

“Without strong watchdog institutions, impunity becomes the very foundation upon which systems of corruption are built.”

Rigoberta Menchú Tum

We have had a fantastic start to this year, thanks to the difficult decisions taken years ago, which are now bearing fruit. Many clients are enjoying double-digit year-on-year (ZAR and USD) returns without taking on undue risk. This has raised long-term returns marvellously, and we're extremely proud that clients are benefitting. The main reasons for the outperformance are the following:

1. Capital reallocation from developed markets (most notably the US) into long-held undervalued developing or emerging markets. The velocity with which this has happened, however, is a little concerning. We touch on this in our 6-month outlook below.
2. Anti-USD positioning in favour of the EUR and emerging market (EM) currencies, including the ZAR, has bolstered our USD returns. Originally implemented given the initial USD overvaluation, this is now reversed significantly. Again, we touch on this in the forward outlook below.
3. Gold has been a market darling for the last year, and we've held our positions into this strength, with intermittent profit taking. Gold is now lingering at all-time highs, but we're still confident it will be a store of value in times of systemic market risk.
4. The low-risk Orbis Global Optimal Fund, the backbone of most of our portfolios, has given excellent returns, even in a rising market, showcasing Orbis' ability to find unloved stocks that are beating their respective markets. The fund remains our largest holding as both valuations rise and concentration risk increases.
5. Maintaining South African equity exposure, despite the dire outlook (which we elaborate on later), has bolstered returns. We've banked profits in this regard for most clients, specifically clients leaning on a regular monthly income.
6. Our largest offshore equity funds - the Australian Balanced Fund Equity carve-out and the Japan Equity fund – have both given double-digit returns over the last year. Despite this acceptable performance, we're still holders of both funds, given that the Australian Dollar and the Japanese Yen still remain fundamentally undervalued.
7. Lastly, we still hold a large swath of interest-earning money market exposure, which is yielding between 7% and 10%, at virtually no risk. This also acts as a handy stockpile of cash to use advantageously should a compelling buying opportunity present itself.

With the above in mind, our main themes for the next 6 months are:

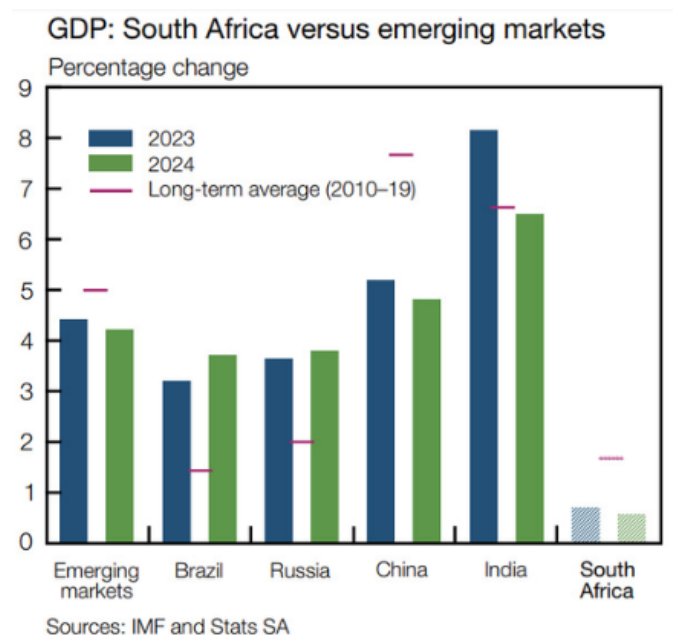
1. Reducing risk and profit taking, as many markets are at all-time highs with extreme valuations, specifically the US.
2. Seasonally, we are also moving into the worst time of the year for markets, and are thus more cautious than usual. Especially after markets have performed so well.
3. The US dollar has had its worst start to a year in 5 decades. For example, it has lost 10% against the Rand in the past three months at the time of writing. For the first time in years, we are buying the USD for selected clients.
4. Allan Gray's offshore funds are closed for local Rand-denominated investments, so we have shifted our allocation to a select group of Coronation funds. Coronation Fund Managers is amongst the most reputable investment houses in South Africa.
5. In light of our concerns about South Africa, we are now aggressively favouring overseas assets. There is a much larger universe of stocks – 50,000 companies overseas, versus only +/-300 in South Africa, and realistically, we only find 75 of those companies to be investable. South African companies have to adhere to the Employment Equity Act and B-BEE laws, which we believe negatively affect their performance and future prospects.

That being said, we are always adapting to changing market conditions and will allocate capital accordingly. One thing we know for certain is that volatility, both to the upside and downside, has seldom been higher.

South Africa

Unfortunately, political mismanagement, crime, corruption, rampant unemployment, and hurtful legislation are damaging the local outlook. We live in the Western Cape, which is generally sheltered from the chaos in the North and East of South Africa. We speak to local asset managers/advisers here in Cape Town who suggest that the Rand is undervalued and things should turn out fine. However, we also consult with clients who work and live in the trenches of Johannesburg, Durban and Pretoria, and they have a completely different opinion.

It becomes extremely difficult to ascertain which path South Africa will take. Sadly, a lot of the facts presently paint a depressing picture for the investment and economic landscape in South Africa.



Whilst trying to remain upbeat about the beautiful country we live in, we can't ignore these unsettling developments.

Lagging GDP growth relative to our BRICS peers. The chart above indicates just how poorly our economy has been growing, not only in 2023 and 2024, but also over a longer-term average. It is far below many of our emerging market peers.

Corruption is deeply rooted in our society. We believe that at every level of Government, there is corruption working to undermine the interests of hard-working politicians with even the best intentions, in the pursuit of self-interest. We are now of the opinion that unless there is a change of Government and major reforms, South Africa will continue to falter for the foreseeable future and struggle to recover.

It comes as no surprise to hear the recent allegations made by General Mkhwanazi against the Minister of Police, Senzo Mchunu, as well as accusations against other ministers and the judiciary in South Africa. We shudder to think how long these illegal activities have hindered political reform. The silver lining: at least the allegations are being made by a voice that carries weight in the eyes of many South Africans. Perhaps this is the beginning of an inflection point where deep-rooted corruption will be brought to light, instead of swept under the carpet like it has been for decades.



Political infighting, not just within the GNU, but the ANC as well. The ANC and its National Executive Council (NEC) are at each other's throats. President Ramaphosa is in an untenable position in our opinion. He, too, has been smeared with money laundering and corruption allegations with Phala Phala. How can he possibly call out any of his fellow ministers? Our concern is that President Ramaphosa may:

- be recalled by the NEC, leaving Paul Mashatile as our next President, or;
- have a vote of no confidence instituted by the Democratic Alliance cast against him, or;
- have his Presidency terminated with a new election called.

All of the above is fraught with danger. We do not feel that the current government, with all the benefits (legal and illegal) that accrue to members with very little danger of being prosecuted, would willingly hand over the keys to a non-corrupt replacement. The new government would hopefully investigate the corruption and misdemeanours of the past, with probable prison sentences for many of those found guilty.

America has also just slapped punitive tariffs on South African goods. Furthermore, we learn that America is going to hold the ANC's feet to the fire over the following issues, as a negotiation tool:

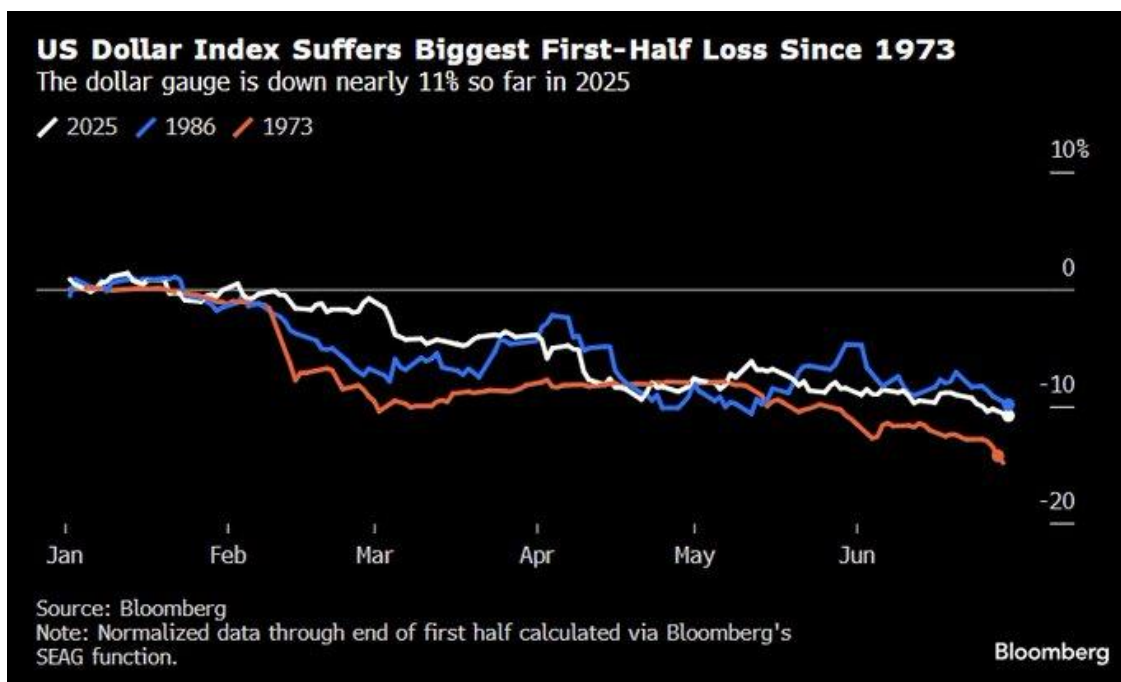


1. Farm attacks must be classified as a priority crime.
2. The chanting of "Kill the Boer" must be addressed.
3. The Land Expropriation Bill should be repealed.
4. American companies should be exempt from the Employment Equity Act.

We cannot envisage the ANC backing down from its stance on **all** of the above, and as such, we can expect a bumpy ride ahead for South Africa.

The Rand

Currencies are notoriously difficult to forecast. The US dollar is the most important trading currency for South Africa:



- South Africa imports critical goods like oil, machinery, and technology, which are often priced in US dollars.
- A weaker Rand raises the cost of imported goods, contributing to inflation.
- Rising interest rates in America (which we believe will be the case) will lead to capital outflows from South Africa, reducing investment in our local markets.
- South Africa holds most of its debt in US dollars.

South Africa is currently enjoying a stay of execution due to overall US dollar weakness. The Dollar index fell 10.80% as the dollar weakened sharply against most developed market currencies. The greenback is down 14.40% against the Swiss Franc, 13.80% against the Euro and 9.70% against the Pound this year. Emerging market currencies have also rallied, including the Rand. At some stage that will turn around, and we believe the Rand is vulnerable. The question we ask ourselves is, would you rather own a stronger ZAR or a weak USD?

- Over 5 years, the dollar is up just **3.71%** against the Rand.
- Over the last 10 years, the dollar is up **41%** against the Rand.
- Over the last 15 years, the dollar is up **130%** against the Rand.

We fail to see how the Rand can reverse course from its trajectory over the past 30 years. We concede that America has its problems, and emerging markets are cheap, but South Africa has its own set of unique challenges that consistently impede it from much-needed growth.

USD/ZAR Exchange Rate (5 years)



We really do not want to be a prophet of doom, but we would like to briefly use an example to emphasize our point; herewith a brief comparison between South Africa and Turkey – both emerging markets.

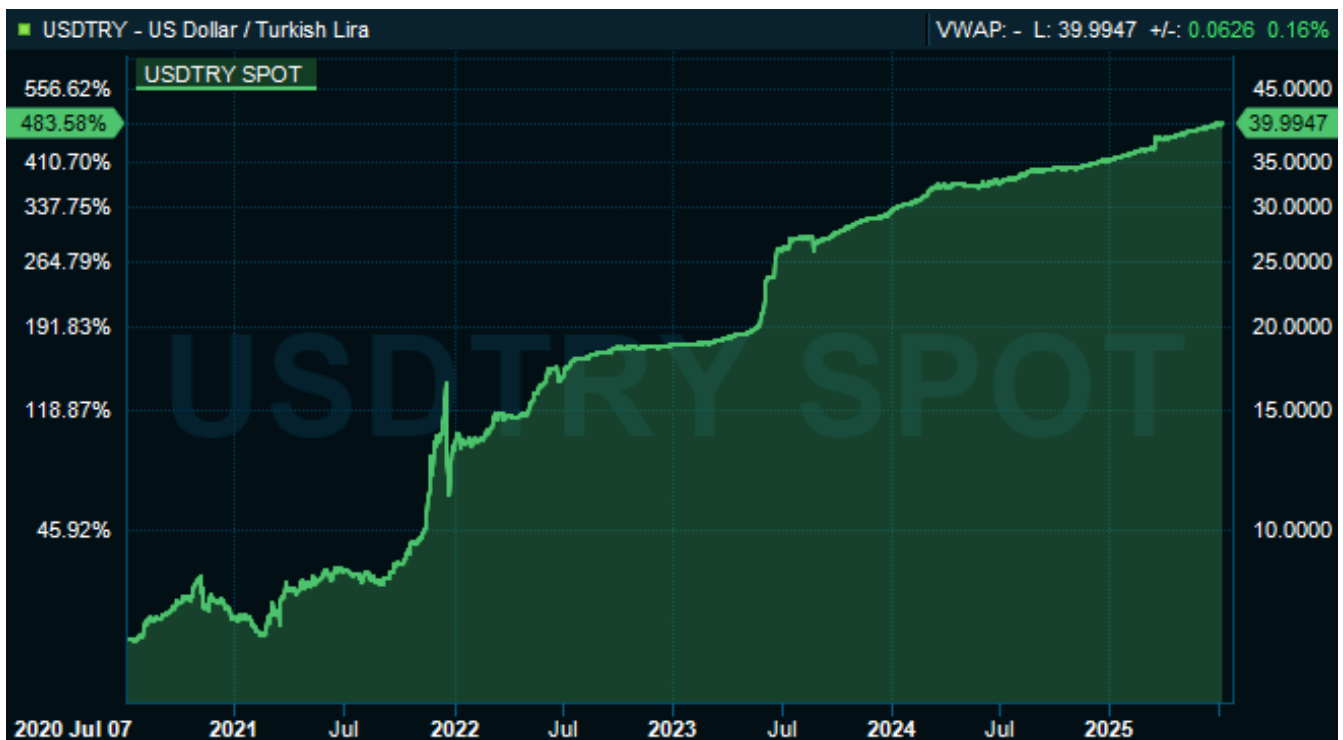
	Turkey	South Africa
Population	85 million	63 million
Average Age	34 years	30.4 years
Per Capita Income	\$11 730	\$6 480
Unemployment Rate	8.40%	33.20%
Corruption Index	34/100 (107 th place)	41/100 (82 nd place)
Absolute GDP (2023)	\$1 118 billion	\$380 billion

There are some stark differences; most notably, the fact that Turkey's economy (by absolute GDP) is almost 3 times larger than South Africa's, and the unemployment rate is 75% lower. Furthermore, the per capita income in SA is almost half that of Turkey, despite the latter having 22 million more citizens. The only statistic that South Africa comes out above Turkey is in their better corruption index rating. However, if you dive deeper, you'll find two frightening similarities between Turkey and SA:

- (1) they both have large and persistent current account deficits (spending more than they're earning) and
- (2) they both have large foreign-currency-denominated debt.

Now, couple this with the ANC's deteriorating foreign policy with the West (specifically Trump), and you have a similar brew responsible for the Turkish economic crisis of 2018, which is still ongoing. Study the chart below of the Turkish Lira (TRY) over a 5-year period against the US dollar – the dollar is up 483.83%. Inflation in Turkey has soared to 35.05%. Interest rates in Turkey are currently 46% per annum.

USD/TRY Exchange Rate (5 years):



As a Turkish retiree or investor, the global purchasing power of your savings was wiped out unless you had a sizable portion invested offshore. This is exactly why we are overweight offshore exposure for almost all our clients. Let this be a warning to all of us, advisers and clients alike - if this can happen in Turkey, it can certainly happen in South Africa.

Despite the above, a comment must be made on the tenacity of South Africa's private sector and its ability to withstand what often seem like insurmountable odds. A lot of the concerns raised above are simply the same issues that South Africa has been dealing with for decades, just wearing a different mask. One cannot forget that in the face of these problems, the JSE All Share has given an impressive 20.86% over 1 year, 12.79% p.a. over 3 years, and 11.70% p.a. over 5 years. The only figure that is lacking is the 10-year annualised return of 6.31% per year, mostly due to the poor performance during the 5 years before Covid.

Although this commentary might feel extremely negative on the back of some impressive performance, please don't mistake this negativity for events we hope to occur. Indeed, as South Africans, we truly hope that South Africa can avoid many of the pitfalls mentioned above. However, it is our job to protect your hard-earned capital against the concerns we have raised, and therefore, we must prepare for the worst.

If you have any queries, please don't hesitate to contact us.

We thank you for your ongoing support.

Sincere regards



Mike Carruthers



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Matt Carruthers