Investec
Wealth & Investment

OUT OF THE ORDINARY

Global Investment View

Q2 2025 – Turbulent Times

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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: *Think about risk*

Paying attention to old-fashioned risks is still a foundation of wealth management.

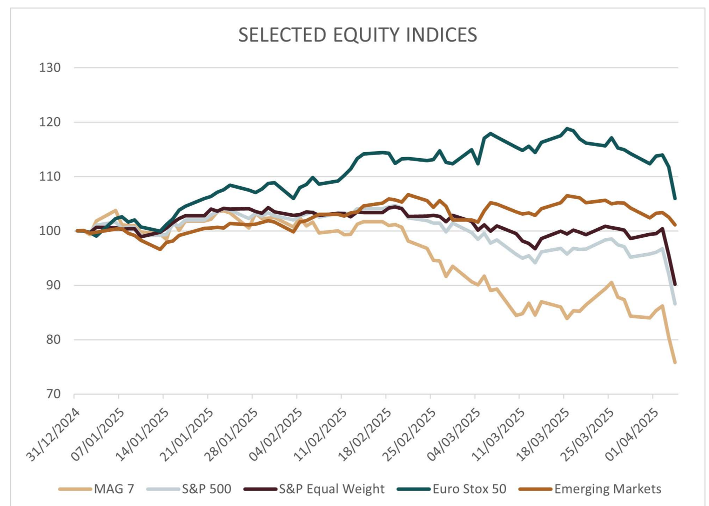
The year has started with many disruptions and market shocks. The Trump administration has been "a bull in a China shop", threatening and then imposing tariffs. The volatility after 'Liberation Day' has been extreme, creating mental whiplash and investor anxiety, but may also create opportunities.

We previously saw disruption to the Magnificent Seven, the group of US-based technology shares that had soared last year. These stocks have fallen dramatically, triggered by the news of DeepSeek, a Chinese competitor to OpenAI's ChatGPT. This was a reminder that outsized profits attract competition, and that attention to old-fashioned valuation and concentration risks is still an important foundation of wealth management in a world of new technology.

A crucial aspect of investment is that the starting price matters. While you may want to invest in a great company, if you enter at an inflated price, you'll find it challenging to make an outsized return, all things being equal. Additionally, inflated valuations leave little margin of safety. For example, it took 15 years for the Nasdaq to recover from falling from its peak in the tech bubble in 2000. While we are not saying that the market is in similar bubble territory, it is interesting to note that at the beginning of this year, valuations in the US were at historic highs relative to Europe, yet year-to-date European markets have significantly outperformed the US.

As wealth managers, our most challenging times are during bubbles and crashes. Today's 35-year-old investor was only 10 years old during the tech crash, and 18 during the 2008 financial crisis. We need to deal with different risk tolerances between generations – such as those who have experienced a tech crash and those who haven't and might be inclined to divest from diversified portfolios and invest in single stocks at heady valuations. Markets are cyclical and patience through these cycles is essential if you want to create and maintain wealth.

Year-to-date returns – Magnificent Seven, S&P 500, S&P 500 (equally weighted) Eurostoxx 50 **and emerging markets**



Source: Bloomberg, Investec Wealth & Investment International, 1 April 2025

During bubbles or times of highly concentrated returns, risk management becomes especially important. Periods of large concentration in market thematic or single stocks can make active management seem ineffective. However, trying to beat an index in such an environment can lead to large positions in single stocks that leave your portfolios vulnerable to both company and thematic headwinds. For example, to benefit from an overweight position in Apple, you would need to hold at least 7% of your portfolio in the company (it's 6.6% of the US index). Similarly, you would need to hold more than 6% in Microsoft and over 5% in Nvidia. Bringing the example back home, Naspers was a dominant component of South African indices for many years and peaked at 26% of the JSE SWIX in November 2017. Any manager who had trimmed their position or considered it imprudent to hold 26% of their portfolio in the counter would have underperformed the index. (It's worth noting that Naspers fell 33% in the year after its weighting in the JSE SWIX peaked).

Diversification is one of the ways we manage risk and it's worth remembering that if you don't have something in your portfolio that's creating discomfort or irritation at any time, the likelihood is you are not truly diversified. True diversification implies investing in a spread of assets that aren't correlated and have different characteristics. This helps to reduce overall volatility.

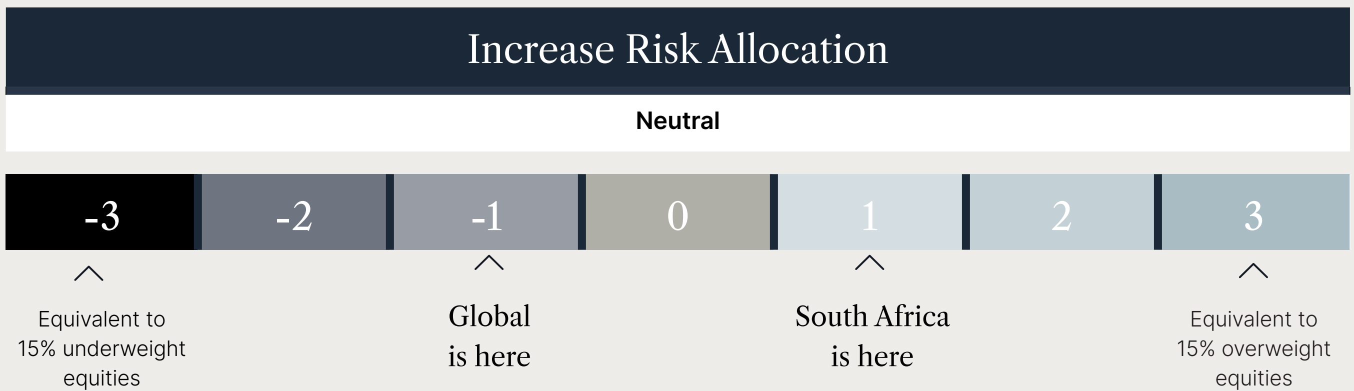
To close on a similar note, we are seeing the diversification idea being carried out in the field of global trade. Almost in anticipation of the recent shock changes by the Trump administration in foreign aid and trade policies, China had already started diversifying its trade away from the US some time ago. China started to do this when Trump was first president, and since then, US exports to China have fallen from 22% of total exports at the start of Trump's previous term, to around 15% of exports today. China has spent the last eight years rewiring its supply chain, and our research shows, it is now the number one trading partner for over 100 countries around the world: it has a significant cushion to absorb trade route disruptions.

Churchill is reported to have said that "those who fail to learn from history are doomed to repeat it". Diversification valuation and time in the market are meaningful lessons from history and worth keeping in mind at times like this.

Marc Romberg & Ali Nortier
Joint Heads of Wealth Management

In contrast to the US, there are increasing signs that European GDP growth will reaccelerate. Fiscal stimulus should spur growth and a peace deal in Ukraine may well boost growth in the short term.

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



Summary

Economic uncertainty in the US has led to a material pullback in US equities. Even after the recent decline, we estimate that the US equity market is still somewhat expensive. In addition, there are increasing risks – the labour market is due for a slowdown, tariff uncertainty is elevated and there are rising risks for the US housing market. US consumer balance sheets are still strong though, and while the Fed is unlikely to cut interest rates in the near term, they have the space to cut should there be a downturn.

Fiscal stimulus in Europe should spur growth and a peace deal in Ukraine may well boost growth in the short term, in part offsetting the consequences of higher tariffs. China too is implementing stimulus measures, and in the light of low inflation has the space to stimulate further. South African assets remain cheap in our view, but the slowdown in structural reform has raised questions about how sustainable a recovery is likely to be, along with increased tariff-related uncertainty.

Rationale:

Uncertainty is elevated. Shifts in US trade policy have introduced sizeable volatility into global markets and have been met with a swift downturn in global equities. Uncertainty is likely to remain elevated for the foreseeable future. It will take some time to fully measure the impact of the new US tariffs, if they remain in place. Should they persist, they are likely to lower growth and raise inflation – and be met with reduced earnings guidance from companies.

EU responds. In response to the US's apparent inward turn, the European Union (EU) has announced plans for sizeable stimulus aimed at shoring up defence and further funding an energy transition. There is a sizeable risk of tariff escalation.

Fiscal pressures are building. The US interest bill is over $1 trillion and presumably is now crowding out other expenses. While tariffs may raise some revenue, it is not clear that the unintended consequences won't further deteriorate US finances. The US also faces sizeable refinance risk as lower-yielding debt is rolled over at much higher yields. The debt ceiling has also become an issue again in the US, with the chance of a government shutdown later this year.

A wealth effect is looming. The wealthiest 10% of US consumers now account for nearly 50% of consumption. There is some risk that a fall in asset prices would be followed by a sizeable drop in consumption.

Consumer balance sheets are in good shape. While a slowdown in US growth is likely in our view, it is important to recognise that US consumers are far from over-leveraged.

Inflation is sticky. Global and US inflation is proving to be sticky, narrowing the scope for aggressive cuts by the Fed. Long-term consumer inflation expectations are high and tariffs raise the prospect of higher short-term inflation too.

"Inflation is sticky. Global and US in lation is proving to be sticky, narrowing the scope for aggressive cuts by the Fed."

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

	23	24	25	26
USA	2.5	2.8	2.2	2
Japan	1.9	0.1	1.2	0.9
EU	0.5	0.7	0.9	1.2
Germany	-0.1	-0.2	0.2	1.1
France	0.9	1.1	0.7	1.1
Italy	0.7	0.5	0.6	0.9
Spain	2.4	3.1	2.5	2
UK	0.3	0.8	1	1.4
China	5.2	5	4.5	4.2
South Africa	0.6	0.7	1.63	1.82
DM	1.68	1.77	1.72	1.78
EM	3.94	4.1	4.17	4.08
World	3	3	2.9	3

Date sampled: 27/03/2025 **Source:** Bloomberg, Investec Investment Management

The US labour market is still strong but is due to weaken. While the latest non-farm payrolls prints have been strong, several leading indicators are pointing to weakness ahead. Consumer employment expectations have plummeted, raising the prospect of increased savings, and reduced consumer spending. Cuts by the Department of Government Efficiency (DOGE) may well have the unintended consequence of a material pullback in consumer spending.

There are risks to the US housing market. Mortgage rates have come down and median house prices have declined too. The net result is that buying a new home is becoming more affordable and the housing market will likely start to unlock. Lower mortgage rates may well lead to an increase in the supply of homes as people move but will also be at a higher effective interest rate as people give up low mortgage rates for a higher one to enable them to move.

Commercial real estate prices are likely 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 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 artificial intelligence, implies the possibility that margins will remain high.

The US equity/bond market correlation is set to decline. Research shows that periods of low inflation volatility are associated with lower equity/bond market correlations. Inflation volatility has declined materially, suggesting a lower equity/bond correlation ahead.

Will there soon be an end to the war in Ukraine? Should there be a swift end to the war in Ukraine, we expect there will be a sizeable peace dividend for Europe. In addition, global energy prices would likely decline in that scenario.

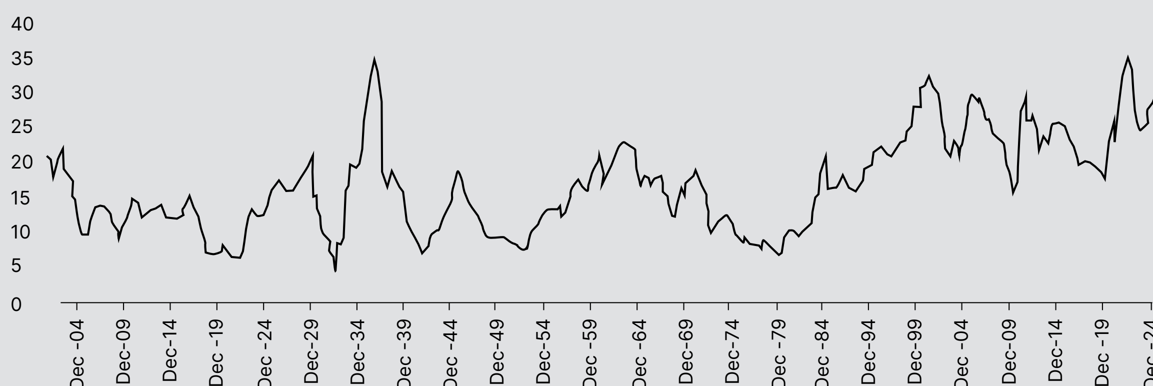
Will the Bank of Japan hike? Wage inflation in Japan remains strong, raising the prospect of increases in interest rates. Given current market volatility, any disruption to the carry trade is likely to be consequential for global markets.

China is ramping up. Chinese inflation remains well below target and there are increasing attempts to stimulate the economy. Leading indicators suggest that China is due a near-term reacceleration. Fears of problems in the real estate sector, such as the Evergrande situation in recent years, appear to have receded, based on current credit spreads.

Chinese innovation is ramping up too. China has recently taken the lead, or is close to the lead in autos, large language models, pharmaceuticals and fusion research. Progress out of China may well threaten margins in the West in a range of sectors.

> “China has recently taken the lead, or is close to the lead in autos, large language models, pharmaceuticals and fusion research.

US Equity Price/Trend earnings



Date sampled: 05/03/2025 **Source:** Investec Wealth and Investment, Shiller

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 40% overvalued. European equities screen as close to fair value.

The rest of the world (outside the US) is looking more attractive. Both earnings and dividend-based models show Europe, the UK, and emerging markets are now at or below fair value.

In summary, the US market still offers little margin of safety while the rest of the world equities screen as fair value/offering value.

More 'cons' than 'pros' to the market outlook. Tallying up the pros and cons of the market outlook gives a list weighted toward cons. There is still ample reason for a cautious approach, justifying our risk score of -1. We summarise the key pros and cons below:

Pros

- US labour market is still strong.
- US consumer balance sheets are strong.
- GDP growth has been resilient.
- Earnings growth has been resilient.

Cons

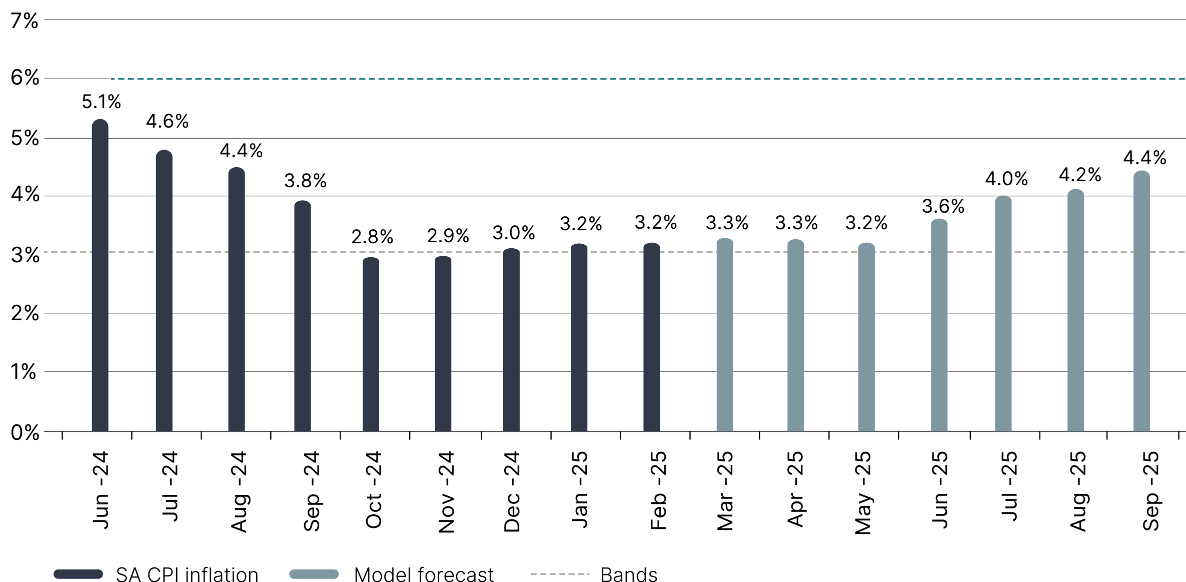
- Knock-on effects of tariffs.
- Inflation is sticky.
- Wealth effect looms.
- Valuation.
- We are at the back end of the cycle.
- Potential risks from commercial real estate.
- Fiscal pressure is building.
- The labour market is set to weaken.
- Earnings expectations are optimistic.

South African market view and asset allocation – reducing the local risk score to 1

South Africa's performance has been strong. South African assets have rallied strongly over the past year. South African equities have outperformed global equities, South African bonds outperformed global bonds and South African property outperformed global property.

Are SOEs stagnating? Among the key state-owned enterprises (SOEs), rail performance, port performance and Eskom's performance are all much better than the lows in 2023 but have also all stopped improving of late. Similarly, business confidence has recently stopped improving too. While South Africa may well still be in a cyclical recovery – spurred by consumer spend and an acceleration in Europe and China, there are still long-term binding constraints on growth that have yet to be lifted.

SA CPI inflation



Date sampled: 25/03/2025 **Source:** Investec Wealth and Investment, Bloomberg

Even so, the SA Reserve Bank will likely keep rates high. The SA Reserve Bank (SARB) has indicated that even though inflation is well below 4.5% and will remain so for some time, growth is weak and real rates are near 20-year highs, it is in no rush to cut rates. It is not clear under which conditions the SARB would cut, given that it did not cut at the March meeting. The market is expecting one rate cut by year-end.

Normalisation implies strong returns over the next five years. A normalised market price/earnings (P/E) ratio in line with historical averages, earnings in line with trend over the next five years would lead to 15% returns a year for South African equities, and 5% for US equities. It may well be the case that the South African equity market multiple does not fully revert to the historical average but even so, there appears to be a sizeable margin of safety in South African equities.

Europe is SA's largest trading partner, by far. Any stimulus in Europe will likely benefit South Africa. In addition, South Africa will likely be a beneficiary of stimulus in China. The net result is that while structural reform may have slowed, the external environment is likely to be more helpful, even if the US imposes tariffs on imports from South Africa.

Risk to the GNU? At the time of writing it is not clear that the Government of National Unity (GNU) will survive in its current form. Should the ANC land up with a minority government, there is a risk that a motion of no confidence will passed against President Cyril Ramaphosa, ending his term as president. In that case, Ramaphosa would not be eligible for another term and it is not certain that the next president will have pro-market policies.

South African equities are attractive. The South African equity market is unequivocally cheap. The local market is trading on a forward P/E of 10, well below the historical average and well below global peers.

Reconciliation with GISG. The GISG score is -1 based on concerns around the US market. The South African market is still cheap and any US dollar weakness will likely benefit the local market. Even so, a slowdown in structural reform and a strong rally in South African assets has seen the South African asset allocation committee reduce the South African risk score to 1.

"The local market is trading on a forward P/E of 10, well below the historical average and well below global peers."

Valuation and asset allocation:

The South African risk score reduced to 1

South African equities: Screen cheap with structural tailwinds. SA Inc and commodity price plays are the favoured sectors. Overweight.

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

Cash: We expect the SARB to continue to cut rates, even if slowly.

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	Q1 2025	Q2 2025	COMMENTS
Global Equity	-	-	GISG score negative. US economy likely to slow. US equities do not offer sufficient margin of safety.
Global Fixed Income	+	+	Global Fixed Income screens as attractive. We expect equity/bond correlation to be low.
Global Cash	+	+	Overweight given global uncertainty.
Emerging Markets	N	N	EM equities screen as fairly priced, in contrast to US equities. Dollar weakness should provide support too.
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	Q1 2025	Q2 2025	COMMENTS
SA Equity	+	+	We have lightened SA equity exposure at the margin while remaining overwieght. SA market is cheap but structural reform appears to have slowed.
SA Fixed Income	+	+	SA fixed income still offers a sizeable margin of safety in our view.
SA Cash	--	--	Underweight to fund overweight positions in equity and fixed income.
SA Preference Shares	N	+	Upside if more preference shares are bought back.
USD/ZAR (+ for ZAR strength)	N	N	ZAR close to fair value in our view.
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	Q1 2025	Q2 2025	COMMENTS
Global Plays	-	-	Global outlook still in question, better value in SA inc shares.
Commodities	N	+	Chinese stimulus should provide an underpin for commodity prices. Moved to overweight.
Precious Metals	-	-	Better opportunities in diversifieds and SA Inc.
SA Plays	++	++	SA recovery slowing. SA Inc shares have done well over the past year. Domestic monetary policy likely to be very restrictive for some time.
Property	+	+	More opportunity in the SA focussed counters than at the index level.
Small/Mid cap	++	++	Valuations still attractive. Slowing signs of structural reform a headwind.

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

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