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OUT OF THE ORDINARY

Global Investment View

Q4 2024 – Prospects of a new cycle

Contents

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The Global Investment View distils the thinking of the Global Investment Strategy Group (GISG) that brings together the insights of Investec Wealth & Investment's professionals in the UK, South Africa and Switzerland. The Group meets quarterly to map out our outlook over the following 18 months, setting a risk budget and identifying some of the potential icebergs that lie in the global investor's path.

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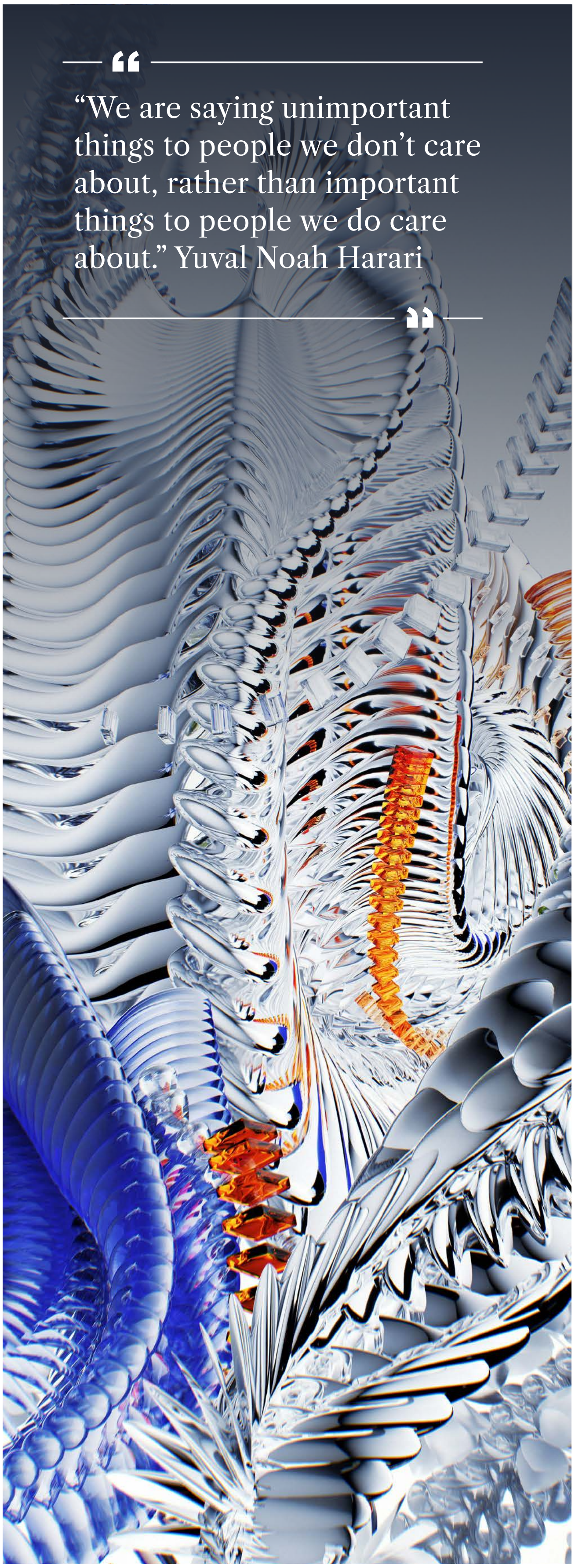
FOREWORD: *Relationships beyond human scale*



Can the new technology available to us now, help us to enhance our relationships? **And can our wealth enhance our relationships?**

We are living through a time of extraordinary innovation. As with the invention of the steam train and the printing press, the roll out of artificial intelligence (AI) is bringing change, disruption, and opportunity.

As a kind of barometer of how much technology matters economically, technology stocks now make up around 25% of the MSCI World Index. AI has grown dramatically as a contributor to this, but is harder to separate out, being part of a technology company's business. The Nasdaq CTA Artificial Intelligence NTR Index went up 152.25% from 20 March 2020 to 16 February 2021 and then dropped 43.48% 12 October 2022). It is currently down 5.28% year-to-date (25 September). We currently hold a diverse mix of technology stocks many of which are AI enablers and beneficiaries, such as Nvidia, ASML, Microsoft, Alphabet, Amazon, Apple, and Palo Alto Networks.

The innovation of communication technology means we can simultaneously get a message on email, on Teams/Zoom, on WhatsApp, social media and have someone trying to talk to us in person. Social media platforms like Facebook and Instagram allow us to connect on a broad scale with people across the globe. Professional networks like LinkedIn also allow this global connectivity. AI has further enhanced communication. We can send and receive streams of AI "personalised" sales messages on Linked-in. Chat GPT 4 can translate real time, between people communicating in different languages. And we can now access chatbot therapists.

This is exciting, but it does mean that we are living through a time of paradox. As a species we have never been more "connected", and yet there is a global pandemic of loneliness or social isolation and a sense of being overwhelmed *https://www.theguardian.com/global-development/2023/nov/16/who-declares-loneliness-a-global-public-health-concern*.

Data researcher Brene Brown calls this circumstance "living beyond human scale" and asks the question: how do we use the technology and innovation beyond human scale to optimise our lives without crumbling? The answer may well be through a different form of connection.

The longest study of happiness, the Harvard Study of Adult Development, followed a large population of adults for eight decades, uncovering what contributed most to their wellbeing.

The result of this 85-year study was that it wasn't money, material positions nor professional success that guaranteed happiness; rather, it was the quality of our relationships and our health that mattered most.

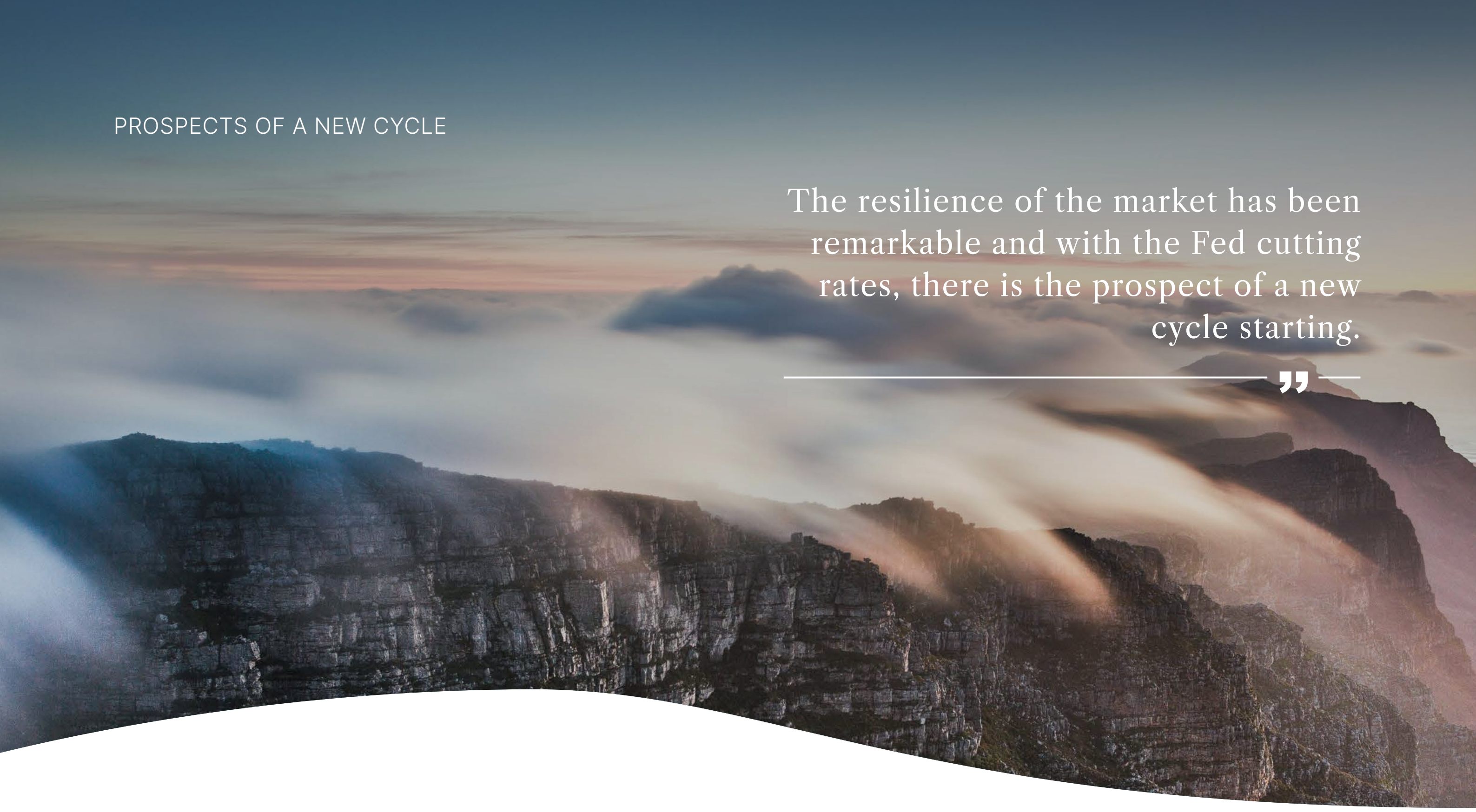
It also found that while loneliness was common, fostering social connections and regularly practising social skills reduced it.

If our relationships are the most important contributor to happiness, how can we foster them during this time? Relationships require presence, time, deep listening, and full attention.

Our wealth could serve us in this, creating more connection, perhaps by outsourcing some of our time-consuming tasks, so that we can spend more time fostering our relationships. We can use our resources to gather friends or family. Or could become more integrated into society or community through philanthropy.

We can use wealth to both invest economically in technology and to fund more time for nurturing our important relationships; creating relationship depth to balance the breath afforded by technology and AI.

Marc Romberg & Ali Nortier
Joint Heads of Wealth Management



> The resilience of the market has been remarkable and with the Fed cutting rates, there is the prospect of a new cycle starting.

The GISG kept its global risk budget score at -1 on a scale of +3 to -3, while the SA risk score was maintained at 1.5 on a scale of -3 to +3

Increase Risk Allocation

Neutral

-3	-2	-1	0	1	2	3
Equivalent to 15% underweight equities		Global is here			South Africa is here	Equivalent to 15% overweight equities

Summary

Global markets have recently been subject to two sizeable risk-off events – and full recoveries. The resilience of the market has been remarkable and with the Fed cutting rates, there is the prospect of a new cycle starting.

However, there are still several reasons for caution. The US labour market continues to slow, Chinese growth continues to disappoint and the growth outlook for Europe remains weak. Rate cuts may take some time to take effect and, given the current economic backdrop, we would prefer a larger margin of safety in global risk assets.

In contrast, we expect growth in South Africa to surprise on the upside over the coming few years. This expectation is at odds with what is currently priced into South African assets. We expect South African equities and fixed income to perform strongly over the coming few years.

Rationale:

Volatility has increased. Since the last GISG meeting, there have been two sizeable risk-off events. In both cases, the US market underperformed emerging markets and the US dollar was not as strong as one would expect. The committee debated whether elevated valuation for both the equity market and the US dollar meant that US equities and the dollar would not provide the same protection they normally would in a large risk-off event.

Inflation forecasts have been revised down. The current consensus forecast is that US inflation will average 2.9% this year, down from 3.2% at the time of the last GISG meeting. Even so, the consensus view is that US inflation will remain above 2% until at least the second quarter of 2025.

Little threat to inflation. Global energy and agricultural prices continue to be weak – suggesting lower headline inflation ahead. Even though the disruption to transit through the Suez Canal is likely to persist, we do not expect disruptions to global trade to materially affect global inflation.

The US labour market is weakening. Nonfarm payrolls have been trending lower of late and are now running at a rate roughly consistent with population growth. Any further slowdown will likely see the unemployment rate increase quickly. Historically, once the unemployment rate starts to increase it marks the beginning of the end of the economic cycle. There is a range of other indicators that also suggest that the US labour market is no longer tight, including falling job openings and quit rates.

Signs of pressure on consumers. Consumer financial health at the low end has deteriorated markedly, as evidenced by increasing charge-offs at banks and the latest set of results of companies that service the low end.

Markets do not appear to be concerned. Despite the evident shift in the labour market, the consensus view is that the US economy will grow at 2.5% this year, followed by 1.7% next year – a mild slowdown. There is some risk of a growth undershoot next year, even if a recession is avoided.

Growth for the past two years and consensus for the next two

	2022	2023	2024	2025
USA	2.1	2.5	2.5	1.7
Japan	1.1	1.9	0.1	1.2
EU	3.45	0.5	0.7	1.3
Germany	1.9	-0.1	0.1	1
France	2.6	0.9	1.1	1.2
Italy	3.9	0.7	0.8	1
Spain	4.6	2.4	2.6	2
UK	4	0.3	1.1	1.3
China	3	5.2	4.8	4.5
South Africa	2.3	0.6	1	1.64
DM	2.73	1.68	1.72	1.67
EM	3.06	3.94	3.91	4.28
World	3.1	3	3.1	3.1

Date: 04/09/2024

Source: Bloomberg, Investec Investment Management

The Fed to continue to cut. The US Federal Reserve has signalled that it would prefer to not see any further deterioration in the labour market and that inflation is at a level that it feels comfortable with. Given elevated real rates, we can expect the Fed to cut meaningfully over the coming year. Rate cuts should provide some relief to consumers and offer the potential for growth to remain resilient.

The ECB is cutting too. Inflation is close to the central bank target, and growth is weak. The next result is that the European Central Bank (ECB) is likely to continue to cut rates for the foreseeable future.

There are risks to the US housing market. Rate cuts raise the prospect of lower mortgage rates – which should see a thawing of the US house market. Even as rates are cut, the aggregate amount spent on interest on mortgages could well go up as people move and finance at higher rates than their prior bonds. Lower rates should see more supply coming to the housing market – which could also depress prices. Having said that, our base case remains that US house prices remain flat over the year ahead.

The US presidential election is too close to call. While Kamala Harris has a clear lead in the polls and betting market, the election is still too close to call.

Tariffs to increase. Irrespective of which candidate wins the US presidential election, it is likely that tariffs on imports will increase next year. The net result is potentially lower fiscal pressures at the cost of reduced consumer spending.

Fiscal pressures are building. The US government interest bill is near 3% of GDP, the highest in at least 60 years. At some point soon the interest bill will start crowding out other federal expenditures in the US.

Excess savings are being depleted. We expect that at some point in the not-too-distant future US excess savings will be eroded. The wealth effect implies some resilience in spending given the strength of the S&P 500 but we still expect spending to slow. Growth in spending will likely continue to be divergent across income groups in the US.

The Fed to ease up on quantitative tightening. The Fed's slowing of quantitative tightening should provide liquidity to US fixed-income markets – and take away some upward pressure on yields.

Commercial real estate prices to continue to decline. We expect that commercial real estate prices in both the US and Europe will continue to decline – but not enough to pose a systemic risk.

Margins have been high – but can they persist? US corporate margins have persistently surprised on the upside over the past year, resulting in earnings proving to be more resilient than expected. New technology – such as the widespread use of AI – implies that margins will remain high.

There are risks to the Chinese outlook. The three-month average of total social finance, a key leading indicator for the Chinese economy, is down year-on-year, implying a soft nine months ahead. Rising exports may prove to be temporary as pre-tariff stockpiling is satiated. House prices continue to deflate, which will likely have knock-on consequences for consumption given wealth effects. While inflation is well below the central bank target, there is a risk in cutting rates due to low bank margins.

> “While Kamala Harris has a clear lead in the polls and betting market, the election is still too close to call.

Low bond yields offer the potential for fiscal stimulus but there has been little indication that it will be implemented on a large scale. The net result is that Chinese growth is likely to be underwhelming for the foreseeable future.

Having said that, both high yield and investment grade credit spreads are well below the levels seen in September 2022, around the time that an Evergrande default became apparent.

> “It could well be that widespread adoption of AI ushers in a new era of productivity growth, but there is also the risk that it takes longer than the market expects to occur.”

> While the EU and emerging markets screen as approximately fair value using our valuation technique, the US market still screens as around 30% overvalued.

Will spending on AI prove to be justified? Capex on AI has ramped up – with little sign of return on investment yet. It could well be that widespread adoption of AI ushers in a new era of productivity growth, but there is also the risk that it takes longer than the market expects to occur. In the interim, there is a question mark over the extent to which recent investment will generate returns for investors.

Earnings forecasts are still optimistic. Despite signs of an imminent slowdown in US and global growth, the consensus forecast is still for double-digit earnings growth this year. There is a material risk of sizeable downgrades over the coming months, even if margins remain higher than average.

The US market is expensive. While the EU and emerging markets screen as approximately fair value using our valuation technique, the US market still screens as around 30% overvalued. European equities trade at a near-record discount to the US using a variety of valuation techniques.

South African market view and asset allocation – keeping the local risk score to 1.5

Opportunities in South Africa. In principle, there are two primary drivers of growth in South Africa – the external environment (estimated using commodity prices) and the internal environment (estimated using South African business confidence). History shows that the economy can grow above 3% in an environment where global commodities are mildly weak – if South African business confidence picks up. We expect that to be the case this time. We expect GDP growth of 2.5% to 3% over the coming five years, well above the consensus forecast and well above what we think is priced into the market.

	Nelson Mandela	Thabo Mbeki	Thabo Mbeki 2	Jacob Zuma	Jacob Zuma 2	Cyril Ramaphosa
Industrial metals[1]	6%	-9%	144%	9%	-17%	32%
Business confidence[2]	40.2	44.0	71.7	40.3	38.4	33.2
Employment growth p.a.[2]	2.0%	2.1%	6.7%	0.9%	1.3%	0.7%
GDP growth[2]	2.7%	3.4%	4.8%	1.1%	1.1%	0.5%
Real trade weighted ZAR[3]	9%	17%	-18%	3%	18%	0%
Inflation[4]	8.0%	5.7%	5.6%	5.4%	5.5%	4.9%
10 year bond spread	9%	7%	4%	5%	6%	7%

[1] Average relative to previous presidency
[2] Average during presidency
[3] Average relative to previous presidency. - ve indicates strength
[4] Inflation targeting only came into effect in 2003

Source: Investec Wealth and Investment, Stats SA, Bloomberg
Date sourced: 11/09/2024

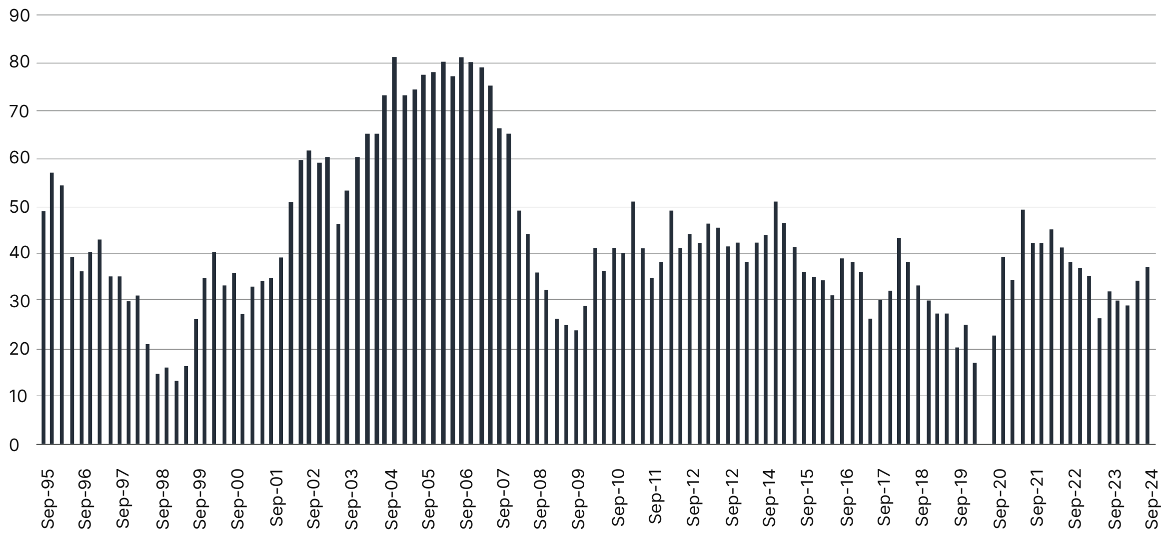
> We expect GDP growth of 2.5% to 3% over the coming five years, well above the consensus forecast and well above what we think is priced into the market.

We are already heading in the right direction. Business confidence has already picked up after the election and we expect it to continue to increase as the performance of state-owned enterprises (SOEs) continues to improve and the Reserve Bank continues to cut rates.

> Rail tonnage has increased over the past year, as has the number of containers handled at South African ports.

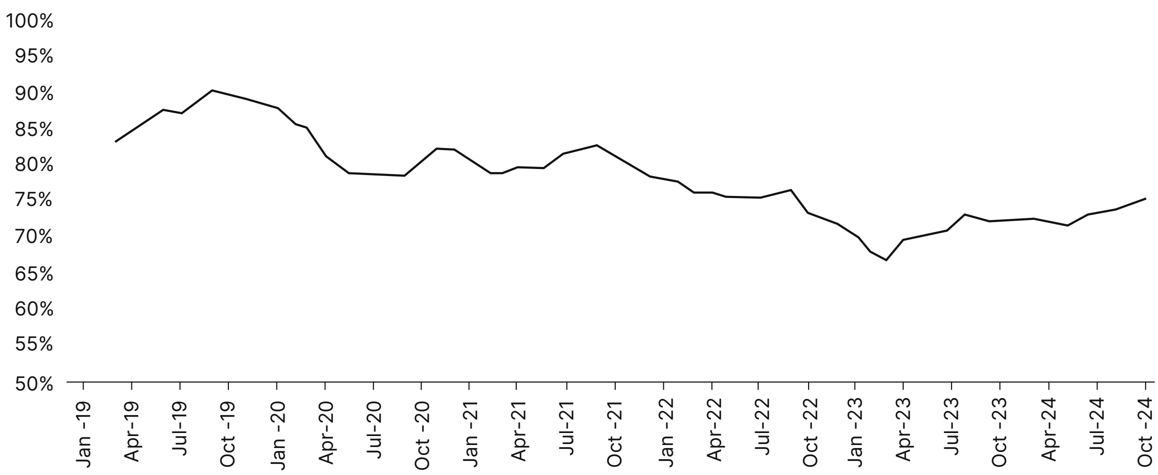
Signs of structural improvement. Rail tonnage has increased over the past year, as has the number of containers handled at South African ports. In addition, Eskom's energy availability factor is at the highest level since 2021, with planned maintenance at a four-year high too. The improvement of SOEs eases the binding constraint on GDP growth and suggests some upgrades to South African GDP growth, and earnings, are due.

BER SA business confidence



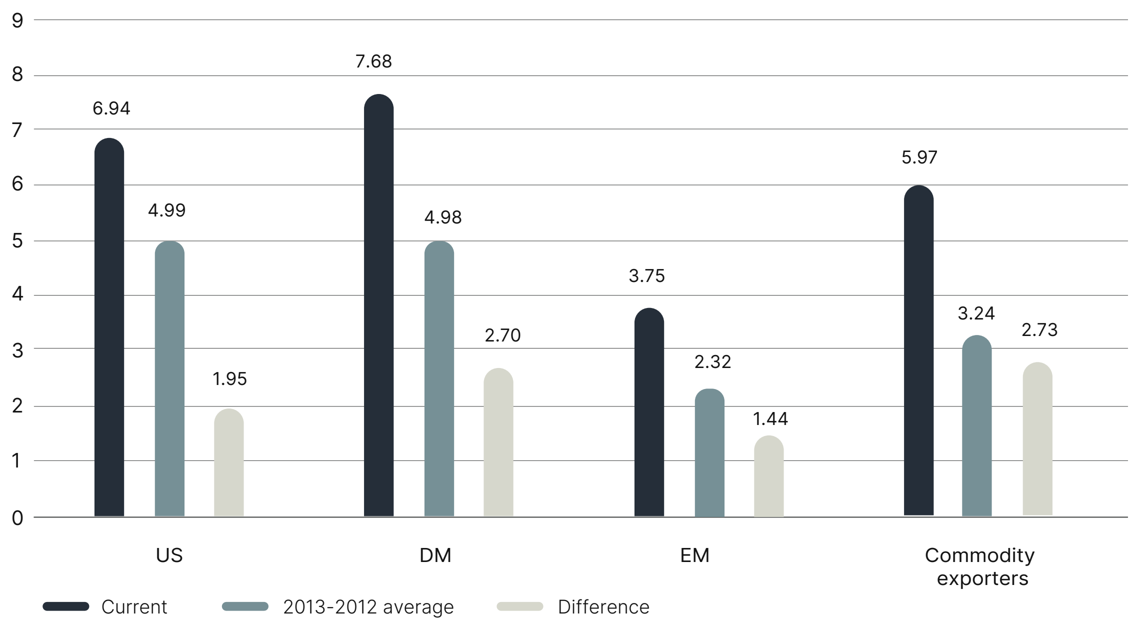
Date sampled: 09/09/2024
Source: Investec Wealth & Investment, Bloomberg

SA SOE performance index



Date sampled: 11/09/2024
Source: Investec Wealth & Investment, Stats SA, ESKOM, Transnet

Spread between SA 10 yr bond yield and peers



Date sampled: 12/09/2024

Source: Investec Wealth & Investment, Bloomberg

> We expect South African consumer inflation to get to around 3% by October, allowing ample scope for further rate cuts.

A normal environment implies strong returns for South African assets. Given the structural improvements in the economy, we do not think it is unreasonable to expect the price/earnings multiple of the local market to revert to the long-term average and for earnings to grow in line with the long-term average. In total, that would imply double-digit annualised returns for the All Share Index (ALSI) over the coming year.

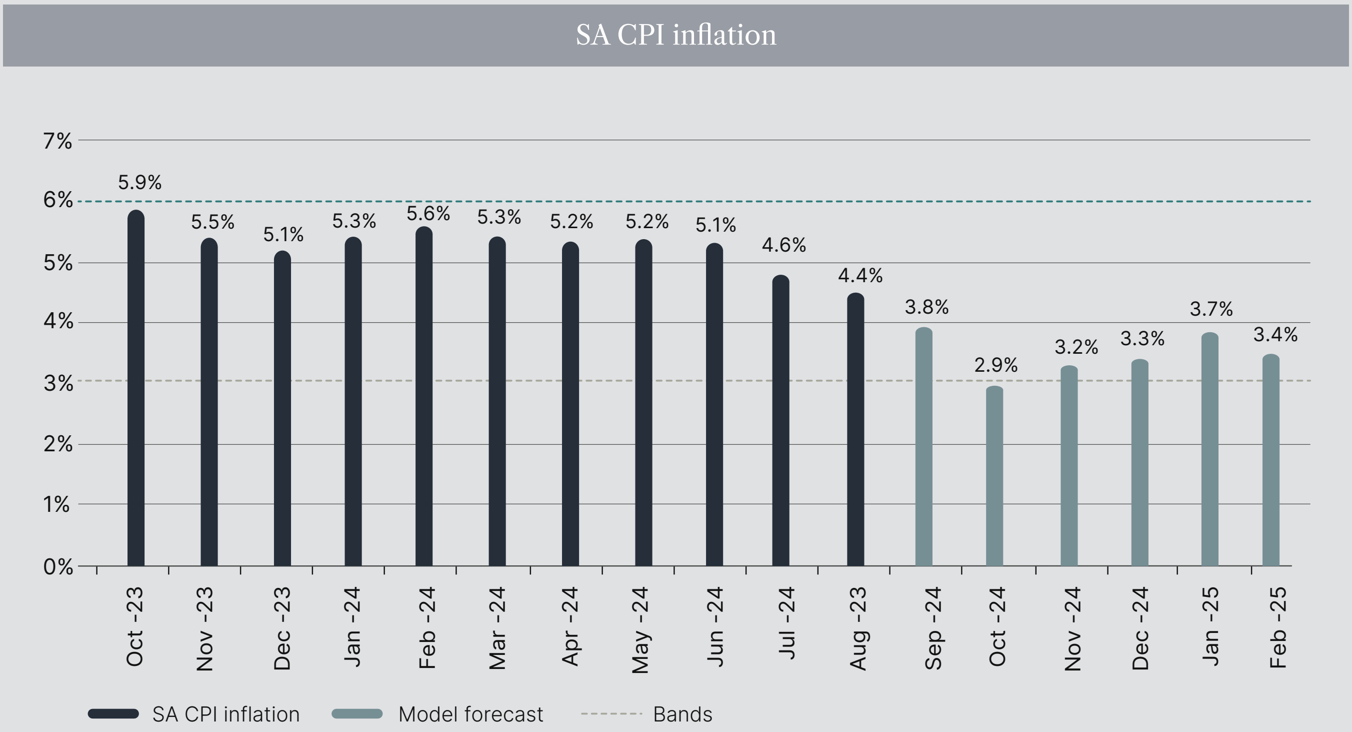
SA risk spread to narrow. Pre-2012 the average spread that the South African long bond yield traded at relative to the US was around 500bps (five percentage points). It is currently nearly 700bps. A normal environment in South Africa implies strong fixed-income returns ahead. Even so, we prefer bonds that are in the "belly" of the curve, rather than at the long end, given recent strong performance.

Inflation to decline. We expect South African consumer inflation to get to around 3% by October, allowing ample scope for further rate cuts.

South Africa is cheap. Despite the nascent signs of a turnaround, South African assets still trade at a material discount to global peers. South African equities, bonds and the rand all trade materially below our estimate of fair value.

South African equities are attractive. The South African equity market is unequivocally cheap. There is upside risk to earnings forecasts too, given the improving electricity situation. We have increased our South African equity allocation to overweight while keeping South African bonds at overweight. We have funded the increased allocation by reducing cash.

Small and mid-caps are attractive. Even after the recent rally, we expect South African mid and small-caps to do well over the coming year. Mid and small-caps should be primary beneficiaries of a stronger growth environment, and we expect will start to draw the attention of global investors.



Date sampled: 19/09/2024

Source: Investec Wealth & Investment, Bloomberg

PROSPECTS OF A NEW CYCLE

'SA Inc.' is our preferred sector. We expect that improving electricity availability and a potential reduction in rates will see a re-rating, with upside risk (potential) to earnings forecasts.

Fixed income should outperform as rates are cut. We have analysed the performance of fixed income, equity and gold at the start of rate-cutting cycles in the US since 1974 and in South Africa since 1998. In both the US and South Africa, government bonds have regularly outperformed equities, gold and cash during the first one-and-a-half percentage points (150bps) of rate cuts.

The rand is close to fair value. Following its recent gains, the rand is now trading in line with our basket of emerging market commodity-exporting peers.

> **A note on the reconciliation with the GISG score.** The GISG score is -1 on the back of recent strong global equity performance while the economic outlook has not appreciably changed, and US equities are still expensive. The outlook for South Africa has materially improved and there is still a significant margin of safety in South African assets in our view, leading us to increase our South African risk score to 1.5

Valuation and asset allocation:

The SA risk score has been maintained at 1.5

Based on our estimates, South African asset classes screen as cheap both in an absolute sense and relative to peers. Global assets screen as expensive.

Equities: Screen cheap with structural tailwinds. SA Inc. is the favoured sector. Overweight.

Bonds: Screen cheap with the prospect of support from lower global bond yields, and lower local inflation and rates.

Cash: We expect the SA Reserve Bank to continue to cut rates.

Gold: Overweight as a geopolitical hedge.

Asset Allocation Positioning:

The metrics below show our asset allocation positioning for global, domestic and by theme.

--	Underweight
-	Moderately Underweight
N	Neutral
+	Moderately Overweight
++	Overweight

GLOBAL ASSET CLASS	Q3 2024	Q4 2024	COMMENTS
Global Equity	-	-	GISG score negative. Global growth set to weaken with sizeable downside risk to earnings forecasts. US market does not offer sufficient margin of safety.
Global Fixed Income	+	+	Global FI screens as attractive. US nominal bonds in particular.
Global Cash	+	+	Overweight given global uncertainty.
Emerging Markets	**N**	**N**	EM equities screen as reasonably priced, in contrast to US equities. EM rate cuts should provide support.
Global Property	-	-	Structural headwinds overwhelming improving valuation.
Global Alternatives	+	+	Offers attractive risk-adjusted returns relative to traditional long-only asset classes. Variations include return enhanced, capital protected and low correlation products.

LOCAL ASSET ALLOCATION	Q3 2024	Q4 2024	COMMENTS
SA Equity	+	+	SA equity market cheap. Structural reform staring to bear fruit. SA Growth likely to exceed expectations over coming few years.
SA Fixed Income	+	+	Rate cuts to provides support for Fixed income. Improving structural outlook for SA should be a tailwind too.
SA Cash	--	--	Short rate to decline materially over coming year. We prefer to be exposed to SA risk and get insurance from offshore cash and fixed income.
SA Preference Shares	**N**	+	Valuation at fair value but potential upside if banking preference shares are bought back.
USD/ZAR (+ for ZAR strength)	+	**N**	Recent ZAR strength has brough the ZAR close to fair value.
Physical Gold	+	+	Allocation to physical gold offers protection against SA and global risks, particularly the risk of higher than expected inflation. Also a hedge against rising geopolitical risk.

SECTORAL/THEMATIC POSITIONING	Q3 2024	Q4 2024	COMMENTS
Global Plays	-	-	Global outlook still in question, better value in SA Inc. shares.
Commodities	**N**	**N**	Strong long term support from global energy transition, neutral for now given global outlook.
Precious Metals	-	-	Better opportunities in diversifieds and SA Inc.
SA Plays	++	++	Expected decline in diesel costs over the coming year as electricity situation improves. Expected rate cuts helpful too. As sector becomes more attractive we expect sizeable inflows from underweight foreign and local managers.
		+	More opportunity in the SA focussed counters than at the index level
Small/Mid cap	+	++	Valuations still attractive. Improving growth outlook for SA not yet recognised in price of sector.

*A neutral indication can mean a zero allocation versus zero benchmark exposure

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