

INVESTMENT NOTE

20 JANUARY 2025

THE HOME OF THE BRAVE



IZAK ODENDAAL

OLD MUTUAL WEALTH
CHIEF INVESTMENT STRATEGIST

Today sees the swearing in of Donald Trump as the 47th US president. It is an odd American tradition that the inauguration takes place more than two months after the election, resulting in an awkward interregnum during which outgoing president Joe Biden was in office but not really in power. It could've been worse, however. Prior to 1936, the inauguration was in March. It meant that for five excruciating months between November 1932 and March 1933, during the deepest depths of the Great Depression, the country was effectively leaderless. Herbert Hoover, the outgoing president, spent most of this time trying to frustrate the transition to his successor Franklin Roosevelt. It is Roosevelt who in turn introduced the much-copied idea of 'the first 100 days' of his term as an important initial period of action, and it was indeed laying the groundwork for the eventual recovery.

Many investors view Trump's first 100 days with some trepidation. He promised many things on the campaign trail, but it is not clear exactly what, when and how they will be implemented. It certainly muddies the waters when trying to think about the year ahead for global markets (next week we'll focus on China and the following week on South Africa).

It would, however, be a mistake to assume that Trump is the only thing that matters. He can certainly cause market volatility in the short term, but larger economic forces (including geography, technology and demographics) dominate in the end and the impact of US presidents on the economy has historically been overstated. Other policymakers also matter, notably the Federal Reserve, headquartered a few blocks away from the White House.

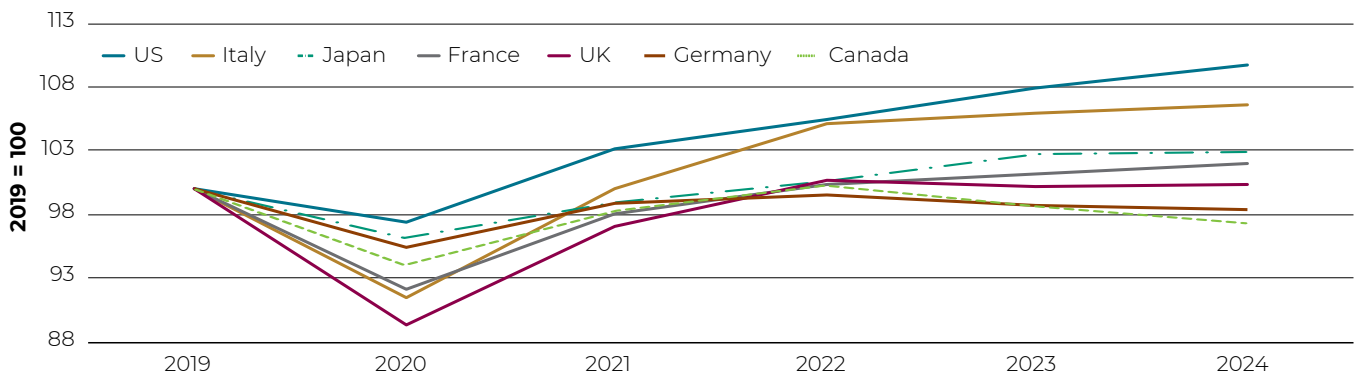


FINE, THANKS

The irony of Trump's 'Make America Great Again' slogan is that America's economy is in good shape at the moment, certainly compared to other major economies. Very much unlike Roosevelt, Trump enters office with an unemployment rate of 4.1%, near multi-decade lows, while GDP growth has been running around 3% over the past two years, well above

estimates of its long-term potential growth rate just below 2%. The booming US stock market has handsomely outperformed the rest of the world, not just during Biden's term, but over the past decade. And then there is the dollar, which is trading near 20-year highs on a trade-weighted basis.

CHART 1: REAL GDP PER CAPITA OF G7 ECONOMIES



Source: OECD

Now clearly, the economy is not working for everyone, otherwise the Democrats would have won the election. Most people were upset about high prices for groceries and fuel, as was the case across the world. Lower inflation, a slower increase in prices, did little to change the mood.

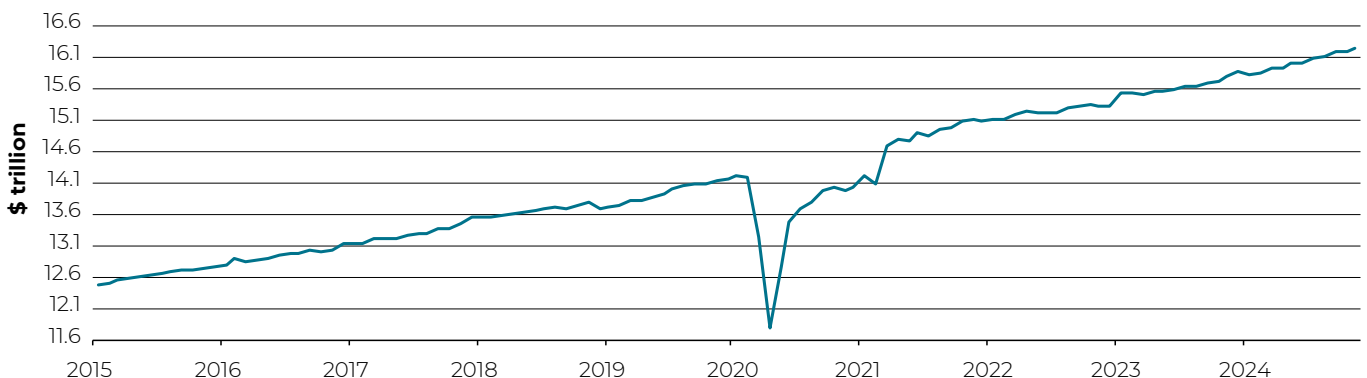
Lower-income families do not benefit from surging equity markets, and for many young people, the dream of buying a house is out of reach due to elevated mortgage rates and high house prices.

GROWTH RISKS

Looking ahead, there is bound to be a lot of noise, but two fundamental questions need to be top of mind: what is the risk of a US recession, and what is the risk of the Fed hiking rates again. Either of these two outcomes will cause a big bear market in global equities. Almost everything else will just be volatility.

Starting with the first question, solid current growth rates of activity, sales, income, and employment together with healthy private balance sheets and company profitability make it hard to see a recession in the near term. It is likely, however, that growth would slow naturally from such strong levels.

CHART 2: US REAL HOUSEHOLD SPENDING



Source: LSEG Datastream

Could Trump's policies accelerate the slowdown? That is obviously not what he wants, but then economic logic is not always what you get with him. Introducing steep import tariffs across the board could be incredibly disruptive, especially if other countries reply with tit-for-tat tariff increases. There is a view among many investors that his bark will be worse than the bite, however, and that the threat of tariffs is a negotiating tactic, as some of his advisers have suggested. Then again, perhaps he really is determined to shock the global trading system. If so, it will very quickly dampen the feel-good expectations of many business leaders.

If the tariff increases turn out to be narrow, targeted and not too high, the impact on US and global growth is unlikely to be significant, though specific sectors will be hit.

As for the other elements of the Trump agenda, it is also still too soon to know. Much emphasis has been placed on deregulation as a means of spurring growth, but the US is already less regulated than most other advanced economies. The boost from deregulation is not as big as might be expected.

Similarly, it is hard to see US oil production surging from current levels, since it is already at a record high of 13 million barrels per day. Trump promised lower fuel prices through increased production, but prices will in fact need to be higher to incentivise more output.

As for tax cuts, the 2017 tax cut package which favoured companies and the wealthy, was due to expire at the end of the year. It will be made permanent. However, to deliver a positive growth boost, additional tax relief will be needed.

RATES RISKS

Turning now to the second big question, the possibility of Federal Reserve hikes. If inflation was to move away from the Fed's 2% target, rather than moving gradually towards it, as is the case currently, the Fed would have to resume hiking.

Market pricing for where the fed funds rate will land has moved around wildly over the past year, as chart 3 shows. Pricing for end 2025 hit a high of 4.5% and a low of 2.6% (currently at 3.9%). So let no one say they know with confidence where rates will settle. However, pricing has consistently

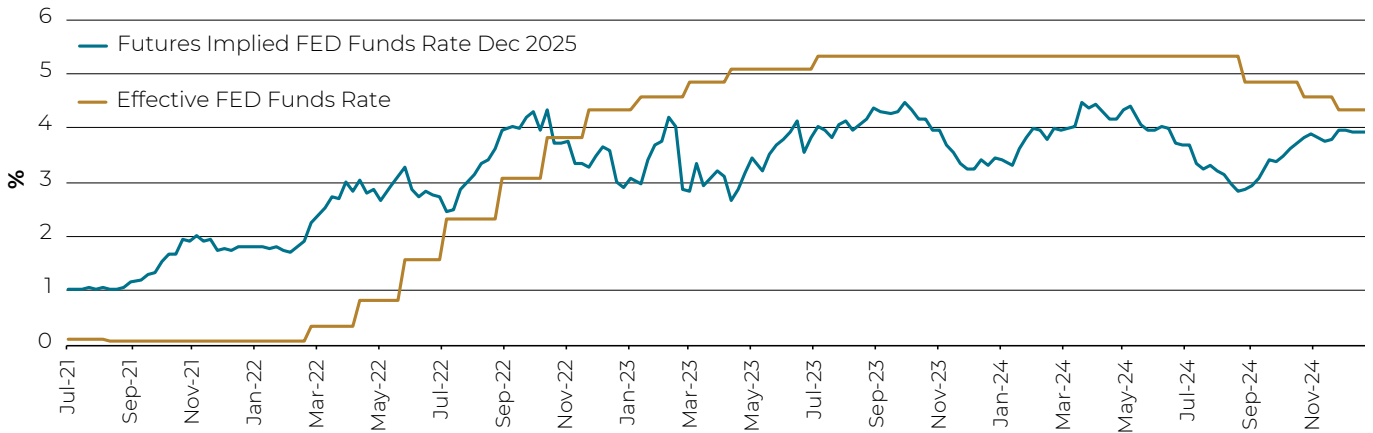
Team Trump argues that these can be funded by tariffs, i.e. as the US government gets more revenue from import taxes, it can reduce income taxes. However, this seems unlikely. The point of tariffs is principally to discourage imports and encourage local production, not to raise revenue. It is true that a century or more ago, tariffs were a major source of government funding, but the government was much smaller then. Therefore, tax cuts will either raise the deficit, which some Republicans will balk at, or require spending cuts, which is always politically unpopular so other Republicans in Congress could object to it. Although the Republicans won a decisive victory in November, they only have a five-seat majority in the House of Representatives and a handful of defectors could scupper any proposed legislation. There could be some cost savings and efficiency gains from Elon Musk's Department of Government Efficiency (DOGE) project – it is not an actual government department – but these will not be enough to offset tax cuts.

This is one area where the US economy is significantly weaker at the start of Trump's second term: the budget deficit (annual government borrowing) and debt level (stock of accumulated borrowing) are much higher than in 2016. These are usually expressed as a percentage of GDP. The US federal debt-to-GDP ratio is already nearing 100%, while the annual deficit is running at 6%, a shockingly large number for a strong economy. In most cases, deficits are only this large when there is a crisis, such as when Covid hit in 2020.

been that rates will be lower than where they are now. Rate hikes would really upset the apple cart.

What could cause higher inflation? If the US economy gets a further boost from Trump's policies, or because businesses feel more optimistic with a businessman in the Oval Office, it could overheat, especially if it runs out of workers due to new immigration restrictions. Add in upward price pressures from newly imposed tariffs, and we could see inflation accelerate away from the Fed's 2% target.

CHART 3: FED FUNDS RATE AND FUTURES PRICING, %



Source: LSEG Datastream

This scenario still seems unlikely, however. Tariffs, for instance, are not inflationary by themselves. They cause one-off price jumps, not necessarily ongoing price increases. The latter will really depend on the prevailing economic conditions and whether companies feel they have pricing power. In 2022, they did, and higher input costs due to supply-chain disruptions and higher commodity prices were passed on to consumers in the US and across the globe. Company margins expanded.

A strong dollar could also counteract the impact of tariffs. Indeed, the strong dollar presents something of a dilemma to the incoming administration. If you want to encourage domestic production and reduce imports, the last thing you want is a strong currency.

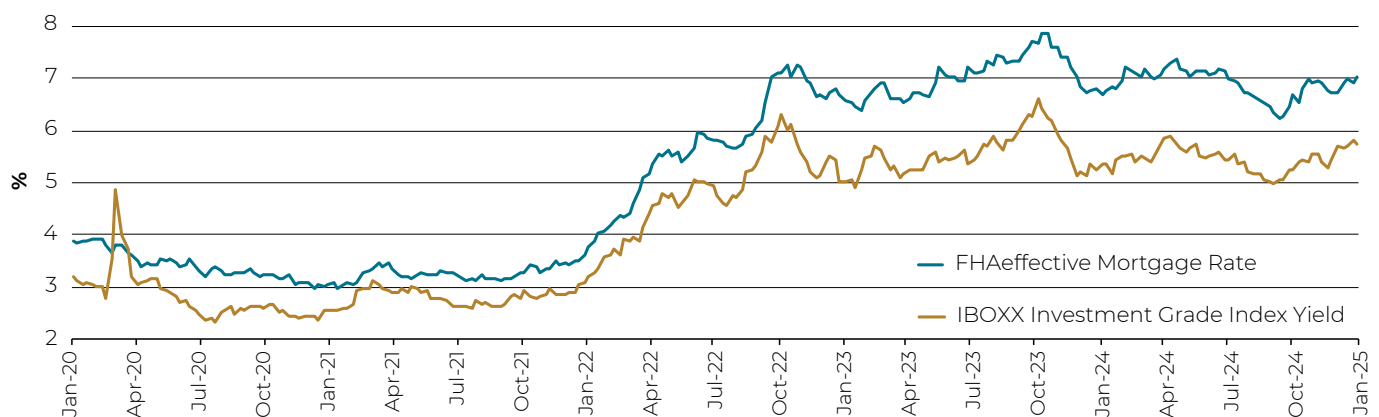
It will also be important for the Fed whether inflation expectations remain anchored. If people believe price movements are temporary, they are unlikely to change their economic behaviour. But if they believe that prices will rise more than 2% annually in the future, it could become self-fulfilling. One survey already shows that people who

identify as Democrats believe inflation will be much higher under Trump, while Republicans believe it will be much lower. This politicised split in outlook makes consumer confidence surveys much less useful as an indicator than in the past. Other indicators of inflation expectations, such as those expressed in the bond market, have not risen much.

Recent labour market and inflation data limit the case for Fed rate cuts over the next few months. However, if growth cools during the course of the year, the Fed is likely to resume lowering rates. It is still searching for – more like groping in the dark – the elusive neutral real rate where the economy is nicely balanced, and rates are neither too high or too low.

In the meantime, however, market-based long-term interest rates (bond yields) have increased in recent weeks even as central banks have been cutting short-term rates. This hurts households through higher mortgage rates and companies through higher corporate bond yields and is therefore one of the factors that will dampen growth this year. However, neither mortgage rates nor corporate bond yields have broken through the trading range of the past three years.

CHART 4: US MORTGAGE AND CORPORATE BORROWING COSTS, %



Source: LSEG Datastream

In summary, it will with no doubt be an eventful year in America, and because it is by far the most important economy to financial markets, it will be an eventful year for all of us. That is whether we like it or not. For people who must pay close attention to economic matters, the challenge is going to be staying focused on the fundamental picture, and not getting distracted by the sound and fury coming

out of the White House. For everyone else, if your portfolio is properly diversified, and your investment horizon is more than a few years, you can probably afford to tune out the noise. There is a certain kind of bravery to doing so, when all the headlines and all your instincts scream at you to act. However, doing nothing is also doing something.

EQUITIES - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US\$	3 778.0	2.72%	1.89%	1.89%	21.09%
United States	S&P 500	US\$	5 997.0	2.92%	1.96%	1.96%	26.55%
Europe	MSCI Europe	US\$	2 058.0	2.90%	2.75%	2.75%	6.08%
Britain	FTSE 100	US\$	10 349.0	2.79%	1.18%	1.18%	9.64%
Germany	DAX	US\$	1 827.0	3.57%	3.87%	3.86%	18.10%
Japan	Nikkei 225	US\$	246.0	-1.32%	-3.06%	-3.06%	2.74%
Emerging Markets	MSCI Emerging Markets	US\$	1 070.0	1.23%	-0.47%	-0.47%	11.69%
Brazil	MSCI Brazil	US\$	1 233.0	4.40%	4.76%	4.76%	-27.68%
China	MSCI China	US\$	62.3	3.28%	-3.33%	-3.33%	24.73%
India	MSCI India	US\$	985.8	-1.43%	-3.73%	-3.73%	4.77%
South Africa	MSCI South Africa	US\$	441.0	3.76%	2.56%	2.56%	20.49%

EQUITIES - SOUTH AFRICA (TOTAL RETURN UNLESS INDICATED OTHERWISE)

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Share (Capital Only)	All Share (Capital Index)	Rand	84 700.0	1.48%	0.72%	0.72%	18.14%
All Share	All Share (Total Return)	Rand	15 494.0	1.52%	0.79%	0.79%	22.53%
JSE Capped SWIX	Capped SWIX (Total Return)	Rand	38 072.5	1.53%	1.17%	1.17%	22.57%
TOP 40/Large Caps	Top 40	Rand	13 779.0	1.85%	1.15%	1.15%	20.74%
Mid Caps	Mid Cap	Rand	25 406.0	0.60%	1.04%	1.04%	23.85%
Small Companies	Small Cap	Rand	42 994.0	-0.84%	-2.91%	-2.91%	34.19%
Resources	Resource 20	Rand	5 088.5	1.23%	12.82%	12.82%	19.44%
Industrials	Industrial 25	Rand	25 430.0	2.35%	-2.32%	-2.32%	20.28%
Financials	Financial 15	Rand	15 624.0	1.11%	-0.50%	-0.50%	27.76%
Listed Property	SA Listed Property	Rand	2 358.2	-0.94%	-1.86%	-1.86%	29.22%

FIXED INTEREST - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
IBOXX Global Government S&P Overall (USD Unhedged)		US\$	73.5	0.83%	-0.55%	-0.55%	-3.55%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Bond	BESA ALBI	Rand	1 094.5	0.53%	-0.74%	-0.74%	16.52%
Government Bonds	BESA GOVI	Rand	1 077.8	0.51%	-0.74%	-0.74%	16.39%
Inflation Linked Bonds	BESA CILI	Rand	375.1	-0.32%	-0.41%	-0.41%	7.99%
Cash	STEFI Composite	Rand	596.9	0.15%	0.36%	0.36%	8.44%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US\$	80.8	1.29%	7.72%	7.72%	3.58%
Gold	Gold Spot	US\$	2 701.0	0.56%	3.25%	3.25%	33.65%
Platinum	Platinum Spot	US\$	949.0	-2.87%	3.72%	3.72%	7.47%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	18.75	1.91%	0.46%	0.47%	1.59%
ZAR/Pound	ZAR/GBP	Rand	22.81	2.28%	3.59%	3.59%	5.96%
ZAR/Euro	ZAR/EUR	Rand	19.25	1.71%	1.55%	1.55%	7.78%
Dollar/Euro	USD/EUR	US\$	1.03	-0.97%	0.49%	0.49%	5.83%
Dollar/Pound	USD/GBP	US\$	1.22	0.31%	2.73%	2.73%	4.37%
Dollar/Yen	USD/JPY	US\$	0.01	-0.88%	-0.58%	-0.58%	5.49%

Source: I-Net, figures as at 17 January 2025

The Old Mutual Wealth Investment Note is published on a weekly basis to keep our clients and financial planners informed of what is happening in financial markets and the economy and to share our insights. Markets are often very volatile in the short term and similarly, economic data releases or central bank actions may cause concerns for investors. This does not mean that investors should take action based on the most recent events. It is better to be disciplined and remain invested in well-diversified portfolios that are designed to achieve long-term objectives. Our Strategy Funds are actively managed, with asset allocation changes based on valuations and in anticipation of future real returns, and not in response to the most recent market noise. The future is always uncertain and that is why our Strategy Funds are diversified and managed with a long-term focus.



WEALTH

Old Mutual Wealth is brought to you through several authorised Financial Services Providers in the Old Mutual Group who make up the elite service offering. This document is for information purposes only and does not constitute financial advice in any way or form. It is important to consult a financial planner to receive financial advice before acting on any information contained herein. Old Mutual Wealth and its directors, officers and employees shall not be responsible and disclaims all liability for any loss, damage (whether direct, indirect, special or consequential) and/or expense of any nature whatsoever, which may be suffered as a result of or which may be attributable, directly or indirectly, to the use of, or reliance upon any information contained in this document.