Q2 2025 INVESTMENT LETTER

JULY 2025

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EXECUTIVE SUMMARY

The second quarter of 2025 was shaped by a complex interplay of domestic resilience and global recalibration.

Domestically, **South Africa benefited from** subdued inflation (headline CPI at 2.8% in May), a supportive monetary policy shift (repo rate cut to 7.25%), and accelerating infrastructure investment.

Operation Vulindlela entered its second phase, with tangible progress in **energy, logistics, and water reforms**.

Financial markets responded positively: SA equities rose 25.2% year-on-year, bonds returned 18.4%, and the rand strengthened on favourable terms of trade. South Africa is also running a primary budget surplus—estimated at 0.7% of GDP in FY2024/25—which reinforces the credibility of its fiscal consolidation path.

Globally, the investment landscape was dominated by the **reshaping of US trade policy**. While initial tariff shocks under President Trump rattled markets, a pivot toward negotiation has since reduced uncertainty.

The US dollar weakened significantly—down 10.7% year-to-date—prompting a **reassessment of global asset allocations**.

Despite fading tailwinds from fiscal stimulus and mega-cap tech dominance, **US assets remain supported by structural strengths: productivity, innovation, and shareholder discipline**.

In this environment, we continue to favour a balanced and diversified approach to capital allocation—anchored in domestic opportunity, but informed by global shifts in policy, currency, and market leadership.

INTRODUCTION

In this letter, we focus on the domestic macroeconomic and market developments that shaped the quarter. Inflation remained well below the SARB's midpoint target, enabling a more accommodative monetary policy stance. Infrastructure investment accelerated, with over R1 trillion earmarked over the medium term, and Operation Vulindlela in its second phase continuing to make tangible progress in energy, logistics, and water reforms.

Private sector capital expenditure also showed continued momentum, particularly in construction and logistics. These developments helped drive a strong rebound in domestic financial markets: SA equities rose 25.2% year-on-year, bonds delivered solid returns, and the rand appreciated on the back of favourable terms of trade and a narrowing current account deficit. South Africa is also running a primary budget surplus—estimated at 0.7% of GDP in FY2024/25—which reinforces the credibility of its fiscal consolidation path.

Against this backdrop, we maintain a constructive outlook for South African assets, while remaining alert to both risks and opportunities in this evolving environment.

Global developments are covered in more depth in our Global Investment Letter. The investment environment was shaped by the recalibration of US trade policy. After an initial shock from aggressive tariffs, President Trump's pivot toward negotiation helped stabilise markets. The US dollar weakened sharply, reflecting narrowing growth differentials and fiscal concerns. While the Magnificent 7 tech giants face new challenges, the broader US equity market remains resilient, supported by strong fundamentals and a shift toward AI-driven productivity gains.

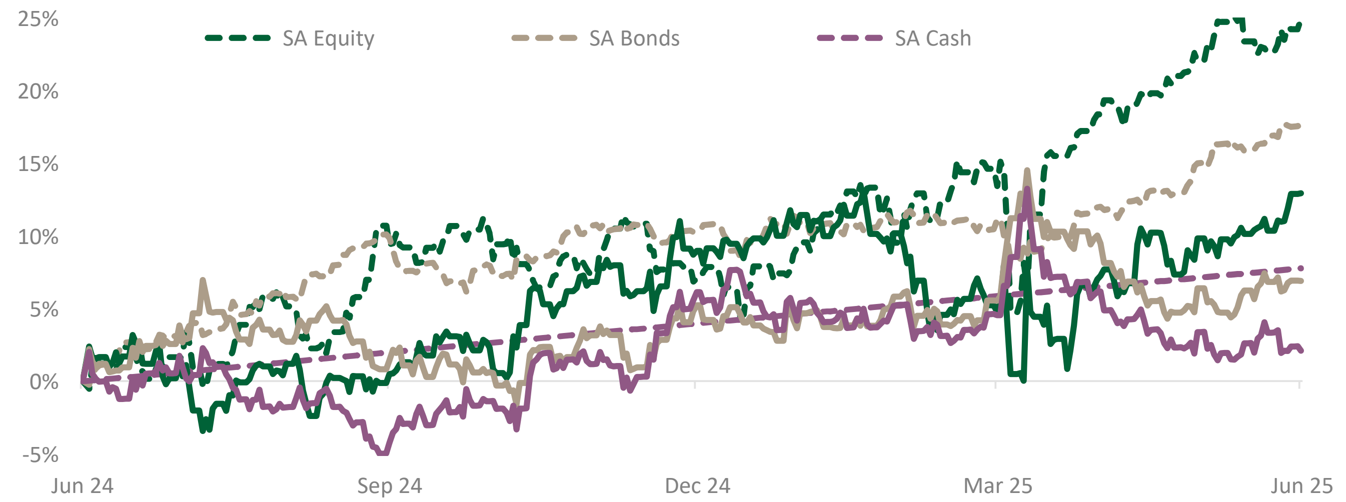
Table 1a: A good period for SA Equity; ahead over 5 years

	3m	6m	1y	3y	5y
SA Equity	10.2%	16.7%	25.2%	17.8%	16.4%
Global Equity	7.8%	3.6%	13.1%	20.6%	14.2%
SA Bonds	5.9%	6.6%	18.4%	13.4%	10.9%
Global Bonds	1.3%	1.6%	6.3%	6.1%	-0.7%
SA Cash	1.8%	3.7%	7.8%	7.5%	6.0%
US Cash	-2.3%	-3.8%	2.0%	7.6%	3.3%

Table 1b: Including this year so far

	2025	2024	2023	2022	2021
SA Equity	16.7%	13.4%	9.3%	3.6%	29.2%
Global Equity	3.6%	21.2%	31.3%	-13.0%	28.8%
SA Bonds	6.6%	17.2%	9.7%	4.3%	8.4%
Global Bonds	1.6%	1.4%	14.9%	-11.7%	2.8%
SA Cash	3.7%	8.2%	7.8%	4.9%	3.5%
US Cash	-3.8%	8.8%	13.0%	8.2%	8.7%

Chart 1[1]: Strong performance from SA Equity and SA bonds



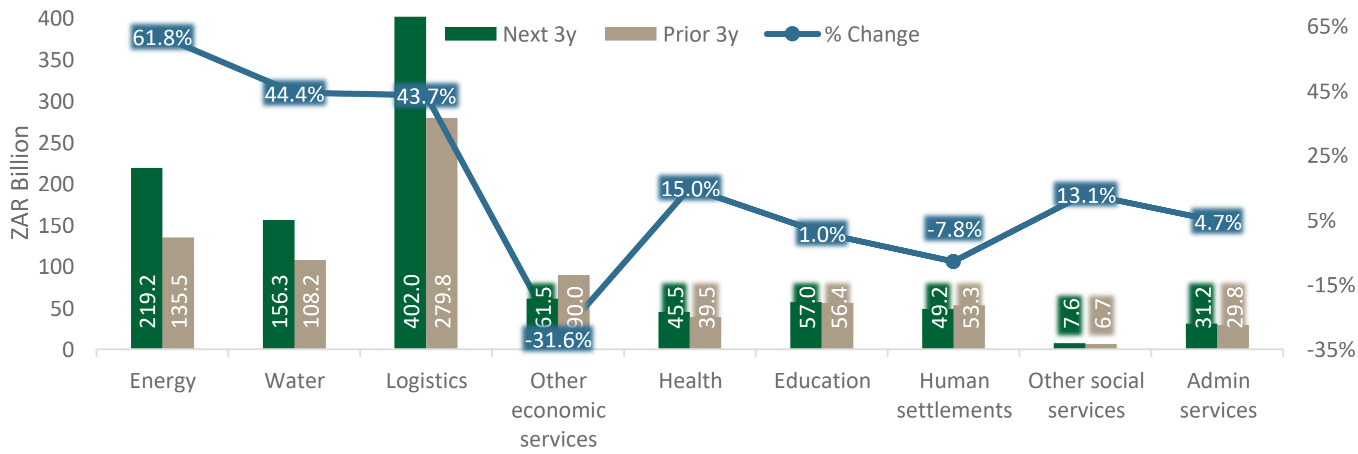
[1] *Source: For all data on this page. Morningstar Direct. As of 30 June 2025. Unless otherwise stated, return figures represent total return in ZAR. Periods longer than 12 months are shown annualised.*

Section 1. Economics

1.1 Budget: Increased Infrastructure Investment

The eventual 2025 Budget reaffirmed Treasury's commitment to fiscal consolidation. The debt-to-GDP ratio is expected to peak at 77.4% in FY25/26, with a primary surplus projected to increase to 2.1% of GDP by FY27/28. Revenue forecasts have been revised downward due to the reversal of VAT hikes and weaker GDP growth, but SARS's enhanced debt collection efforts could yield R20–R50bn annually. Spending on frontline services has been trimmed. Public infrastructure investment remains a central pillar. Over the 2025 Medium Term Expenditure Framework ("MTEF"), government has allocated R1.03 trillion to infrastructure (ca. 29% increase), using a mix of funding mechanisms including capital transfers, state-owned company borrowing, and, importantly, targeted allocations via the Budget Facility for Infrastructure ("BFI") to support strategic and blended finance projects.

Chart 2[2]: Increased allocation to Infrastructure over MTEF (next 3 years)



Preliminary private sector capital expenditure (capex) data showed mixed momentum in early 2025. Total capex on new assets declined by 8.9% quarter-on-quarter to R117 billion in Q1 2025, following a sharp surge in Q4 2024. The decline was broad-based, with notable contractions in spending on computer software (-43.4%), IT equipment (-26.9%), and vehicles (-25.4%). However, construction works bucked the trend, rising 27.4% q/q and more than tripling year-on-year (+241.9%), suggesting a pivot toward infrastructure-heavy investment. Despite the quarterly dip, total capex was still 40.7% higher than Q1 2024, **reflecting a strong rebound in private sector investment over the past year[3].**

Chart 3a: Quarterly capex: Asset Type

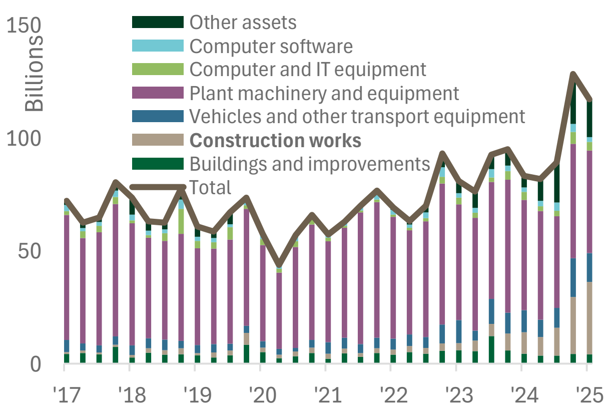
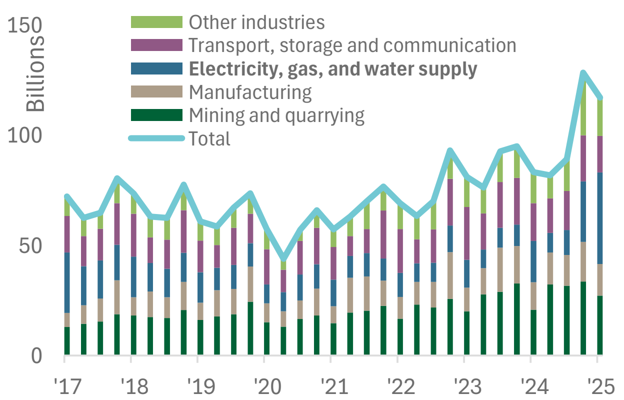


Chart 3b: Quarterly capex: Industry



[2] *Source: National Treasury, 2025 Budget.*
[3] *Source: including charts 3a and 3b – StatsSA, as of 31 March 2025.*

1.2 Monetary Policy: Potential Recalibration

In May, the SARB cut the repo rate by 25 basis points to 7.25%, citing benign inflation dynamics and weaker economic growth prospects. Headline CPI inflation remained below 3% in April, and core inflation remains anchored at the bottom of the 3–6% target range. The SARB also revised its 2025 GDP forecast down to 1.2% (from 1.7%), reflecting disappointing mining and manufacturing data and high unemployment. While global volatility persists, the rand has stabilised, and inflation risks are now seen as balanced.

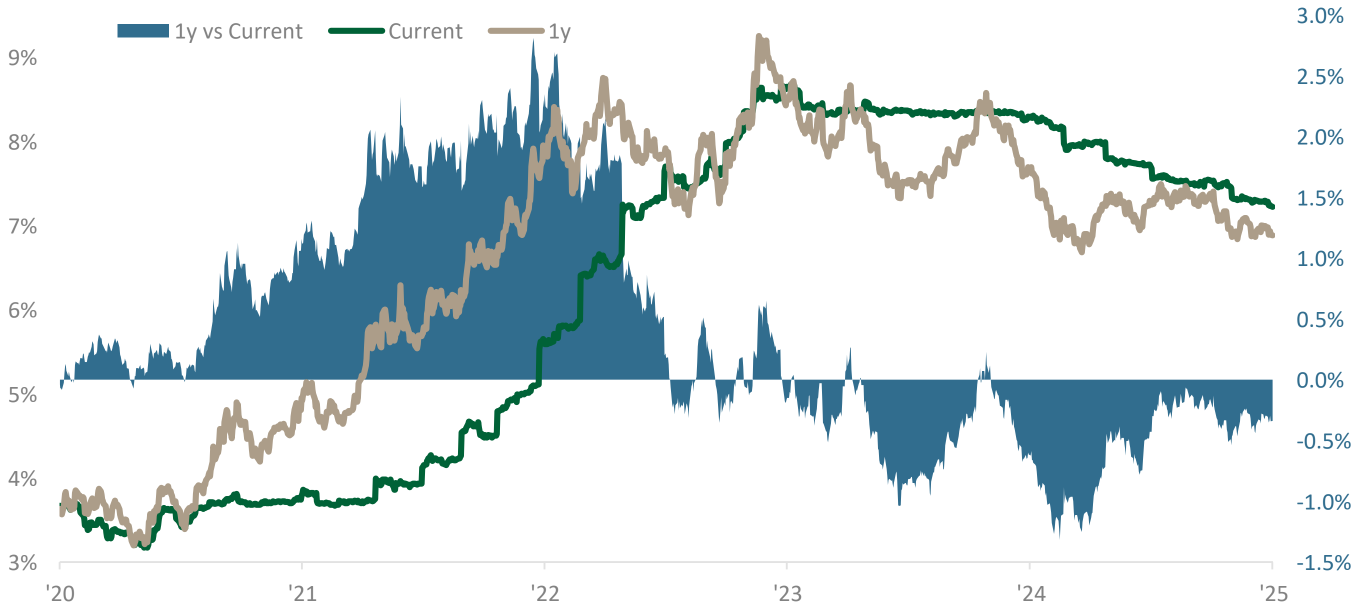
The latest BER Inflation Expectations Survey (Q2 2025) shows a broad-based decline in inflation expectations across all social groups. The average forecast for 2025 headline CPI dropped to 3.9%, down from 4.4% in Q1, marking the first time in over four years that expectations have fallen below 4%. Expectations for 2026 and 2027 are also lower, at 4.3% and 4.5%, respectively. Five-year-ahead expectations now average 4.4%, closely aligned with the SARB's midpoint target. This improved anchoring of inflation expectations supports the case for a more accommodative policy stance.

> A recent SARB working paper, "*Less Risk and More Reward*" (May 2025), makes a compelling case for adopting a point target of 3%.

The authors argue that a lower, more credible target would reduce inflation expectations, lower borrowing costs, and improve macroeconomic stability. Their modelling suggests that such a shift could permanently raise GDP, enhance fiscal sustainability, and reduce inequality—particularly by improving the purchasing power of lower-income households[4]. We monitor these developments closely and look for formal comments from National Treasury in this regard.

Markets (chart 4 below), for their part, are currently pricing for roughly one more 0.25% cut within the next 12 months. This direction of travel, should it materialise, would put monetary policy on a more neutral footing Simplistically: the SARB currently expects core inflation to average around 4% over the next three years; a repo rate at 7% puts the real rate at around 3%. The SARB currently views 2.7% to be a long run neutral real policy rate.

Chart 4: Money market pricing for further interest rate cuts[5]



[4] https://www.resbank.co.za/en/home/publications/publication-detail-pages/working-papers/2025/less-risk-more-reward

[5] *Source: Bloomberg. 30 June 2025. Chart shows current 3-month interest rate and 3-month interest rate in 1-year priced by FRA market.*

Section 2. Politics

2.1 US-SA Diplomatic Relations

The diplomatic chill between South Africa and the United States has eased slightly following President Ramaphosa's visit to Washington, but the relationship remains structurally fragile. While trade and investment talks have resumed—seen as the most tangible outcome of the Oval Office meeting—deep fissures persist, particularly under President Trump, who could reignite tensions at any moment. The 30% tariff on South African exports has been reinstated and is set to take effect on 1 August 2025.

Geopolitical risks compound this fragility. South Africa's ties to Iran and Iran's inclusion in BRICS+ have drawn scrutiny, especially amid escalating US–Israel–Iran tensions. Trump's Executive Order earlier this year alleged, without evidence, that South Africa was pursuing military and nuclear cooperation with Iran. In response, Ramaphosa has reportedly instructed ANC officials to avoid inflammatory commentary on the Middle East. While this has helped de-escalate immediate pressure, a prolonged regional conflict could still amplify diplomatic and economic risks for South Africa.

2.2 GNU: Unnecessary Noise

The Government of National Unity (GNU) continues to be plagued by internal tensions, particularly between the ANC and DA. The dismissal of DA Deputy Minister Andrew Whitfield sparked renewed tensions, with the DA issuing a 48-hour ultimatum demanding the removal of ANC ministers it deems compromised. Although the DA ultimately refrained from exiting the GNU, it withdrew from the National Dialogue and threatened a motion of no confidence in President Ramaphosa. These developments underscore the lack of trust and consultation mechanisms within the GNU, and investor sentiment has deteriorated as a result. Despite this, the GNU persists—now largely due to the shared imperative of excluding the EFF and MKP from national governance.

> Key events currently on in the calendar that could potentially impact the GNU (and broader SA politics) include:

- **December 2025 – ANC National General Council (NGC).**

  A pivotal moment for ANC succession politics. Could clarify the standing of Deputy President Paul Mashatile, Minister Senzo Mchunu, and other potential contenders. May also reshape GNU dynamics depending on internal alignments.

- **February–March 2026 – National Budget.**

  A high-risk flashpoint for the GNU. If fiscal priorities diverge or if Treasury fails to internalize lessons from the 2025 budget impasse, tensions between the ANC and DA could resurface.

- **2026 – MKP Momentum and KZN Volatility**

  While internal instability and lack of access to state patronage constrain the party, its populist appeal and exclusion from power could heighten political tensions and risk violence, particularly if SAPS dysfunction persists.

- **2026 – Local Government Elections (LGEs).**

  Could shift power in key metros like Johannesburg. A strong DA performance may weaken Mashatile's political base in Gauteng and alter leverage within the GNU. This could either strain or reinforce the coalition depending on outcomes.

- **December 2027 – ANC Elective Conference.**

  Will determine the next ANC president and likely 2029 national candidate. Investor focus will intensify as this approaches, especially if Mashatile remains a frontrunner amid reputational concerns.

Section 3. Financial Markets

3.1 Currency

The broad US dollar index ("DXY") retreated 7.0% this quarter, continuing its trend from the first quarter. This was broadly in response to market participants taking the view that President Trump's economic policies will be detrimental to growth. This, together with gold being the preferred asset to hold to guard against geopolitical risk – its price is up 24.4% this year in US dollars.

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 R17.72/US$ (or 3.5% stronger).

3.2 Fixed Income

After being relatively flat over the first quarter, SA bonds rallied strongly over the second quarter, delivering 5.9% in rand (ahead of the 1.8% delivered by cash).

Illustrated below in charts 5a and 5b[6], we note the shift lower in the curve being largely because of the market appreciating continued fiscal prudence from National Treasury as well as optimism around the prospects for a revised inflation target by the SARB. The yield on the 10-year SA government bond ended the quarter at 10.0%, down from 10.6%. Importantly, and visible in these charts, are the lowering of short-term rates: 3-month cash rates are down around 0.7% since the end of last year (from 8.5% to 7.8%). This follows the lowering of the repo rate.

We view SA government bonds to be priced close to fair value given the current outlook and, while short-term rates are lower, they may still offer real value compared to current and expected future inflation. 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.

*Chart 5a: SA government bond yield curve **levels***

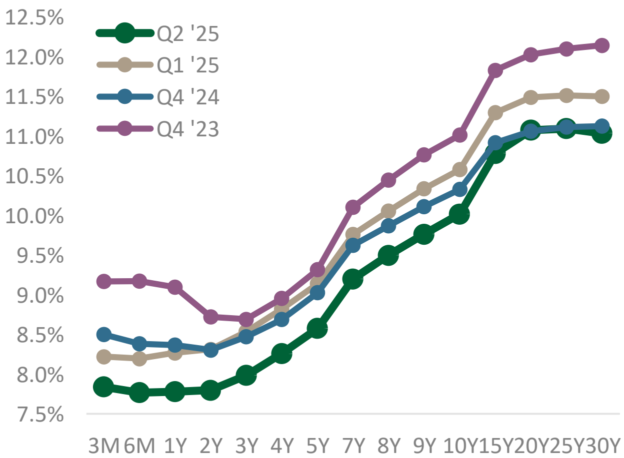
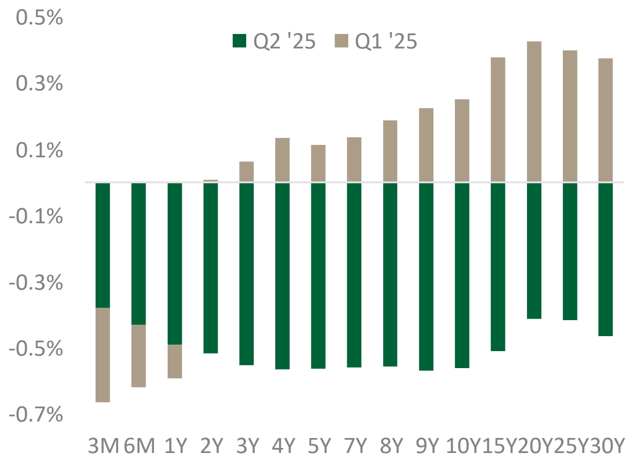


*Chart 5b: SA government bond yield curve **moves***



3.3 Equity

The second quarter of 2025 marked a strong recovery across global equity markets. The MSCI World Index, which tracks developed markets in US dollar terms, rose by 11.6%, reversing the modest losses seen in the first quarter. Emerging markets outpaced their developed counterparts, gaining 12.2% over the quarter, with standout performances from Latin America and Asia. Countries such as Mexico, Peru, Korea, and Taiwan delivered double-

[6] *For both charts, and all figures quoted on this page: Bloomberg. As of 30 June 2025.*

digit returns, supported by resilient earnings and improving investor sentiment.

South African equities participated meaningfully in this global rally. The JSE All Share Index—measured in South African rand—advanced 10.2% in Q2[7], driven by strong gains in the resource and industrial sectors. Resource shares benefited from rising commodity prices and a weaker US dollar, while industrials were lifted by robust performances in technology and telecommunications. Financials, though positive, lagged the broader market.

Looking at the year-to-date picture, equity markets have delivered impressive returns. The MSCI World Index is up 9.8% in USD terms, while emerging markets have surged 15.6%. Frontier markets have led the pack with a 20.3% gain. The JSE All Share Index has returned 16.7% in the first half of the year, with the resource sector once again leading the charge—up nearly 40% year-to-date. Industrials followed with a 15.3% return, while financials gained 6.5%.

Within the local market, performance varied significantly by company size. Large cap stocks were the clear winners, delivering a 21.2% return year-to-date, supported by heavyweight counters in the mining and telecom sectors. Mid-caps posted a respectable 10.1% return, while small caps lagged meaningfully, returning just 1.8% over the same period. This divergence suggests that investor appetite has remained concentrated in more liquid, globally exposed names, while smaller domestic-facing companies have struggled to keep pace.

Overall, South African equities have been buoyed by a combination of global tailwinds and local catalysts. Precious metals stocks, along with companies like MTN, Naspers, and Reinet, delivered outsized gains. However, not all sectors shared equally in the upside—consumer-facing industries such as retail and healthcare underperformed, reflecting ongoing cost pressures and cautious household spending.

Foreign investors continued to pare back exposure to South African equities in June, with net outflows of R26.6bn—though this moderates to R8.7bn when adjusting for technical factors like Valterra's shareholder shift (secondary listing on the London Stock Exchange). Selling was concentrated in banks, food producers, and tech, while selective buying in gold and platinum miners, telecoms, and insurers suggests a more nuanced view beneath the headline. Over the first half of 2025, cumulative foreign selling (excluding dual-listed stocks) reached R77bn, continuing the longer-term trend of cautious repositioning, albeit with pockets of renewed interest in high-yielding and defensive sectors.

We remain constructive on SA equities due to corporate balance sheets being strong and management battle-hardened from operating under many years of low to no domestic economic growth, as well as policy uncertainty. In addition to this, valuations remain undemanding at an aggregate level and cash returns to investors (through dividends and share buy-backs) remain attractive.

*Chart 6a: SA equity **PE ratio** compelling versus peers*[8]

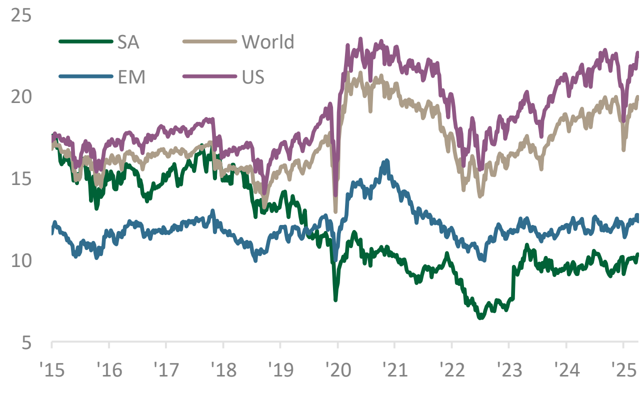
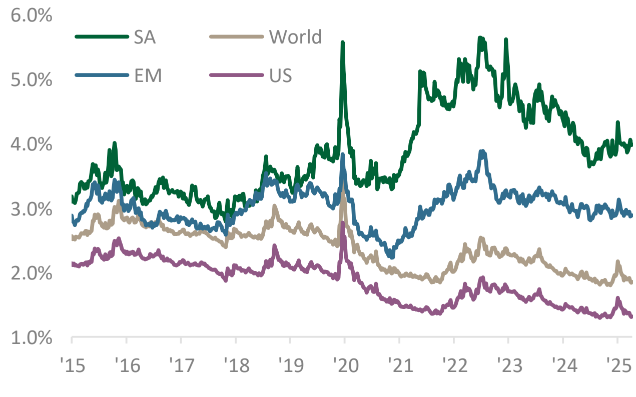


*Chart 6b: with attractive **dividend yields***



[7] *Source for all figures on this page: Bloomberg. As of 30 June 2025.*
[8] *Source for both charts: Bloomberg. As of 30 June 2025. Charts show 12-month forward Price-to-Earnings ratios & dividend yields*

SUMMARY

The second quarter of 2025 reinforced our cautious optimism for South Africa's long-term investment case.

Despite global headwinds—including renewed US tariffs and fragile diplomatic relations—South Africa's macroeconomic framework remained intact. Fiscal consolidation efforts continued, infrastructure spending accelerated, and inflation expectations declined. The SARB's policy recalibration, alongside the potential for a more credible inflation target, supports a more stable monetary environment.

Financial markets reflected this resilience. Domestic equities outperformed global peers, bonds rallied, and the currency strengthened. While political risks remain—particularly within the GNU and ahead of key 2026 events—our outlook remains constructive.

We continue to monitor developments closely and allocate client capital in a prudent and diversified manner.

We thank you for your continued support.

SFIM SA Investment Committee
July 2025

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