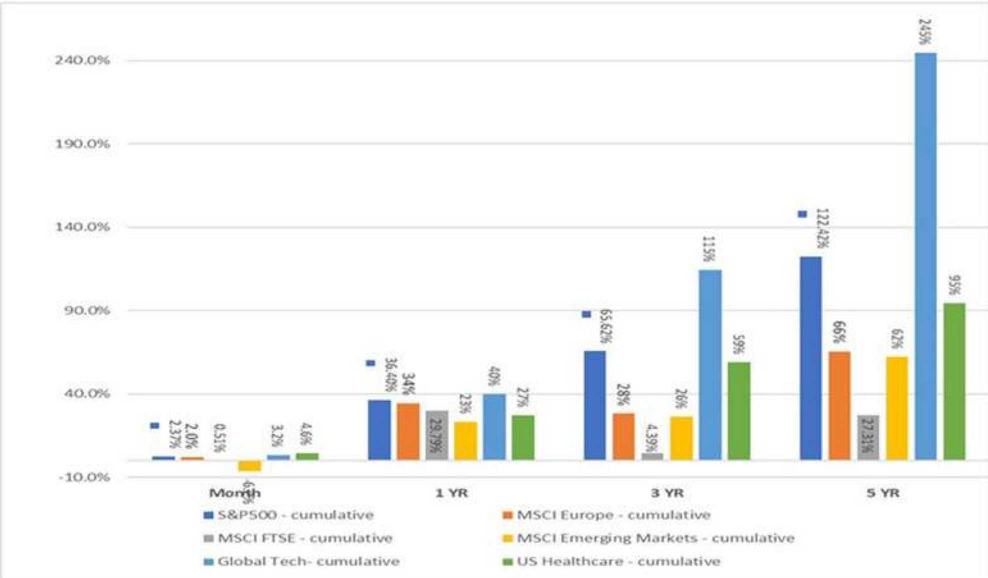
The US10Y yield retraced from 1.45% to 1.24% in July as longer term inflationary pressures continue to fade.

SOURCE: DOUGLAS INVESTMENTS

Block 8, Bryanston Gate, Cnr Curzon & Main Road, Bryanston, 2191
P O Box 67306, Bryanston, 2021
www.douglasinvestments.co.za
TEL: +27 11 463
FAX: +27 87 237 0797
FSP NO: 26359
DOUGLAS INVESTMENTS

EQUITIES

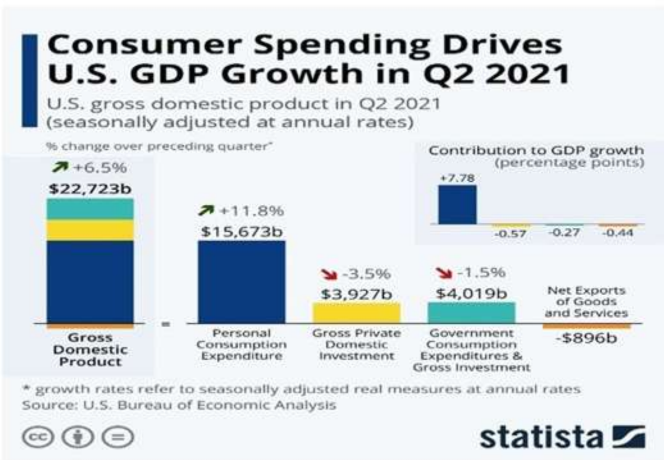
INDICES PERFORMANCE (ROLLING CUMULATIVE FIVE YEAR RETURNS IN USD):



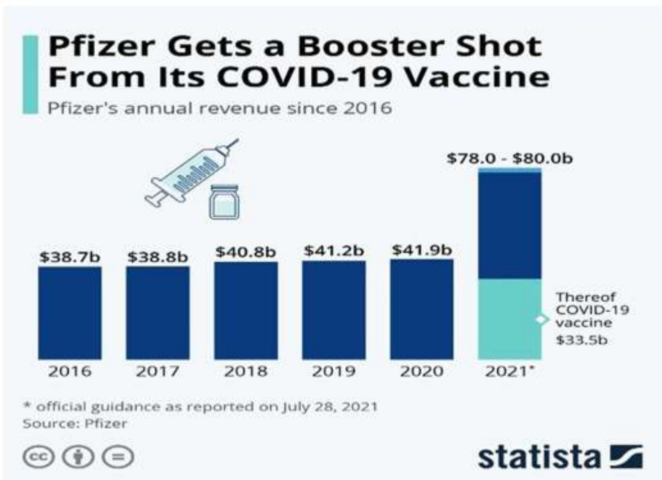
SOURCE: ISHARES

All developed market indices were up for the month; emerging markets, led by China, was the biggest loser retracing 6.2% for the month. Technology (3.2%) and Healthcare (4.6%) were the biggest winners. The threat of a rise in longer term inflation continues to dissipate which is good for Technology valuations in general. Healthcare continues to benefit from the tail wind of the COVID pandemic as showed in the earnings results below. The S&P500 remains the best index to be invested in over the past 5 years.

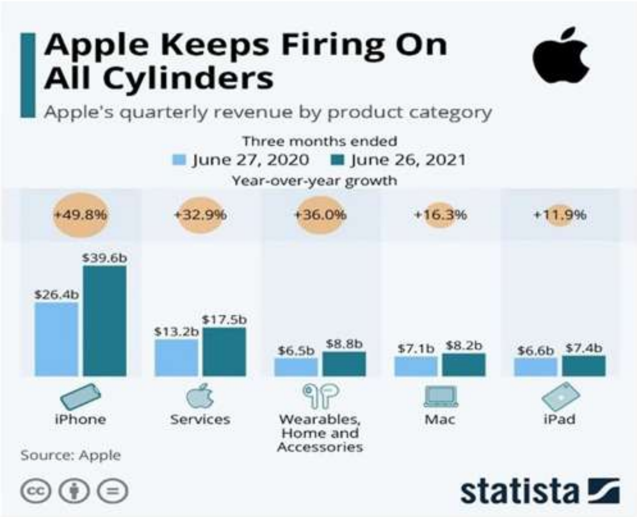
EARNINGS AND VALUATIONS



US GDP grew at an annualised rate of 6.5% in Qtr2. The key driver of the growth is consumer spending which grew at 11.8%. Whilst domestic investment and government consumption grew in absolute terms their growth rates were negative from the prior quarter. The rebound in GDP and improvement in the US economy is providing a platform for good corporate earnings.

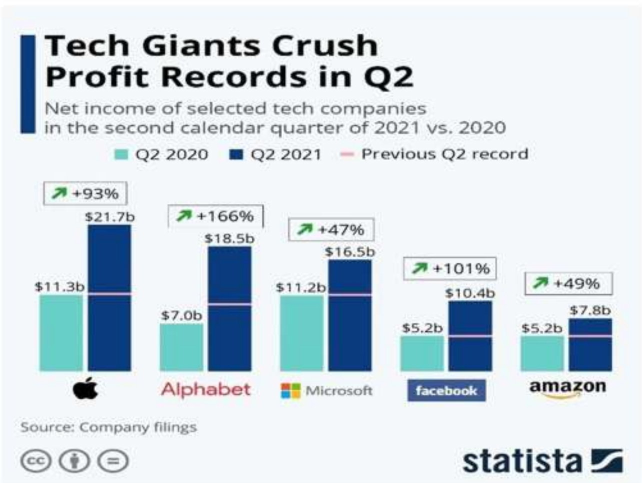


Pfizer reported stellar Qtr2 results beating top and bottom line expectations. Net profit for the quarter totaled $5.56 bil on revenue of $18.98 bil many thanks to its COVID 19 vaccine, which accounted for 41% of its revenue in the quarter. The graph alongside shows the forecasted revenue for the full year 2021 and the effect the COVID 19 vaccine is projected to have on its results. This demonstrates our focus on upweighting the exposure to healthcare.



Apple reported blowout Qtr2 results with revenue soaring 36% to $81.4 bil for the quarter! This is traditionally the weakest quarter for Apple as iphone users typically wait till Qtr3 to upgrade. This quarter was the strongest ever in its history with iphone sales driving the growth. All of the other segments as shown in the graph alongside have also displayed growth in excess of 10%. The company did moderate its growth expectations given the global chip shortage issues.

Tesla continues to make significant strides in increasing its scale and production of electric vehicles. The graph alongside shows the ramp up in deliveries over the past decade which is pretty staggering. The investment and commissioning of its giga factories in China, Germany and the US will enable Tesla to ramp up its delivery schedules to meet rising demand. Once this inflection point is reached, Tesla will start to ramp up its profitability and hopefully start to make the extended valuation more acceptable!

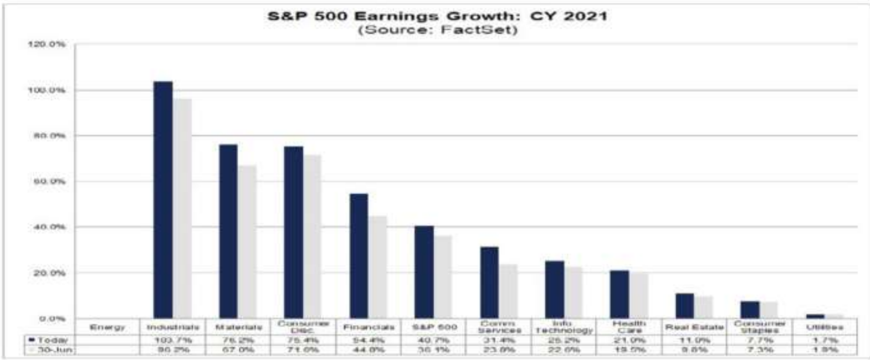


Tech giants continue to generate outstanding growth and returns. The scalability and reach of these businesses as well as the adoption by consumers worldwide is supporting valuations. Mega tech is however causing headaches for governments around the world whether it be anti-competitive related issues or taxation issues. This will no doubt have some impact on the growth rates of these businesses but for the time being one cannot ignore these in ones portfolio!

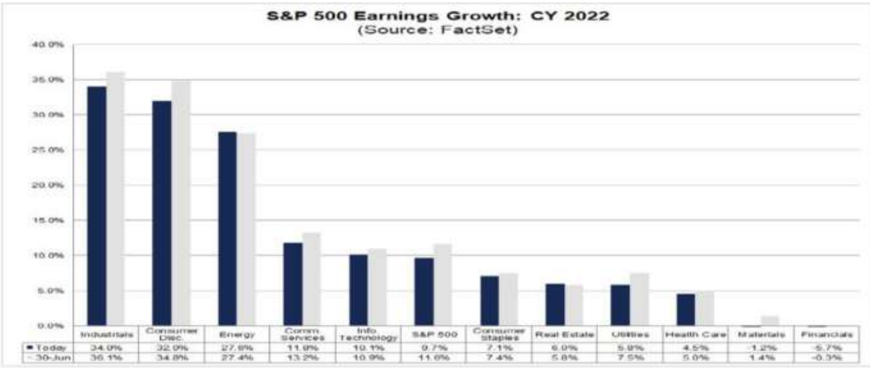
S&P 500

We have previously highlighted the earnings surprises across all sectors of the S&P500. With nearly 60% of the companies having reported Qtr2 results, 88% of these companies have reported positive EPS surprises. Below is a table showing the extent thereof across all industries. At the end of June it was forecasted that EPS would rise by 63.1% for Qtr2 2021 compared to 2020. It is now forecasted that EPS will rise by 85.1% for Qtr2.

Full year 2021 forecasted earnings growth continues to be revised upwards across most of the sectors. S&P500 earning are expected to increase by 40.7% now versus 36.1% at the end of June. As economies open up and the global supply chains get going, visibility starts to improve.



Full year 2022 forecasted earnings growth continues to be broad based but more moderate than 2021. Earnings revisions have trended down marginally with the S$P500 forecasted to grow by 9.7% versus 11.6% at the end of June.



On the commodity front, Anglo and Rio Tinto reported staggering interim results to 30 June 2021. EBITDA was $12.1 bil for Anglo and $22 bil for Rio showing the extent of rising USD commodity prices on underlying cash generation. Both have aggressive pay-out ratios (Anglo 40% and Rio 75%) so healthy interim dividends are to be expected from these companies. We have liked this sector for a while given the free cash flow generation off the back of commodity prices and high pay-out ratios. We remain favourably exposed to this sector using either single stock selection (i.e. Sibanye) or a metals and mining ETF.

The recent sell off of Chinese equities has been nothing short of mind blowing with $1.5 trillion in market cap wiped out (we hope temporarily!). We have attached a click through to a video on the inner workings of Chinese policy and how this has effected investor appetite towards Chinese companies whether they are listed in Shanghai, Hong Kong or via an American Depository Receipt in the US.

https://www.bloomberg.com/news/videos/2021-07-28/why-china-s-stock-market-is-selling-off-video

Clarity from Beijing is paramount on the way forward to instill confidence in investors over the medium to long term. Until this is forthcoming investors are likely to sit on the side lines and watch with bated breath. We continue to believe that a global equity portfolio needs to have exposure to Alibaba and Tencent to name a few and think that these businesses will ride out the current storm.

conclusion

Global equity markets have reacted positively to corporate earnings surprises as well as the most recent stance by the Fed on monetary and fiscal policy. The recent sell off in Chinese equities has had a profound effect on emerging market equity performance. We hope this has been overdone as its difficult to exclude exposure to the second largest economy in the world from an equity perspective.

In South Africa, we experienced one of the worst political weeks in history with wide spread looting and disrespect for the rule of law. With the benefit of hindsight it was probably a ticking time bomb as the gap between the “haves and the have nots” is only getting wider. If anything, the ANC need to speed up policy changes to encourage job creation and a more inclusive economy. Until this happens, inequality will prevail and more unrest is likely to emerge. The ANC seems to be more divided now than in its history so one hopes that CR can weed out the detractors and get on with rebuilding South Africa and instilling confidence again.