

INVESTMENT NOTE

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THE TRUMP QUESTIONS



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Now that the dust has settled somewhat following the US election, we can ask more clear-eyed questions about what lies ahead. That doesn't mean, however, that we have complete certainty. The only certainty that investors have today compared to the start of the year is that Republicans control both the White House and Congress. Much else is up in the air. There are three important things to bear in mind as we search for the ever-elusive certainty.

Firstly, while we know the broad outlines of the Donald Trump agenda, we don't know exactly what we will end up with. Trump's term in office only starts in late January. The next two months will be an awkward interregnum where Trump gets the attention, but outgoing president Joe Biden is still officially in charge. Once sworn into office, the new administration will not be able to implement its entire wish list at once. In many instances, political processes will need to be followed. How implementation is sequenced will

matter to markets. If we think back to Trump's first term in office, 2017 was a honeymoon year of deregulation and corporate tax cuts that made companies more profitable and sent equity prices surging higher. The dollar weakened, and the global economy picked up steam. The trade wars only started in 2018 and were very negative to market sentiment. This time, we might get the tariff increases before the tax cuts.

Even a Congressional majority doesn't mean everything will be rubber-stamped. Trump does not need to run for election again, but each of the 435 members of the House of Representatives and 33 Senators will be up for re-election a mere two years from now, and they will be well-aware that American voters historically turned away from incumbent parties in the mid-terms. There will also be substantial lobbying from business leaders to protect their interests from extreme policy changes. So here we just need to be patient and see what is delivered, but also be prepared for things to happen at short notice.

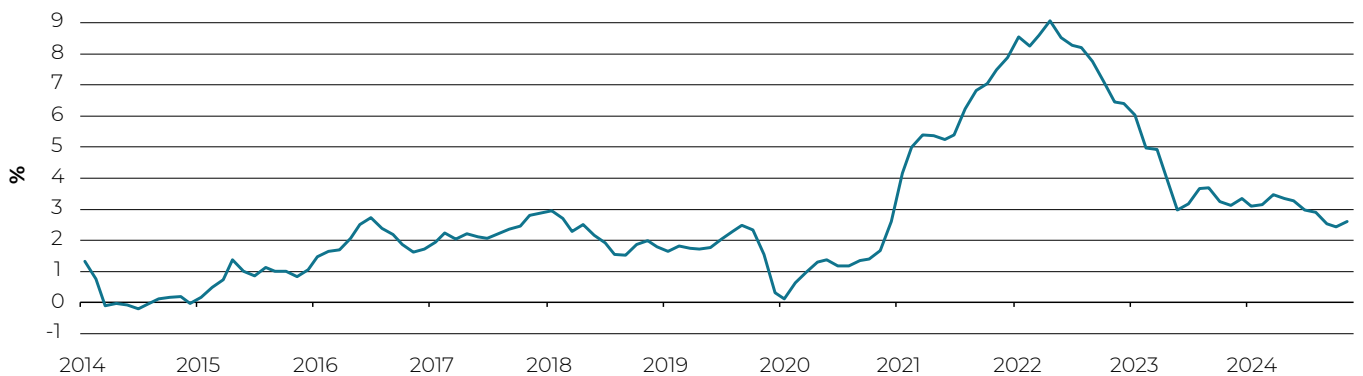


NOT THE ONLY GAME IN TOWN

Secondly, as much as Trump will dominate the headlines, he is not the only game in town. Policymakers in other countries are not going to sit on their hands, and in the US itself, the Federal Reserve will operate independently of the White House. In Trump's first term, the Fed was on a very gradual hiking cycle after a period of low inflation and weak growth. Eventually, in late 2018, it had gone too far. Credit markets seized up and the Fed was forced into a hasty reversal by early 2019. This time round, inflation has been falling from multi-decade highs, while growth has been resilient.

Clearly beneath the rosy surface there were enough people who were unhappy with the state of the economy and their personal finances to vote the Democrats out of office. This was a trend across the many elections held worldwide in 2024, with incumbent parties losing votes on an unprecedented scale. Therefore, one of the big questions for 2025 is whether these cracks in the shiny façade of the US economy will widen or narrow, and what role the new administration's policies will play?

CHART 1: US ANNUAL CONSUMER PRICE INFLATION, %



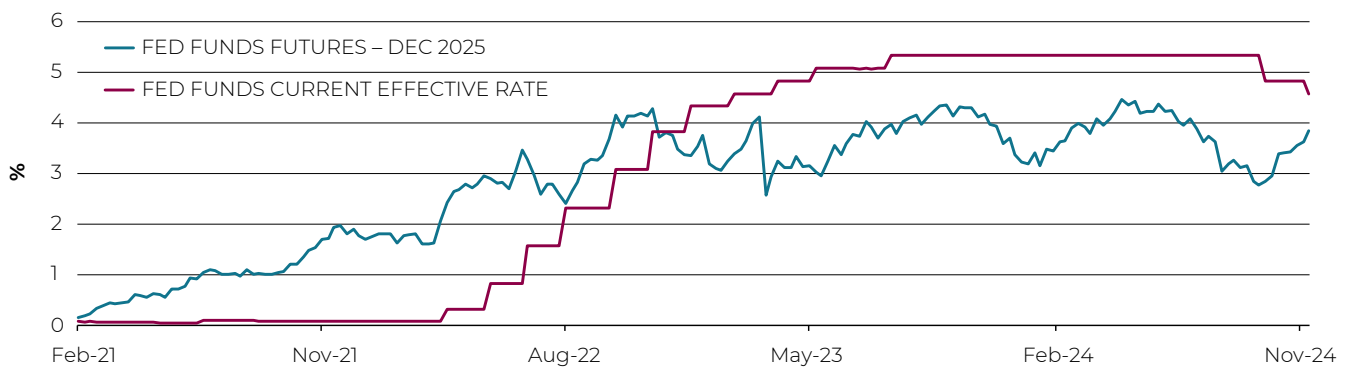
Source: LSEG Datastream

The decline in inflation we saw during 2023 and most of 2024 has stalled out somewhat. This is something the Federal Reserve will pay close attention to, but for now has taken the view that the disinflationary trend will continue to zigzag lower. In a speech last week, Fed chair Jerome Powell noted he expected inflation to drift lower towards the 2% target, but "on a sometimes bumpy path". He also noted that the resilient economy "is not sending signals that we need to be in a hurry to lower rates".

The Fed is likely to cut a few more times but will clearly proceed cautiously. It knows the Trump administration's

policies could be inflationary but cannot respond preemptively to plans that have not been implemented yet.

For one thing, there is usually a lag between policy changes and the impact on the real economy, and as noted above, these policies might not be implemented immediately or at all. There is a risk that there is a quiet period on the inflationary front where complacency builds on the part of investors or the Fed (or both). For now, what we do know is that market expectations for rate cuts have been scaled back considerably. Futures markets price in a fed funds rate of 3.8% by the end of 2025, significantly higher than the 2.8% priced in at the time of the jumbo September rate cut, but still lower than what the market expected in April.

CHART 2: FEDERAL FUNDS RATE, %

Source: LSEG Datastream

In a nutshell, we are still looking at declining short-term interest rates, but they will not fall as much as previously expected. This higher-for-longer interest rate outlook in the US contrasts with the expectation that other major central banks will have to double down on interest rate

cuts, notably the European Central Bank and the People's Bank of China. The Bank of Japan is still an outlier among developed central banks in terms of raising interest rates, but its moves are likely to be modest and the yen has lost ground against the dollar.

CHART 3: TRADE-WEIGHTED US DOLLAR INDEX

Source: LSEG Datastream

The trade-weighted dollar index shown in Chart 3 has therefore rallied to its strongest level in a year,

though it remains below the 20 year-record it reached in late 2022.

NO STRAIGHT LINES

Thirdly, things don't move in straight lines. Action leads to reaction. Newton's third law holds true in politics, economics and markets almost as much as in physics.

There are two obvious examples. A stronger dollar works against what Trump would be trying to achieve with higher tariffs. The stronger the dollar, the easier it becomes for Americans to import and the more expensive to export. He cannot control the dollar directly, but it could force him to temper some of his plans.

The second example is the rise in bond yields, which if sustained, can undermine the optimism in the equity

market directly and indirectly. (If you are somewhat confused, remember that the Fed controls short-term interest rates, but longer-term rates, i.e. bond yields, are set by the market, and can move in a different direction).

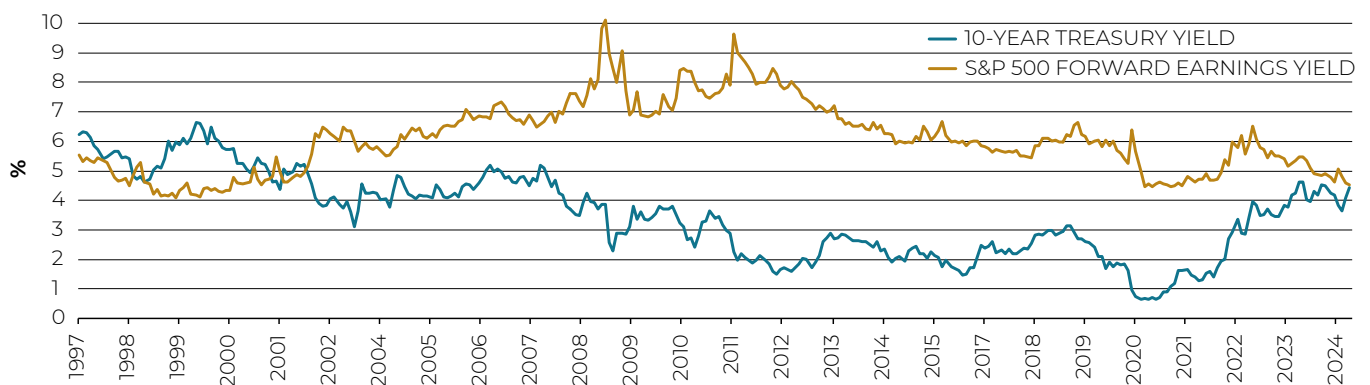
So far, the increase in US Treasury yields, the borrowing cost for the government, has not been entirely matched by the increase in corporate bond yields. This means the spread between corporate and Treasury bonds has narrowed, an indicator of economic optimism. This same optimism has driven equity prices higher, notably the shares of smaller companies who tend to be more economically sensitive.

Mortgage rates, however, have increased notably, from around 6.25% a month ago to above 7% today. Unlike in South Africa, where mortgage rates are tied to the central bank's short-term interest rate, US home loans are linked to 30-year bond yields. This will be an ongoing drag on housing market activity, and also renders property ownership unaffordable for many since house prices remain high. In fact, the National Association of Realtors calculates a housing affordability index that combines mortgage rates, house prices and household incomes,

and things haven't been this bad since 1985. This can hardly make for a happy electorate.

Higher bond yields also provide competition for equities. Theoretically, investors should demand some compensation for holding riskier equities over safer bonds. This is known as the equity risk premium. A common back-of-the-envelope way to calculate this is the gap between the forward earnings yield (inverse of the price: earnings ratio) on the S&P 500 and the yield on the 10-year Treasury.

CHART 4: US BOND AND EQUITY YIELDS, %



Source: LSEG Datastream

The last time this premium was zero was in the aftermath of the dotcom bubble in 2002. For two decades, investors were handsomely compensated for the additional risk of owning equities, but no more. It suggests that either the market is overly optimistic about prospects for US stocks, or that bonds are no longer seen as "safe", perhaps due to rising US debt levels and ongoing political polarisation. There is some merit to both arguments.

What we do know is that investing the last time the gap was this small resulted in bonds outperforming equities over the subsequent 10 years.

QUESTIONS FOR SOUTH AFRICA

Finally, when it comes to South Africa, there are three related questions to ponder. Firstly, how much will South Africa be impacted by US tariff increases? The US is an important export partner for South Africa, but not really the other way around. South Africa runs a trade surplus with the US, meaning we export more goods to the US than we import from the US. That might seem hard to believe, given the popularity of American brands in South Africa, but bear in mind that your Levi jeans, Apple iPhone and Nike shoes

Trump's "America First" policies mean the US equity market could have the wind at its sails from an earnings growth point of view – certainly compared to other major markets – though some of his policies could counteract others. But the dilemma investors have grappled with for a few years now, whether growth or valuation offers the better indicator of future returns for US equities, will become more acute as we move into 2025.

were probably not made in America. It makes South Africa vulnerable to US tariffs, though we are unlikely to be high on Trump's agenda since the surplus is small when viewed from America's perspective. When it comes to trade in services (think Netflix or Microsoft subscriptions), the US runs a surplus with South Africa.

Secondly, how does the Reserve Bank respond to a higher-for-longer US rate outlook? Our central bank will of course

keep a close eye on what the Federal Reserve does and is also likely to be more cautious. However, it is likely to continue cutting the repo rate as domestic inflation is set to remain on target during 2025. The forecasts at the time of the September monetary policy committee (MPC) meeting had a starting rand-dollar exchange rate of R18.04. The current exchange rate is about 1% weaker today, but the oil price about 3% lower, so there is little immediate risk of higher inflation. At any rate, the MPC was likely to be gradual in its cutting cycle irrespective of the US election outcome, so there is no reason to scale back what were already conservative expectations about the path of South African short-term interest rates. The repo rate still seems likely to settle around 7%.

Thirdly, how much ongoing spillover will there be to financial markets? We've already seen the rand trading around the

weakest levels since August, though it is still slightly positive against the dollar year to date, a rare currency to have achieved that. Historically, local markets have taken their cue from what happens in the US, but there is always nuance in how this happens. Nonetheless, it is through financial markets that South Africa is likely to experience the biggest impact of the Trump administration, good or bad. That was also the case during his first term.

Needless to say, however, there is considerable uncertainty in all of the above. Navigating the next four years will require greater patience on the part of investors, and the ability to look through the noise to focus on fundamental changes. Ultimately, long-term returns depend on fundamentals, not sentiment. It also means diversification will be our best friend in 2025, as we try to expect the unexpected.

EQUITIES - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US\$	3 711.0	-2.11%	1.75%	17.10%	24.74%
United States	S&P 500	US\$	5 871.0	-2.08%	2.91%	23.08%	30.38%
Europe	MSCI Europe	US\$	2 019.0	-2.70%	-3.54%	-0.05%	7.00%
Britain	FTSE 100	US\$	10 173.0	-2.45%	-2.74%	3.32%	9.45%
Germany	DAX	US\$	1 745.0	-1.58%	-2.46%	9.60%	16.26%
Japan	Nikkei 225	US\$	250.3	-3.26%	-2.61%	5.50%	13.05%
Emerging Markets	MSCI Emerging Markets	US\$	1 085.0	-4.49%	-3.13%	5.96%	10.26%
Brazil	MSCI Brazil	US\$	1 381.0	-1.07%	-1.78%	-23.28%	-17.75%
China	MSCI China	US\$	63.6	-6.09%	-3.36%	14.60%	8.15%
India	MSCI India	US\$	1 025.7	-2.72%	-3.24%	11.24%	24.93%
South Africa	MSCI South Africa	US\$	452.0	-5.64%	-5.24%	8.92%	12.44%

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	83 873.0	-1.47%	-1.77%	9.08%	12.13%
All Share	All Share (Total Return)	Rand	15 291.0	-1.46%	-1.75%	12.83%	16.30%
JSE Capped SWIX	Capped SWIX (Total Return)	Rand	37 433.5	-1.47%	-1.76%	12.81%	17.17%
TOP 40/Large Caps	Top 40	Rand	13 666.0	-1.54%	-1.99%	11.02%	14.16%
Mid Caps	Mid Cap	Rand	25 210.0	-1.66%	-1.74%	15.72%	23.04%
Small Companies	Small Cap	Rand	41 203.0	-0.39%	-0.44%	26.15%	31.31%
Resources	Resource 20	Rand	4 720.6	-6.02%	-8.20%	-2.90%	0.00%
Industrials	Industrial 25	Rand	25 215.0	0.02%	-0.68%	13.57%	14.89%
Financials	Financial 15	Rand	15 921.0	-0.87%	0.26%	23.31%	28.49%
Listed Property	SA Listed Property	Rand	2 359.9	0.81%	0.21%	26.60%	39.47%

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\$	74.6	-1.35%	-1.63%	-4.92%	0.68%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Bond	BESA ALBI	Rand	1 085.1	0.06%	1.06%	15.38%	18.92%
Government Bonds	BESA GOVI	Rand	1 068.4	0.08%	1.06%	15.26%	18.82%
Inflation Linked Bonds	BESA CILI	Rand	368.5	0.44%	-0.34%	5.50%	7.82%
Cash	STEFI Composite	Rand	588.9	0.15%	0.33%	7.45%	8.51%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US\$	71.0	-3.83%	-2.68%	-7.74%	-12.30%
Gold	Gold Spot	US\$	2 563.0	-4.54%	-7.91%	24.24%	30.04%
Platinum	Platinum Spot	US\$	936.0	-3.31%	-7.23%	-5.17%	4.58%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	18.20	-3.39%	-3.25%	0.56%	-0.10%
ZAR/Pound	ZAR/GBP	Rand	22.96	-1.09%	-1.13%	1.48%	-1.66%
ZAR/Euro	ZAR/EUR	Rand	19.17	-1.70%	-0.08%	5.39%	2.89%
Dollar/Euro	USD/EUR	US\$	1.05	1.90%	3.62%	5.14%	2.86%
Dollar/Pound	USD/GBP	US\$	1.26	2.39%	2.25%	0.67%	-1.71%
Dollar/Yen	USD/JPY	US\$	0.01	1.13%	1.53%	9.46%	1.98%

Source: I-Net, figures as at 15 November 2024

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