FUNDS ON FRIDAY
by Glacier Research

glacier by Sanlam

22 March 2024
Volume 1220

Information Deluge or Delusion?

Authors: Sam Houlie, Co-CIO: Fundamentals, Differential Capital

"Help, I need somebody (Help), Not just anybody (Help)" - The Beatles 1965

The use of superior information to gain an investment edge is as old as time. The difference today is the warp speed at which information becomes available and can be gathered.

Overwhelming. Exciting. Exhilarating. Frenetic. Confusing, at times.

Inflation and Load-Shedding – are emotive topics for domestic investors. In this article, we will use these topics to address the broader aspect of data harvesting and the conditions under which it offers the most value.

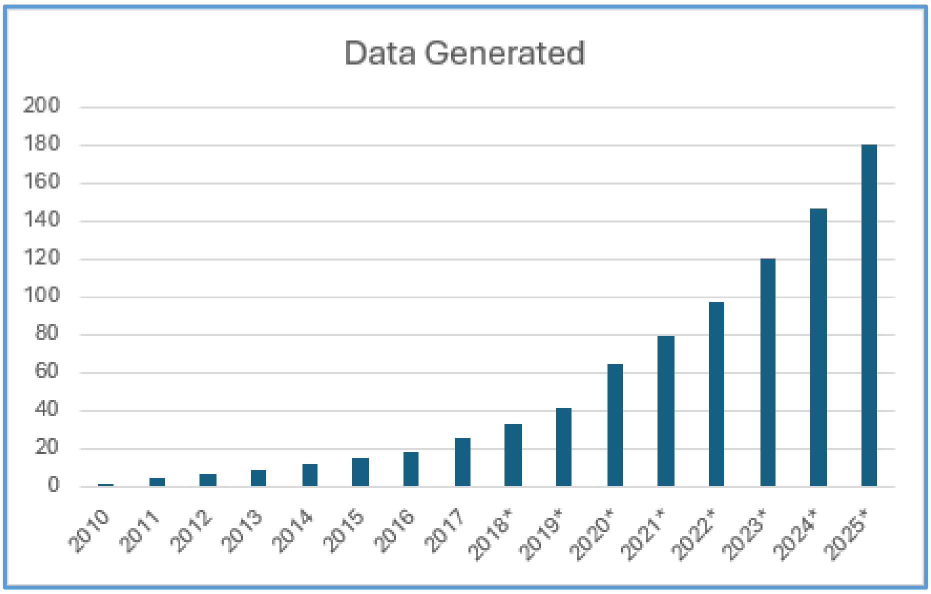
Glacier Financial Solutions (Pty) Ltd, I A member of the Sanlam Group | Private Bag X5 I Tyger Valley 7536 I Email: client.services@glacier.co.za | Tel +27 21 917 9002 I Fax +27 21 947 9210 I Web www.glacier.co.za | Reg No 1999/025360/07 I Licensed Financial Services Provider
Glacier Management Company (RF) (Pty) Ltd is a registered and approved Manager in Collective Investment Schemes

This document is intended for use by intermediaries. The information contained in this document has been recorded and arrived at by Glacier Financial Solutions (Pty) Ltd in good faith and from sources believed to be dependable, but no representation or warranty, expressed or implied, is made as to its accuracy, completeness, or correctness. The information is provided for information purposes only and to assist the financial intermediary to submit an investment proposal to the client and should not be construed as the rendering of investment advice to clients.

Data explosion:

Data creation (measured in Zettabytes) has mirrored the exponential rate of progress in the technology landscape.

Graph 1: Data creation in zettabytes



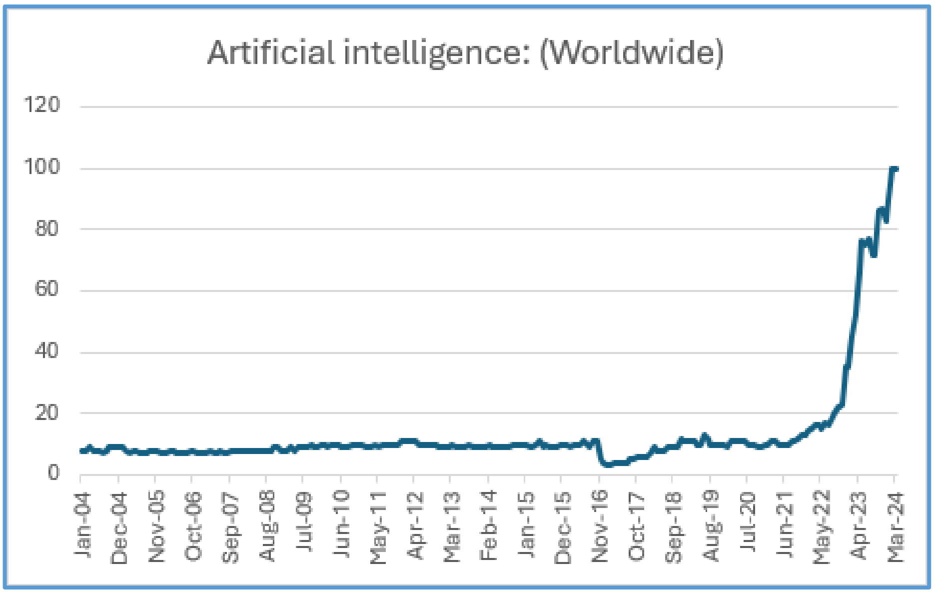
Source: DOMO Data Research

In the face of rapidly incoming data - How does an investor keep up?

- How do you know the data is correct?
- How do you know the data is complete?
- How do you know the data is relevant?
- How do you decide what to discard?
- How do you know what to focus on?
- How does it translate into superior investment outcomes?

The GenAI revolution has been a game-changer. The following graph displays the recent explosion in AI interest since 2023 - typical of any transformative technology.

Graph 2: AI interest over two decades



Source: DOMO Data Research

SA Inflation & Load-Shedding:

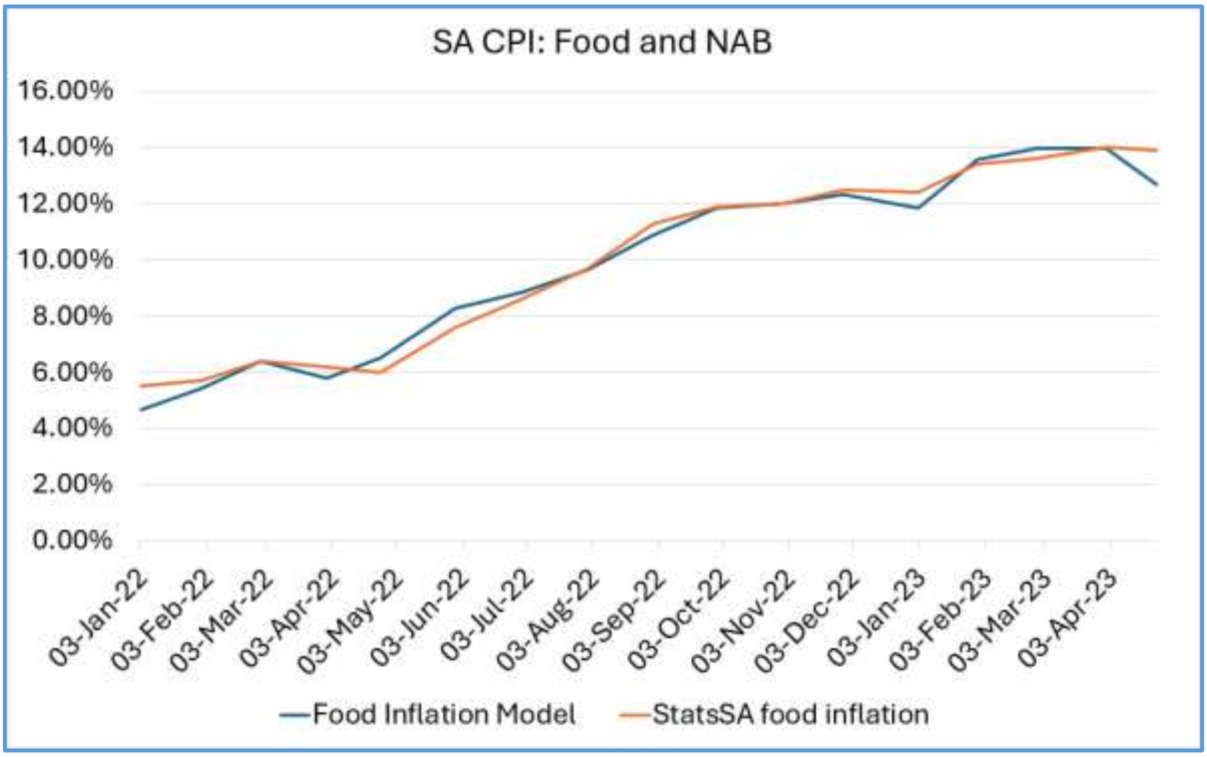
“You know, it’s a good thing that we haven’t had high inflation in 40 years. It’s a great thing. You know, we …..had high inflation in the ‘70s and the ‘80s, it’s a very unpleasant phenomenon” - Jerome Powell 2022.

Inflation matters in investing. At the macro level, the market gets inflation mostly right. In a few rare instances, astute data modelling and harvesting offer a meaningful edge. Market inflection points are an example of such an instance—if you have the tools to be ahead of the game.

Years of benign inflation left investors unprepared for the rapid increase in late 2020 to 2022. The US Fed got it wrong – famously calling it “Transitory” until it was not. In hindsight, the rapid rise and steady fall of inflation was such a rare, multi-decade opportunity. Harvesting the inflation data in real-time provided the potential to position for outperformance in equities and fixed-income securities.

The graph below displays actual reported SA Food Inflation alongside a second line (which correctly anticipated the turn-around at the peak).

Graph 3: SA CPI: Food and NAB



Source: Stats SA and Differential Research

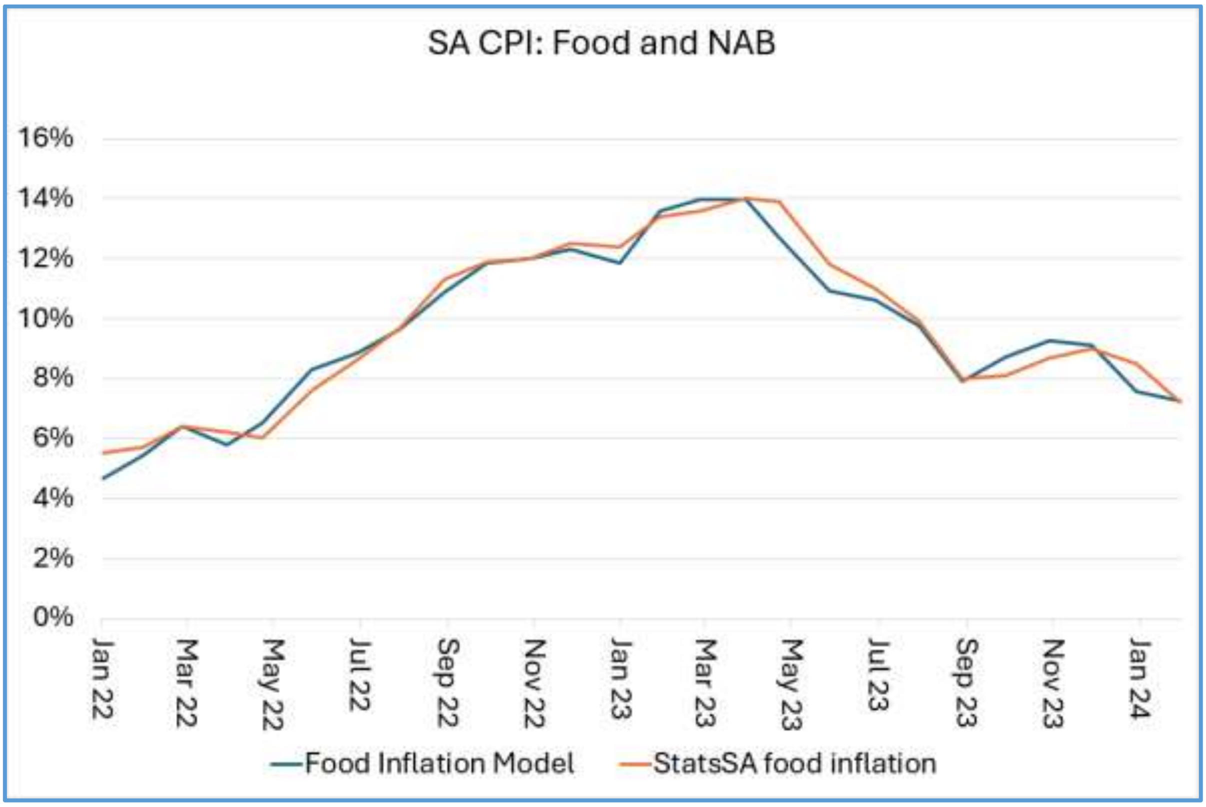
A few additional points about SA Inflation,

- Stats SA publishes inflation data on a regular basis and in some detail.
- Inflation is reported with a lag. Market participants typically digest the information on announcement day and respond accordingly.
- The underlying data is increasingly available and accessible.
- Translating available data into a meaningful signal that 'mimics' or 'approximates' the official Stats SA number is therefore possible.
- The ability to forecast or nowcast SA Inflation, while possible, comes at a cost – a cost that includes data infrastructure, man-hours, disciplined execution and constant monitoring. The cost is not trivial – if it were, then everyone would be doing it. The work required ranges from the mundane to the sublime.

The second line on the graph above represents the output of a model used to estimate SA Food Inflation. In effect, the model took full advantage of available data and created a "signal" that was both *timely* (marginally earlier than Stats SA) and *accurate* (closely approximating the official numbers).

The "signal" was most useful <u>at and around the most recent inflection point</u> – immediately before and after the peak.

Graph 4: SA CPI: Food and NAB



Source: Refinitiv Differential Research

Extending the graph for the recent inflation print reveals that,

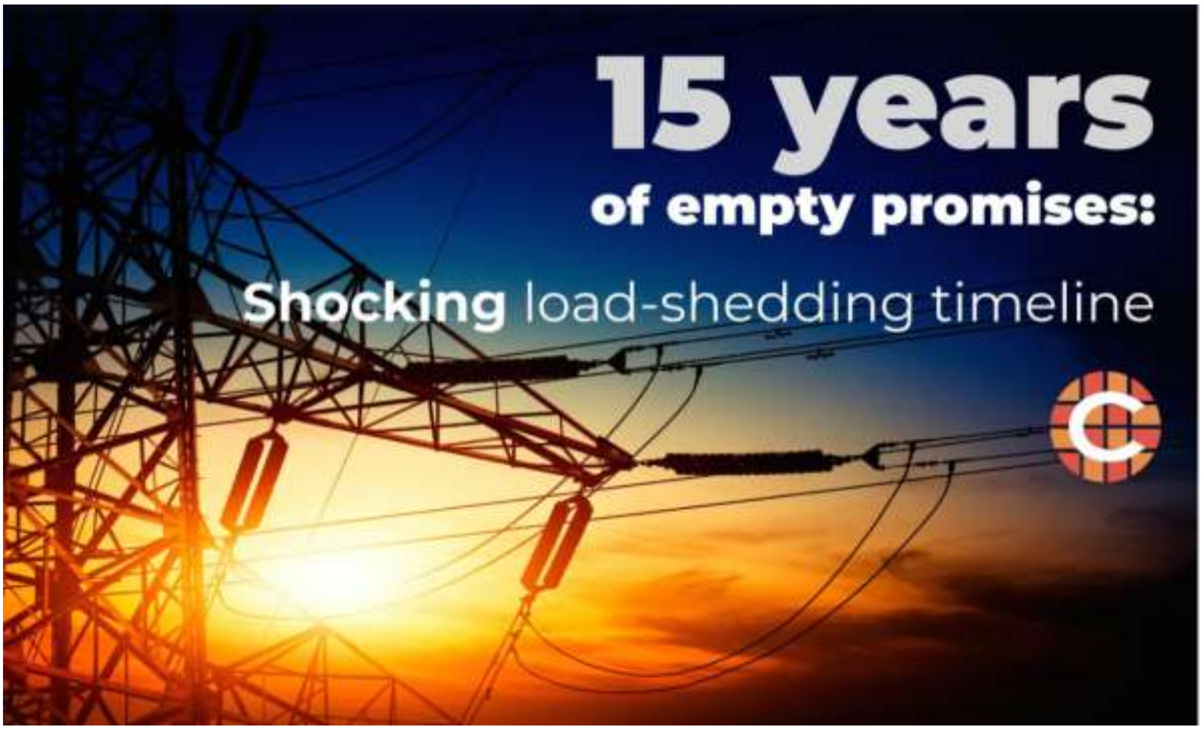
1) Food Inflation is now substantially lower – relative to the peak. Like most of the world, South Africa is in a disinflationary cycle.

2) In terms of trajectory - the 'surprise element' has disappeared. Put another way, there is once again room for investor complacency on the inflation front.

Thankfully, what is true at the macro level does not hold once you drill deeper. The data is rich. At the micro level (or individual stock level), inflation data harvesting can be beneficial in the quest to beat the broader equity market. Pricing power is a crucial element in fundamental equity work – the insights provided will always outweigh the cost of extracting the data on a real-time basis.

Similarly, domestic loadshedding has been around for a while (too long, most would say). Data has been available but offered no opportunity for outperformance – investor expectations were well calibrated.

Figure 1: Load-shedding timeline

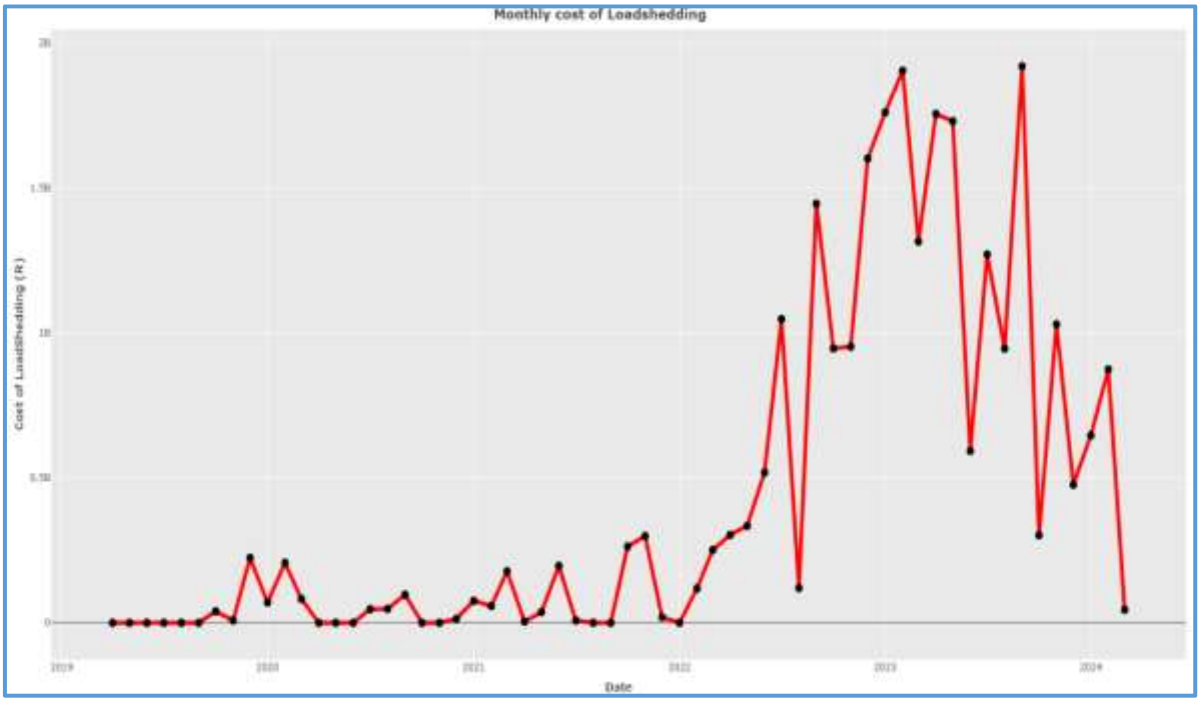


Source: The Citizen September 29th, 2022

The inflection point arrived in early 2023 - when equity, bond and currency markets offered a significant opportunity for data harvesting. Investors were forced to revise their expectations due to a lethal combination of a weakened SA economy, rapidly escalating load-shedding and a high oil price. Data guided investors to avoid areas of the equity market that would be most impacted while tilting towards stocks with zero or low exposure. The opportunity itself was short-lived (a few months). By late 2023, the market had priced in the negative economic impact, and the macro context had changed.

What goes up must go down (sometimes).

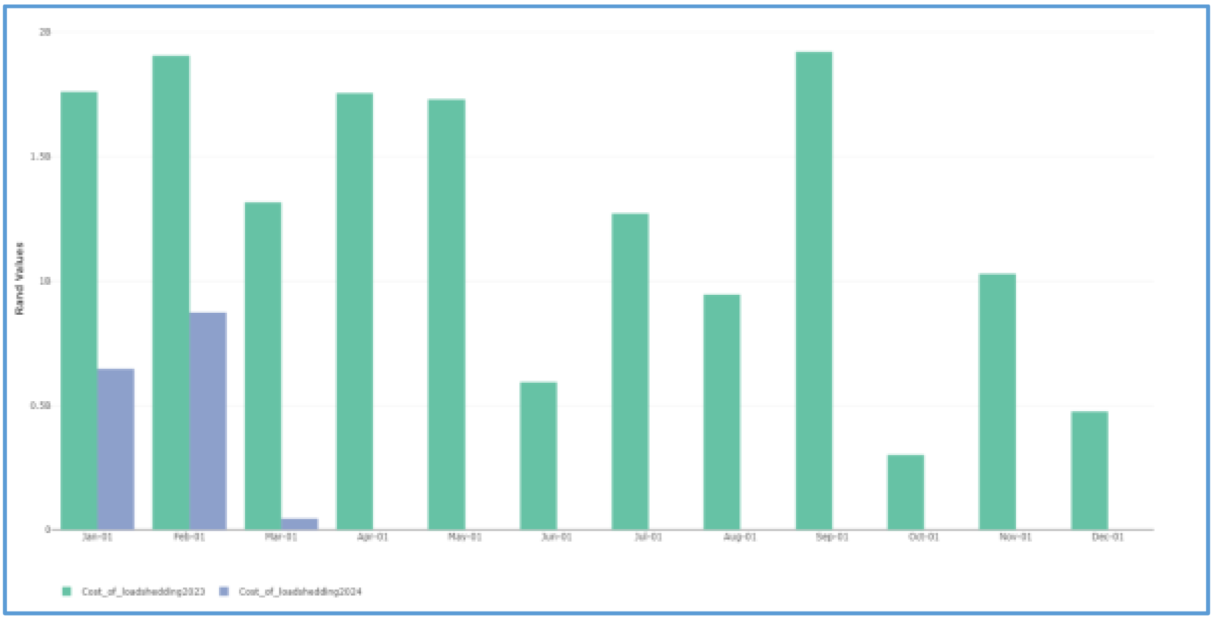
Graph 5: Monthly cost of load-shedding



Source: Eskom; Differential Research

In the case of load-shedding, the debilitating impact forced a change in management behaviour. Businesses invested heavily and are better prepared today – with a muted impact on business continuity. Survival came with a significant cash flow and earnings impact. The graph below compares the aggregate monetary impact of lower load-shedding in 2024 versus last year.

Graph 6: Monetary impact of lower load-shedding in 2024 vs 2023



Source: Eskom; Differential Research

The trajectory of improvement in early 2024 is clear. Accordingly, there is still an opportunity to use load-shedding data to find mispricing within the SA equity market – particularly in stocks that were hardest hit and will show significantly better results in the next reporting period(s).

The “window of opportunity” lasts for the next six to twelve months but has an expiry date.

- For investors with investment horizons beyond 12 months, the data harvesting opportunity will be less meaningful – it could rightfully be considered as ‘noise’.
- In contrast, for those who believe that shorter-term mis-pricings can be exploited by using relevant data - it might be more interesting.

Either way, load-shedding related data could become less relevant in 2025. Data accuracy will offer scant consolation if the market correctly discounts the fundamental impact. The ongoing cost of extracting the data might even outweigh the potential to outperform the market.

Concluding thoughts:

Outperforming the market on a consistent basis is not easy to achieve. Active managers have to earn their keep. Inflation expectations seem to be well discounted. The impact of Load-Shedding, to a lesser extent.

The explosion in Data and GenAI is an exciting development, but it is just a component of the investment toolkit. Investors and allocators still require a sound investment philosophy.

Time and effort spent on data harvesting add the most value when it is aligned with a genuine opportunity to outperform the market.

Glacier Research would like to thank Sam Houlie for contributing to this week's *Funds on Friday.*

Sam Houlie

Co-CIO: Fundamentals

Differential Capital

Sam holds the position of Director at Differential Capital and fulfils the role of Co-Chief Investment Officer, overseeing fundamentals. With nearly thirty years of experience as an analyst and portfolio manager in both global and South African financial markets, Sam's career has evolved significantly. In 2022, he made a substantial investment in Differential, an innovative investment manager utilising Data Science, Machine Learning, and AI techniques. A qualified Chartered Accountant and CFA Charter holder, Sam has a rich professional background, having previously contributed to the success of renowned firms such as Allan Gray, Ninety-One, and Counterpoint Asset Management, where he managed award-winning funds across the entire asset class spectrum.