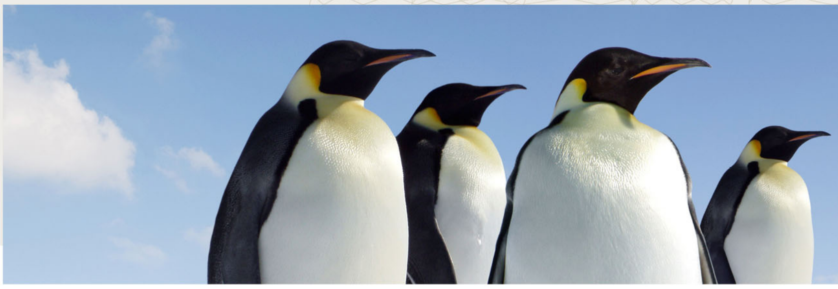

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For Your Perusal

Highlighting Interesting Investment Research

Investment Outlook

*By Michele Santangelo**

As we reflect on last year's stock market performance, we also identify sectors and themes that will likely dominate in the year ahead.

2023 unfolded amidst geopolitical tensions, economic uncertainty, and rising interest rates. Despite these challenges, 2023 produced the “magnificent seven”, referring to the incredible performance of Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla.

The surge of artificial intelligence (AI) and related ventures propelled the share prices of technology stocks. Nvidia was the poster child of the AI boom, rallying by more than a staggering 200% in 2023.

One of the biggest stories of 2023 was in the medical sector. The popularity and efficacy of the obesity-fighting drugs launched by Novo Nordisk and Eli Lilly have driven their share prices to record highs. The success of these obesity drugs has led investors to infer that healthier people will require less medical care, medication, and surgeries, which has played out in the medical device, biotechnology, and pharmaceutical space.

Casualties of 2023’s rising interest rates

The rising interest rate environment produced many casualties. Long-dated bonds continued their bear market descent while interest rate-sensitive sectors also suffered. Real estate was a significant loser as rising interest rates dampened investor sentiment.

Clean energy was one of the more surprising casualties. Many clean energy leaders, such as Enphase and SolarEdge, saw their share prices fall by more than 70%. The weight of higher interest rates dampened consumer demand for solar energy while also increasing the cost of funding.

Amidst the challenges, uranium emerged as a clear winner in the energy sector, rallying over 70% for the year. It is the fuel used in nuclear power plants and is gaining further acceptance as a clean energy source that can produce stable base load power at scale. Many countries continue to build plans for more nuclear power. China currently has 26 nuclear reactors under construction in addition to its massive wind and solar projects.

Geopolitics and cyber-security

War and geopolitics also grabbed headlines as conflict in the Middle East escalated. The increase in oil prices was temporary, but cybersecurity firms took another sharp step higher following a tremendous rally at the beginning of the year. Many fast-growing cybersecurity firms, such as CrowdStrike and ZScaler, doubled their share price from a low base in 2022.

Fintech and crypto

Valuations across fintech derated quickly from their lofty levels previously. Paypal, Block, and Adyen are major players in the fintech space that have experienced significant falls. Mastercard and Visa, however, remain steadfast as the oligopoly of the payment processing world.

As an extension to the fintech theme, the crypto market came out of a "crypto winter" in 2023 with the largest cryptocurrency, Bitcoin, moving up by 150%

Developed markets outpace emerging markets.

Global markets have had diverse equity market performances. The U.S. led developed markets, followed by the EU. At the same time, the Japanese market stood out as the Yen continued to weaken and investor sentiment towards Japanese companies improved on company reforms.

Emerging markets showed the most significant performance dispersion. Chinese equities were some of the weakest in the world despite early optimism around their covid reopening. The Chinese property market woes have significantly weighed on the economy and sentiment coupled with further technology trading curbs implemented by the U.S. Unfortunately, South African equities did not fare too well either weighed down by record load shedding and economic stagnation.

Emerging markets did have many winners, including Mexico, now the U.S.'s largest trading partner at China's expense. Brazil also produced a strong performance, as did India.

2024 Expectations

"There is very little value added trying to predict where the market is going or guessing whether it's overpriced or under-priced," billionaire investor Bill Miller once said.

Market consensus indicates that the interest rate cycle has peaked. Our macro-positioning for 2024 is underpinned by slowing global economic growth that will help ease inflation. This slowdown in growth will free up central banks to cut interest rates.

At a thematic and sector level, we foresee several areas poised to add alpha to portfolios:

- **Biotechnology** will be a major beneficiary of declining interest rates. This macro support and significant cash holdings relative to market capitalisations provide a strong combination for sector gains. We are bullish over the medium to long term as the impact of AI in the drug discovery process accelerates the industry's ability to bring viable drug therapies to market.

- **Technology** companies should extend their share price gains after a strong year as earnings and profit margins are forecast to continue to rise. Large-cap tech will continue to enjoy the benefit of increased corporate spending on cloud and AI.

- **Luxury goods** companies have performed well since 2020, but moderating expectations have seen many companies trade well off their share price highs. Our favoured picks in this sector include LVMH, Moncler, Ferrari, and Richemont.

- **Cloud and AI companies** should continue to perform well as spending accelerates across industries implementing cloud and AI programs. This trend will see increased spending on technology solutions and benefit companies that offer services to the industry, like consulting firm Accenture.

- **Real Estate** has been under significant pressure for several years, but there are opportunities in the sector as suppressed valuations and an improved interest rate outlook become tailwinds.

- **Clean energy** has started to rebound from its lows and is a sector with structural tailwinds. Declining interest rates will boost the sector as projected internal rates of return become more attractive. Solar companies that rely on consumer spending will receive a demand boost as consumers benefit from lower interest rates.

- **Private equity and alternative asset managers** are very well positioned with significant deployable capital and strong fundraising programmes. Some well-positioned names are Brookfield, Apollo and KKR.

- **Fintech** is a sector that has gone from market darling to pariah over the last two years, but valuations are now more attractive. Players to watch are PayPal, Block, Mastercard and Visa.

- **Small capitalisation shares** have underperformed dramatically globally but have seen a mild uptick as the central banks take a dovish stance. The attractive valuations of small-cap shares supported by supportive monetary policies provide a solid narrative for firm performance.

- **Special situations** continually occur in financial markets irrespective of macroeconomic conditions, and we anticipate 2024 will be no different. Pershing Square is a great example, as the listed hedge fund trades at a greater than 30% discount to net asset value and continues to generate strong returns.

There will undoubtedly be volatility in equity markets in 2024, but this is nothing new. Volatility allows equity investors to earn a lucrative equity risk premium. The investment team at Independent Securities remain steadfast in their long-term view on equities for building long-term wealth, notwithstanding any challenges.

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