Q1 2025 INVESTMENT LETTER

APRIL 2025

STONEHAGE FLEMING

NOW AND FOR FUTURE GENERATIONS

EXECUTIVE SUMMARY

Developments over the first days of April were in stark contrast to what transpired over the first quarter of 2025. In the domestic economy, the **future of the Government of National Unity ("GNU") came into question** and rattled domestic markets.

Add to this import tariffs levied by the US on countries around the world on **"Liberation Day",** financial markets behaviour and the global economic outlook became very different. The broader global economic implications of these are covered in the letter from our Global Chief Investment Officer ("Global CIO") group's desk. We invite you to read it **here**.

While SA equities were the standout performer over the quarter – driven by precious metals miners rallying on elevated geopolitical risk – they have since given up almost all their gains.[1] The same is true for SA bonds and the rand.

We consider the current monetary policy stance of the SARB to be tight. Simplistically: current realised headline inflation of 3.2%, subtracted from a current repo rate of 7.5%, gives a *real* repo rate of 4.3%. The SARB views the steady state *neutral (neither tight nor loose)* rate to be 2.5%.

There has been a step change in responsiveness to increasing growth enabling capital expenditure, with significant infrastructure investments announced by the public sector over the next three years. Work on further enhancing partnerships with the private sector continues. **It is positive to see capital expenditure by the private sector increasing.**

In the domestic political economy, after legislation such as the NHI, BELA, and the Expropriation Bill were signed by the President, the GNU underwent its first real test when the National Budget, first due to be tabled on 19th February, was postponed to the 12th of March due to disagreement amongst GNU members. In this regard, **events early in the month of April have been fluent and meaningful.**

Financial market volatility has increased and remains high. We expect it to stay this way as the world digests unfolding US trade (and diplomatic) policies – and the dust settles on the local political front.

We remain alert to the opportunities and risks and, as always, are following a balanced and diversified approach to allocating client capital.

[1] *Source: Bloomberg. As of 4 April 2025.*

INTRODUCTION

The year commenced with a series of significant events transpiring. Both on the domestic front, as well as what came from abroad seemed to kick off once inauguration of US President Trump took place. As a deluge of tariffs and tariff proposals were announced interlinked with a step change in the US foreign policy agenda, South Africa found itself *placed* squarely in President Trump's sights.

The effect of the Trump administration "flooding the zone", was increased volatility of global, but predominantly US, asset prices – as market participants attempted to price the policy implications on US economic growth, inflation, and company profitability. Eventually leading to a decline in the broad US dollar index, and a rally in the price of gold (deemed to be a haven asset during periods of heightened geopolitical risk), this saw the rand strengthening against the US dollar, and a rally in the share prices of JSE listed gold mining companies pulling the broader South African Equity market higher.

On the local front, after legislation such as the NHI, BELA, and the Expropriation Bill were signed by the President, the GNU underwent its first real test when the National Budget, first due to be tabled on 19th February, was postponed to the 12th of March due to disagreement amongst GNU members. In this regard, events early in the month of April have been fluent and meaningful. We spend time offering our views on this later in this letter.

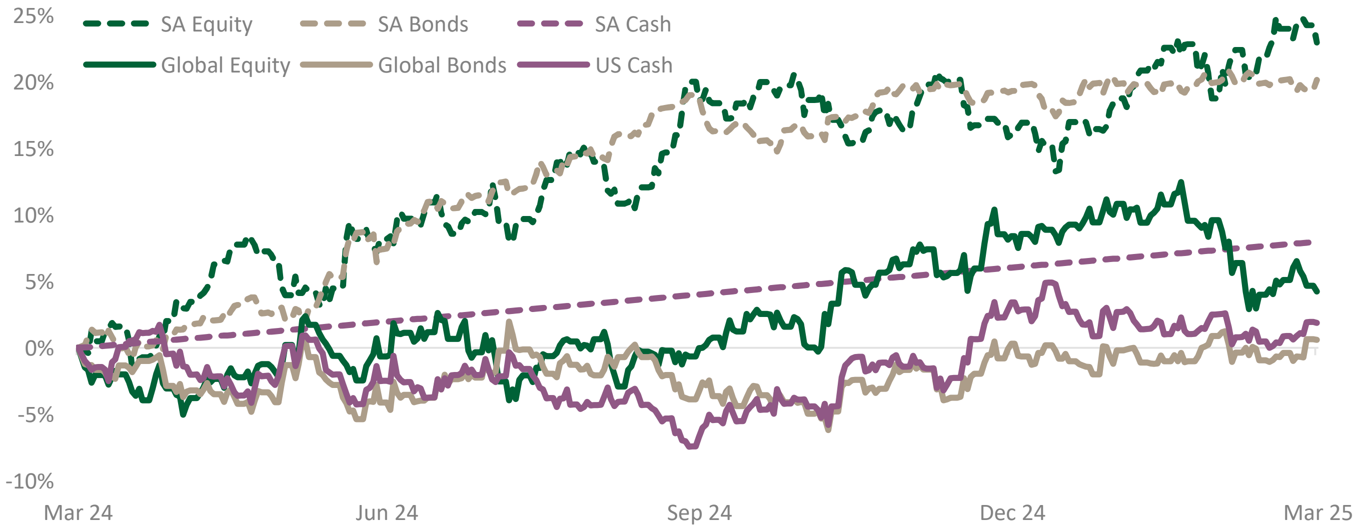
Table 1a: A good period for SA Equity; ahead over 5 years

	3m	6m	1y	3y	5y
SA Equity	5.9%	3.7%	22.9%	9.4%	19.1%
Global Equity	-3.8%	4.3%	4.1%	15.4%	15.9%
SA Bonds	0.7%	1.1%	20.2%	9.8%	11.7%
Global Bonds	0.3%	4.0%	0.2%	6.5%	-0.8%
SA Cash	1.8%	3.8%	8.0%	7.3%	5.8%
US Cash	-1.5%	9.2%	2.1%	12.7%	3.2%

Table 1b: Including this year so far

	2025	2024	2023	2022	2021
SA Equity	5.9%	13.4%	9.3%	3.6%	29.2%
Global Equity	-3.8%	21.2%	31.3%	-13.0%	28.8%
SA Bonds	0.7%	17.2%	9.7%	4.3%	8.4%
Global Bonds	0.3%	1.4%	14.9%	-11.7%	2.8%
SA Cash	1.8%	8.2%	7.8%	4.9%	3.5%
US Cash	-1.5%	8.8%	13.0%	8.2%	8.7%

Chart 1[2]: It was a good 1-year period for domestic assets in general



[2] *Source: For all data on this page. Morningstar Direct. As of 31 March 2025. Unless otherwise stated, return figures represent total return in ZAR. Periods longer than 12 months are shown annualised.*

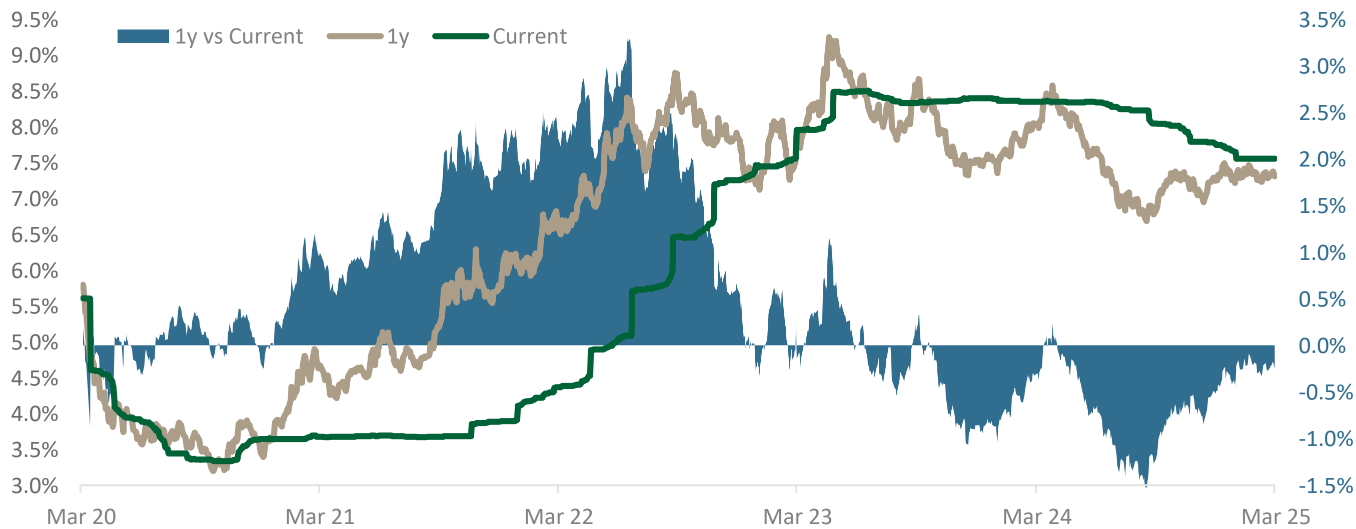
Section 1 Economics

1.1 Inflation and Interest Rates

After a delay in the release of the January 2025 CPI figure, due to additional checks required by StatsSA for the first release incorporating the updated basket, both the January and February figures showed inflation of 3.2% year-over-year at a headline level. This indicates to us that inflation is contained and therefore does not require high real interest rates. After cutting the repo rate by 0.25% (to 7.5%) at its January MPC meeting, the SARB elected to keep the rate unchanged at its March meeting – seeing the balance of risks to their medium-term outlook skewed to the upside.

Some economists expect at least one more 0.25% cut this year, with others viewing this cutting cycle as having concluded. Markets (chart 2 below), for their part, are currently pricing for one more 0.25% cut within the next 12 months. We consider the current monetary policy stance to be tight. Simplistically: current realised headline inflation of 3.2%, subtracted from a current repo rate of 7.5%, gives a *real* repo rate of 4.3%. The SARB views this steady state *neutral (neither tight nor loose)* rate to be 2.5%.

Chart 2: Money market pricing for further interest rate cuts[3]



1.2 Economic Growth

While indicators of business confidence remain elevated versus recent history, they are still below neutral levels. Notwithstanding higher disposable income from the two-pot retirement reforms and lower inflation, consumer confidence turned markedly lower during the first quarter. This was predominantly due to a potential increase in the VAT rate and elevated geopolitical tensions between SA and the US at the time of the survey.

Public sector wages, social welfare grants, and interest on debt have historically comprised a large and increasing portion of government's expenditure. Economic growth requires investment in productive assets. A step change in responsiveness to this need is taking place, with significant infrastructure investments announced by the public sector over the next three years: National Treasury is targeting fixed investment growth of 4.7% per annum over its Medium-Term Expenditure Framework ("MTEF"). This translates to R 1 trillion over the next three years[4].

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[3] *Source: Bloomberg. 31 March 2025. Chart shows current 3-month interest rate and 3-month interest rate in 1-year priced by FRA market.*

[4] *Source: National Treasury. Revised Budget. 12 March 2025.*

We note private sector capital expenditure starting to pick up too, much of it in partnership with the public sector. This being a product of the government's drive to crowd in the private sector as it builds out, for example, logistics infrastructure aimed at ameliorating troubles at Transnet. A key development on this front during the quarter was the launch by Transport Minister, Barbara Creecy, of a Request for Information online portal: a further step in the process of enabling private sector participation in rail and port infrastructure and operations.

Taken together with tourism-boosting visa reforms, and stability in electricity generation, good is transpiring.

Chart 3a: Industry capital expenditure increasing

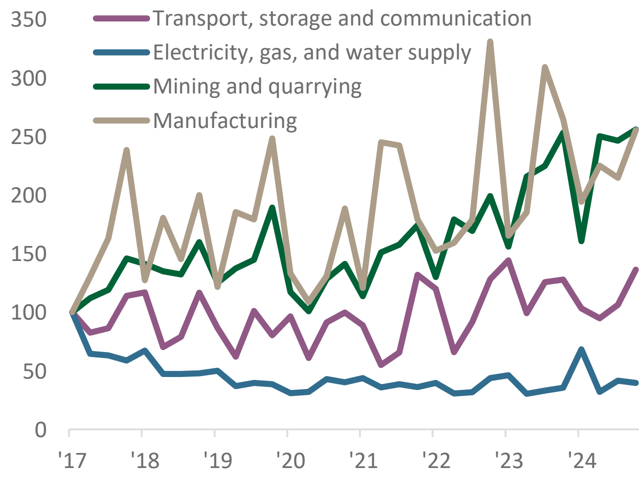
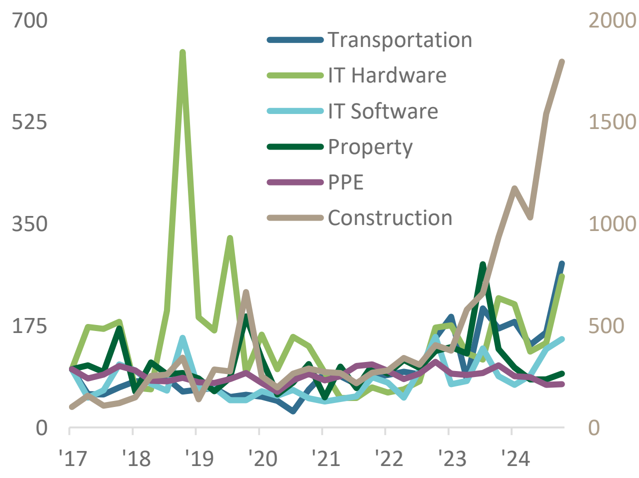


Chart 3b: Significant pickup in construction spend



The above two charts show indices of quarterly capital expenditure by the private sector, rebased to 100 as of March 2017[5]. We note in chart 3a that businesses in the Mining and Manufacturing industries have continued to increase capital spending since Covid, while on chart 3b we note the exceptional increase in spend on Construction, albeit from a low base (right axis). On this chart we also observe a broad pickup in capital expenditure since the conclusion of the National Elections last year.

We would note that, as elaborated on in the next section, investor and private sector confidence will have deteriorated given recent budget / GNU as well as global/tariff developments. Hence, willingness to invest capital may remain tepid.

1.3 US Tariffs (and US-SA diplomatic relations)

The broader global economic implications of President Trump's "Liberation Day" tariff announcements are covered in the letter from our Global CIO group's desk. We offer a few comments here under the banner of US-SA trade and diplomatic relations.

Witnessing the deterioration in diplomatic relations between SA and the US this year has been jarring and unfortunate. Indicative of the economic cost thereof, concerns about the future of SA eligibility for preferential exports to the US under the African Growth and Opportunity Act ("AGOA") transformed into a blanket tariff of 30% (with some key exceptions) on all goods imported by the US from SA.

This is meaningful, if maintained. Were the tariffs to remain in their current form, and SA loses its eligibility under AGOA, economic growth this year could be 0.3% lower. Inflation could move up to 1% higher on the back of sustained rand depreciation[6].

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[5] *Source (for both charts): StatsSA. As of 31 December 2024.*
[6] *Source: SBG Securities (Elna Moolman). 3 April 2025.*

1.4 National Budget & the GNU

From a purely economic perspective, we thought the first iteration of the budget prudent: funding for frontline workers, agreed wage increases, and more significant allocations to capital expenditure (infrastructure) derived from minor spending reprioritisations and a broad-based tax increase. The alternative could have been to fund the deficit by issuing debt (borrowing more), which would have been antithetical to National Treasury targeting debt stabilisation – and would have been viewed in a negative light by financial markets and ratings agencies.

This first national budget under coalition government proved to be a messy affair and had markets on tenterhooks between its first and second iteration. Developments remain fluid, with those transpiring over the first days in April negatively impacting markets. While news coverage is ample, our (and we believe the market's) current main concerns are twofold:

1. If there are any amendments to the budget (as tabled on 12 March and approved by parliament on 2 April), what form will they take? Importantly, will a replacement source of revenue (likely another form of taxation) be found if the increase in the VAT rate and bracket creep are done away with?
2. What will become of the GNU given the DA's vote against the budget?
   a. If they choose to **remain** (and/or the ANC does not expel them), we believe the path to a functional ANC/DA relationship will be long and arduous – as much damage was done during the budget negotiations. Investor anxiety over a potential breakdown will be pervasive.
   b. If they choose to leave (and/or the ANC does expel them), we believe there may be two possible outcomes for the GNU (to maintain a parliamentary majority):
      i. **Middle road**: it is joined by smaller parties like BOSA and Action SA, or
      ii. **Low road**: it is joined by the EFF or the MKP

We remain hopeful that the GNU holds in its current form but think there is significant risk of it not. More likely would be the GNU continuing with a few (more) smaller parties joining the ANC to make up a parliamentary majority. The low road outcome in our (and the market's) view would be the EFF joining the GNU, but we view this unlikely (and/or the MKP joining it even less so).

While we lament the outcome of the budget negotiation process and the tremendous cost it inflicted on ANC/DA relations, we found the below appraisal apt:

Stepping back, the past six weeks of ANC/DA jostling has emphasised the primary point of tension within the GNU, which is that the ANC has yet to fully accept the political limitations that it faces as a result of losing the national majority last year, and the DA has yet to learn how to operate as a part of, rather than in opposition to, government[7].

Perhaps one of the reasons for the flare up in tensions, is also a softening element with regards to policy implications: the DA has had a limited role in shaping national policy since the GNU was formed, meaning its exit should not *significantly* impact policy continuity (except in the low road outcome). We would note, however, that the DA's involvement in government has and does enhance policy *implementation*.

Furthermore, we expect the work under **Operation Vulindlela** ("OV"), which resides in the Presidency, to continue. Implementation of these structural reforms is *largely* insulated from GNU-related developments.

[7] *Source: SBG Securities (Simon Freemantle) – The current state of play. 3 April 2025.*

Section 2. Financial Markets

2.1 Currency

The broad US dollar index ("DXY") retreated 3.9% this quarter, giving up gains made in the final quarter of last year. This was broadly in response to market participants taking the view that President Trump's economic policies will be detrimental to growth in the short-term. This, together with gold being the preferred asset to hold to guard against geopolitical risk resulted in the gold price rising 20.1% over the quarter in US dollar.

Gold being a key export commodity for South Africa, the local economy saw its terms of trade improve as well as the rand rallying against the US dollar – ending the quarter at R18.37/US$ (or 2.8% stronger).

2.2 Fixed Income

After rallying strongly last year, returns from SA bonds (+0.7%) were broadly flat this quarter and, reflective of the volatile geopolitical environment, behind SA cash (+1.8%). The closing yield on the SA 10-year government bond at the end of the quarter was 10.6%, which remains high compared to current inflation (3.2%) and offers an attractive real yield.

The same is true of cash rates. We noted the high real repo rate when we considered monetary policy earlier, and this logic feeds through to cash and money market instruments too. The average yield on 12-month maturity Negotiable Certificates of Deposit ("NCD's") was 8.1% at the end of the quarter – 4.9% more than current headline inflation.

A key question we constantly ask is what is in the price, and we view SA government bonds to be close to fair value. There is a risk that, should the GNU dissolve, yields could move higher (prices lower). We are alive to this risk and have positioned accordingly. Our portfolios are leaning into cash and money market instruments where we are earning attractive real returns, while balancing this out with exposure to longer duration assets.

We consider changes in yields as well as shifts in the curve to get a sense of bond market behaviour. In chart 4a we note the large shifts in the curve as showing the size of the risk premium priced out by the market last year. We also note the steepening of the curve this year due to longer maturity yields rising on budget risk and the short end lowering due to the reduction in the repo rate. Then, in chart 4b[8], we note the marginal selloff in the SA 10-year (yields rise) government bonds this year. Although these yields are still much lower than in recent history.

Chart 4a: SA government bond yield curve

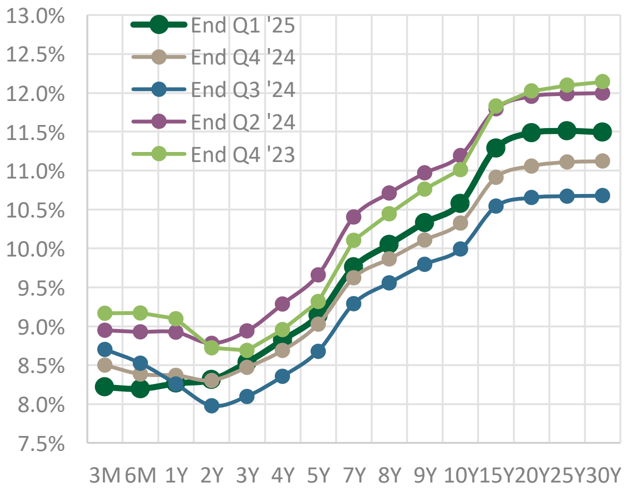
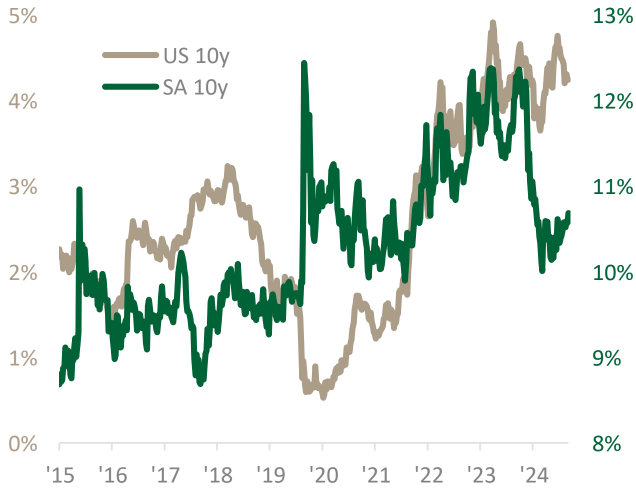


Chart 4b: US & SA 10-year government bond yields



[8] *Source: For both charts, and all figures quoted on this page: Bloomberg. As of 31 March 2025.*

2.3 Equity

While South African mid and small-cap companies saw their share prices rally last year, it was large capitalisation stocks (+8.5%) outperforming their small (-7.1%) and mid-cap (+0.1%) counterparts so far this year. The JSE All Share index delivered a total return of 5.9% over the quarter.

Looking under the surface, we note that it was precious metals miners that drove this strong performance – and particularly the gold miners that benefitted from a higher gold price. In aggregate, FTSE/JSE Precious Metals and Mining index is up 58.6% over the quarter. Excluding the effect of these, the overall equity index delivered negative returns over the quarter.

A reminder that, where appropriate, we also engage global assets within our domestic portfolios and have participated in the strong longer-term performance. Year-to-date performance from these assets has broadly detracted from returns as markets sold off in the face of US tariffs.

> We mentioned in our previous letter that we see three main risks to our optimistic outlook for SA equities.

1. extended escalated geopolitical tensions, especially in the Middle East affecting oil prices and global risk sentiment,
2. volatility under a Trump presidency (including further deterioration in SA-US diplomatic and trade relations), and
3. disruptive coalition politics domestically.

The latter two came to a head over the past few weeks. We've noted our views around the budget / GNU and potential implications for South Africa of US import tariffs. The global and local equity market fallout from these two events occurring at the same time has not been insignificant.

While company earnings might contract on slower global growth, South African corporate balance sheets are still strong and management teams are battle hardened from operating under many years of low to no domestic economic growth, as well as policy uncertainty. Add to this that valuations remain undemanding at an aggregate level and cash returns to investors (through dividends and share buy-backs) remain attractive.

Chart 5a: SA equity valuations remain compelling versus peers[9]

[9] *Source for both charts and figures quoted: Bloomberg, as of 31 March 2025. Charts show 12-month forward Price-to-Earnings ratios*

Chart 5b: And, versus their own history

SUMMARY

Our outlook for the South African financial markets at the margin remains optimistic (if less so than in prior quarters), based on compelling asset valuations and continued structural reforms.

The outlook for US and global growth has deteriorated largely due to the announcement of US tariffs. This has implications for SA economic growth and financial market performance. Together with the current uncertainty around the continuation of the GNU in its present form, risks have increased meaningfully.

What has us leaning marginally optimistic is the seriousness of intent to increase public sector infrastructure spending by government and National Treasury. Should the private sector continue to be involved, this would be positive for growth in the long run. Much of the good that has transpired over the past few years came from work under OV. That its implementation is largely insulated from GNU-related developments is a net positive for the South African economy.

As has been the case this month so far, we anticipate financial market volatility to remain elevated as a new world order continues to unfold under a Trump administration and the future of the GNU unveils itself. We remain alert to the opportunities and risks and, as always, are following a balanced and diversified approach to allocating client capital.

We thank you for your continued support.

SFIM SA Investment Committee
April 2025

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