

Market Commentary

Quarter 1, 2025

Trade stress – investors fear uncertainty

Entering 2025, President Trump launched an unprecedented challenge to a geopolitical order that has prevailed for decades. In a dizzying series of announcements, the US slapped hefty tariffs on free-trade deal partners like Canada and Mexico, as well as economic rivals like China, while warning of more measures to come. The steep increase in US tariffs and uncertainty over trade have wreaked havoc across global financial markets.

Trump's embrace of Russian President, Vladimir Putin and withdrawal of support for Ukraine horrified much of Europe and raised questions about the US commitment to NATO. Western allies' worries come as the Republican leader talks about claiming Greenland, the Gaza Strip and adding Canada as the 51st state of the USA. These major shifts in US foreign policy have led to a surge in optimism about the European economy – driving the dollar down sharply against the euro and sending stocks in Europe to record highs on the back of Germany's landmark fiscal package. This in turn spurred the biggest jump in German bond yields since just after the fall of the Berlin Wall in 1989.

“As a ‘new world order’ takes shape, the environment for US assets has gotten meaningfully more dangerous”
- Greg Jensen: Co CIO Bridgewater Associates

The MSCI AC World Equity Index lost 1.3% in Q1, dragged down by US equities, which represent approximately 70% of the index. The MSCI Europe Index surged 6% and the MSCI Emerging Market Index rose nearly 3% on the back of the rotation we witnessed out of US equities. Investors reduced holdings of US equities by the most on record, according to the latest Bank of America survey. Asset managers reported being around 23% underweight US stocks, which represents a plunge of 40% from the previous survey.

Fears and uncertainty about US growth, saw declines in long-dated Treasury yields. The US 10-year Treasury yield ended the quarter at 4.2%, 35 basis points lower relative to the start of January. Overall, the Bloomberg Global Aggregate Bond Index gained 2.6% in Q1 2025.

Global equities
▼ 1.3%
(MSCI AC World Index)

Global bonds
2.6%
(Bloomberg Global
Aggregate Index)

US – Wall Street goes from hope to panic

US markets roared into 2025, fuelled by optimism about the prospects for broader economic growth, for companies dealing in artificial intelligence (AI), and the promise of a business-friendly presidential administration. But over the quarter, investors have been re-evaluating those elevated expectations. The prevailing market fear now is that President Trump's current economic policies – tariffs, federal job cuts, and strict immigration – could further slow economic growth. The initial thinking was that tax cuts and deregulatory plans would spur the market forward but that has been swiftly undercut as the chaotic roll-out of tariff hikes and the push to slash federal spending, clouded the outlook.

Tariffs have turned the economic outlook on its head

At the end of last year, the Fed presumed they would spend 2025 gradually cutting rates to keep inflation heading downwards, without a big rise in joblessness, to achieve the so-called soft landing. The latest projections point to the prospect that tariffs covering a swath of goods and materials will send prices up while sapping investment, sentiment, and growth – at least in the short run.

A combination of stagnant growth and higher prices, sometimes called stagflation, could make it harder for the Fed to cut interest rates this year to pre-empt any slowdown. They subsequently held interest rates unchanged for a second straight meeting in March. They marked up CPI to end the year at 2.7% versus the 2.5% anticipated in December and lowered the outlook for economic growth from 2.1% to 1.7%, with slightly higher unemployment by the end of this year.

“Tariffs are a consumer tax, so they lower incomes and spending power”
- Jan Hatzius, Goldman Sachs economist

Equity markets dropped sharply

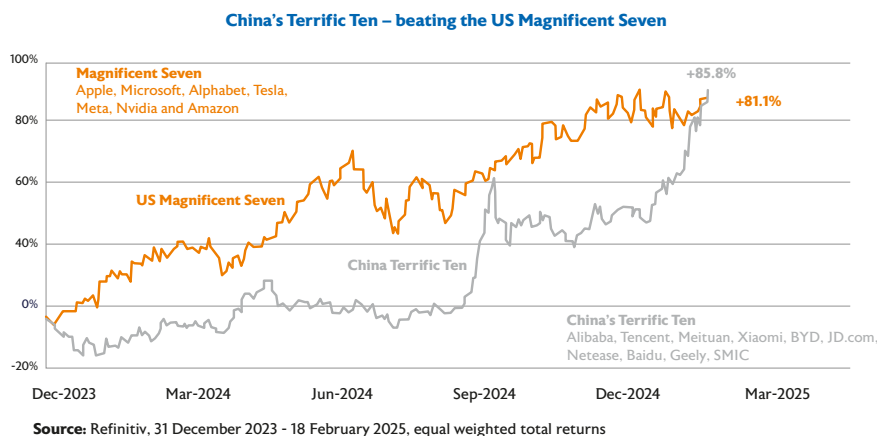
The stock market's sell-off in March may have felt like a never-ending nightmare, as the volatility that has gripped Wall Street showed no signs of abating. The Nasdaq Composite sank 10% and the S&P 500 Index fell 4.3%. Investors sold technology shares with the three big shares in the tech sector – *Apple*, *Microsoft* and *Nvidia* – all in the red year-to-date, with *Nvidia* down more than 22%. Big Tech has faced growing investor criticism about its ballooning AI spend and whether or not it will eventually turn into profits. Consumer discretionary shares such as cruise operators *Carnival* (down 22%) and *Royal Caribbean* (down 10%), are a sign of concerns that consumer spending will be hit hard by tariffs and related price increases. Among the few gainers were consumer staples, a defensive sector, with McDonald's rising almost 7% in Q1.

China – improved sentiment

After years of underperformance, Chinese stocks are attempting another rebound. The MSCI China Index gained 15% in dollar terms in Q1. The government is becoming more business-friendly, and rapid advances have been made in leading-edge technologies. Recent data suggests some green shoots in the economy, prompting financial institutions such as *HSBC* and *Morgan Stanley* to upgrade their growth forecasts. Despite optimism, concerns remain about the sustainability of this turnaround. Trade tensions, fears of deflation and still-subdued domestic consumption could sour sentiment again.

DeepSeek - upset the apple cart

Chinese tech stocks have been on a run this year, leaving their once-unbeatable US peers in the dust. An equal-weighted basket of China's ten tech heavyweights including *Alibaba Group* and *Tencent* – dubbed the “Terrific Ten” by *Refinitiv Research* – surged and outperformed the US ‘Magnificent Seven’ stocks. The ‘magnificent Seven’ lost 16% in Q1.



It is a sharp reversal of fortunes that few investors saw coming. Earlier in the new year, the Nasdaq gauge notched yet another record, while Chinese shares were still marred by years of regulatory crackdown and a tepid consumption recovery. Overnight, DeepSeek upended the perception that it will take years, if ever, for China to catch up to the level of the US's AI supremacy.

The rally received another push in March with a spate of new AI tools from the likes of *Alibaba* and *Baidu*, while *Tencent* posted its fastest pace of revenue growth in more than a year. *Alibaba* will be producing AI for BMW in China and provide AI technology to Apple's iPhones in China. While the jury is out on whether these AI releases match or surpass the most cutting-edge systems from Western AI developers, the newer options are putting more pressure on the business models of leading US companies.

Chinese consumers not spending

President Xi Jinping signalled China's determination to push ahead with an ambitious growth goal this year, despite the trade war. China announced a GDP growth target of about 5% for 2025.

For more than a decade, policymakers in Beijing have backed the need to rebalance the economy by shifting away from investment and exports toward consumption. To boost consumption, policymakers will need to restore confidence among households – they need less saving and more spending. China is one of the countries with the highest savings rates in the world, at approximately 40% of GDP.

Beijing plans to achieve this through a mix of government subsidies, better consumer protections and a push to increase household earnings, particularly for low- and middle-income groups. If successful, it could reverse the deflationary spiral and create a more positive cycle where consumer spending drives corporate profits. China's consumer prices dropped 0.7% in February, as disinflationary pressure persisted.

In March, China's State Council unveiled a slew of measures including increasing residents' income and establishing a childcare subsidy scheme aimed at boosting domestic consumption. But rebalancing the economy and raising the share of consumption in a sustainable way is no easy task – as can be seen in Japan, which over the years has relied on overseas demand to make up for a weak domestic economy.

Europe – continued to cut interest rates

The European Central Bank (ECB) cut interest rates twice in the quarter to boost growth, with the region's stalled economy facing twin shocks from Trump tariff threats and a sudden need to radically increase military spending. The ECB reduced its key interest rate to 2%, the sixth cut in seven meetings. A trans-Atlantic trade war could slow the continent's growth while its impact on inflation is less clear.

US tariffs pose a serious threat to Europe's export-oriented economy. The ECB lowered its forecast for eurozone growth to only 0.9% this year, while nudging its forecast for inflation up to 2.3%.

Ambitious defence-spending

Washington's shift in its Ukraine policy was accompanied by a broader shift in its policy toward Europe. The decision cemented the new reality that transatlantic security is no longer Washington's foreign policy priority. This led to an immediate proposal by the European Union to set up a \$158 billion fund to bolster military spending and support Kyiv – the most ambitious defence-spending package in the bloc's post-Cold War history. The US accounted for 43% of global weapons exports over the past five years in the wake of Russia's invasion of Ukraine. But the Trump administration's decision to cut off deliveries of US weapons might now affect Europe's appetite for them.

Germany – agrees historic fiscal package

German lawmakers passed a landmark spending package, paving the way for as much as €1 trillion in civilian and defence investments to jolt the region's economy and reduce its military reliance on the US. The package was made possible by a constitutional amendment that effectively exempts defence-related spending from the provisions of Germany's strict fiscal rules, which ban budget deficits bigger than 0.35% of GDP. This exemption will apply not just to spending on military hardware, but also to cybersecurity, intelligence and civil protection.

Few changes prompted by President Trump's second term could be as consequential for Germany shedding fiscal prudence to turbocharge its economy. This marked the closest Germany has ever come to reinventing its ailing export-dependent economic model, by boosting domestic demand to offset flagging international trade and tepid global demand for German goods.

Economically, Germany is likely to be the main beneficiary. After years of prudence, it has one of the lowest public debts in Europe as a percentage of GDP. But chronic underinvestment has also left it with an unreliable railway system, patchy mobile networks, an aging power grid and a public administration stuck in the paper age.

The DAX Index gained 12% in the first three months of the year.

UK – pauses rate cut cycle

After the Bank of England (BoE) cut interest rates by 25bps to 4.5% in February, it kept interest rates on hold at its latest meeting, sticking to its mantra of only gradual moves ahead as it grapples with the fallout from President Trump's trade war and mixed news on the British economy.

Japan – still in 'tightening' cycle

The Bank of Japan (BoJ) kept interest rates steady at its March meeting after raising its policy rate to 0.5% in January, the highest level in 17 years. However, borrowing costs in Japan recently notched a new multi-year high after the central bank bolstered expectations for a further tightening in monetary policy if a surge in food prices causes broader and stronger inflation.

The Nikkei closed down 10% on US tariff jitters.

South Africa – growth remains sluggish

In 2024, the local economy expanded at the slowest pace in four years as most sectors failed to contribute due to logistical constraints, weak consumer spending and poor fixed investment. GDP expanded only 0.6% compared to 0.7% in 2023 – its worst performance since the height of the coronavirus pandemic in 2020.

Cautious monetary policy approach

The SARB kept interest rates unchanged at 7.5% at its March meeting and persisted with relatively high real interest rates in SA, after three consecutive cuts of 25 bps each. One of the key reasons for the central bank's decision to hold off on another rate cut is the global economic environment.

"The world economic environment has become unpredictable."
- SARB Governor, Lesetja Kganyago

A 'no growth budget'

Finance Minister, Enoch Godongwana, finally delivered his fourth National Budget on 12 March 2025, following its unprecedented postponement on 19 February 2025. The government clearly remains hesitant to make the necessary 'tough' decisions to address the country's economic challenges. The small personal taxpayer base will now pay more by not adjusting income tax brackets and rebates for inflation. Anyone who receives a salary increase to keep up with inflation will 'creep' into a higher tax bracket and automatically pay more tax. The individual taxpayer burden has effectively increased by R18 billion.

However, the bigger disappointment is that despite increasing taxes, the budget contained little on significant government spending cuts. The same promises of efficiency and reform have appeared in previous budgets, yet government spending continues to rise with little measurable impact on economic growth or service delivery.

South Africa's gross government debt has risen considerably over the past 15 years, increasing from a very respectable 26% of GDP in 2008 to a now concerning 76.2% of GDP in 2025. The increased level of debt has not only contributed to the deterioration of SA's international credit rating, but it has also pushed the debt servicing cost to more than 20% of government revenue, limiting the flexibility of our fiscal policy. National Treasury forecasts the economy to grow by only 1.9% in 2025 and the International Monetary Fund (IMF) forecasts only 1.2%. This is well below the ambitious target that the private sector envisioned in its partnership with the government.

"The GNU is under more pressure than ever to transform increased investor confidence into tangible growth outcomes, which is the only viable path to tackling South Africa's fiscal and socio-economic issues."
- Futuregrowth Asset Management

JSE breaks through record 90 000 points

The JSE All Share Index rose 5.9% in Q1, led by resources, which were up a staggering 28%. Gold shares were major contributors, with the 'safe haven' bullion hitting record highs above \$3 100 an ounce, fuelled by central bank buying and haven demand amid rising geopolitical and macro uncertainties. According to some reports, around 70% of central banks plan to increase their reserves in 2025. The gold market ended the first three months of the year with an impressive 19% gain, its biggest quarterly rally since July 1986. Other commodity prices in dollar terms, such as copper (+12%), platinum (+10%) and palladium (+9%) are also higher due to a combination of factors including metal demand with copper key in renewable energy infrastructure, supply chain disruptions – Trump's threat of tariffs – and China's economic performance.

SA equities
▲ 5.9%
(All Share Index)

Financials were down 2%, while industrials gained 4.3%, led by big industrial/index shares such as Richemont (+18%) – after reporting a strong uplift in sales – and Anheuser-Busch InBev (+21%). AB Inbev earnings beat expectations in Q4 2024, as the world's largest brewer boosted margins of its top-selling beers.

SA Inc shares have been a drag on performance, particularly in the retail sector – food and clothing. This is mainly because these SA Inc shares ran strongly in the latter part of 2024, after the announcement of the new GNU. They may have gotten ahead of their fundamentals, hence the profit taking witnessed in the quarter.

Bond yields 'tick up'

The JSE All-Bond Index (ALBI) returned 17% last year on the back of the GNU frenzy, lower inflation and interest rate cuts. Despite all the positives last year brought, many challenges and risks remain, amid concerns over the national budget and political risks. Doubts linger about the government's ability to achieve sustainable growth and fiscal discipline. Bond yields climbed steadily during Q1, with the 10-year government bond yield at 10.6% at quarter end. The ALBI was up marginally by 0.7% for the quarter.

SA bonds
▲ 0.7%
(All Bond Index)

Money market gained 1.9% year-to-date and the rand has gained 2.7% against a weakening US dollar.

Albert Louw
STANLIB Multi-Manager