Truffle Asset Management

Economic Commentary
January 2025

The South African market rebounds

South African equities rebounded strongly in January with a 5.3% return in US dollars, after three consecutive months of negative performance at the end of 2024. This recovery outpaced the MSCI World and North America indices which delivered returns of 3.6% and 3.0% respectively. Strong January performance in SA was driven by the Materials sector which rallied 29.3% on the back of higher gold and PGM shares. MTN also saw notable gains, benefitting from expectations of a tariff increase in Nigeria. On the downside, the Consumer Discretionary sector, which had been a standout performer in 2024, experienced losses.

Trump 2.0: US commences with tariffs

Donald Trump's election as the 47th president of the United States of America is set to bring significant changes to US policy. The use of tariffs as a negotiation tool to extract better concessions from their trading partners was always going to be a key strategy for Trump. Therefore, it came as no surprise that in early February he once again pulled this lever. The US initially imposed a 25% tariff on all imports from Canada and Mexico except for Canadian energy (subject to a 10% tariff). The stated rationale for these tariffs related to combatting drug trafficking and illegal immigration. Shortly thereafter, these new tariffs were temporarily suspended when Canada and Mexico agreed to take measures aimed at curtailing fentanyl supply and illegal border crossings. The US has also imposed a further 10% tariff on Chinese imports, however China retaliated with tariffs on US goods, and export controls on rare earth metals. They also initiated an antitrust investigation into Google.

The ultimate scope, duration and geographic impact of US tariffs remains uncertain. In the short term however, tariffs are inflationary and effectively a tax on consumers, reducing consumption levels and negatively impacting GDP growth. Many of the impacted goods cannot easily be produced in the U.S. For example, U.S. refineries that import Canadian oil are purpose-built to refine heavy crude oil and cannot switch to refining a local domestic supply: sweet, light U.S crude oil is simply not a viable option. Similarly, Apple sources 40% of an iPhone's total component value from China so unless alternative suppliers can be found, tariffs on Chinese imports will increase production costs and consequently consumer prices. Furthermore, retaliatory tariffs from other nations will weigh on U.S exports, compounding the economic impact.

In our view, the U.S. will avoid inflicting damage to their own economy and it is therefore likely that Trump will use tariffs as a bargaining tool to extract benefits or concessions from allies and potential adversaries, rather than actually implement them. Even perceived benefits that show the US in a winning light would likely suffice to de-escalate trade conflicts. This view hinges on the assumption that all parties act rationally and unfortunately, at this stage the risks to all parties are mostly skewed to the downside. Over the long-term uncertainty over trade will likely discourage investment within the U.S. and globally, which could suppress long-term economic growth.

SA economic growth to steadily recover

South Africa's economic data has been somewhat erratic leading up to the end of January, reflecting a mixed picture of recovery and lingering structural challenges. November's economic indicators were relatively stable, but December showed disappointing figures. However, as January unfolded early signs of a recovery emerged, particularly in the retail and automotive sectors. Caution is warranted when evaluating retail sector numbers given the impact of the two-pot pension reform is still filtering through the system. Meanwhile, new vehicle sale sales rose 10.4% in January, with new passenger vehicles rising by 18.3%.

On the political front, the ANC and DA have reached an agreement that ensures medical aid schemes will not be dismantled, addressing a long-standing concern, and proving significantly positive for those working in the healthcare sector. This is also positive for investor sentiment as the GNU continues to demonstrate their ability to work together.

Globally, South Africa continues to navigate a complex geopolitical landscape. U.S. politicians have expressed increasing antagonism toward SA policies on land expropriation, adversarial relationships with U.S. allies and SA's BEE ownership framework. While some of these concerns such as land expropriation may have been exaggerated, others reflect different world views and deeper ideological differences. South African policymakers face the difficult task of balancing relations with both China and the U.S. to avoid alienating key trade and investment partners. This will require cool heads and political nous!

We still expect the SA economic growth to recover to 1.8% in 2025, which should underpin the earnings and ratings of many SA shares in our portfolios.

SA Equities still offer reasonable returns

Looking ahead, we expect SA equities to deliver mid-teens returns in 2025, with performance being underpinned by attractive dividend yields and an earnings recovery off a relatively low base. Within equities, the valuations of many offshore-based counters are more compelling, and we have rotated our portfolio positioning away from many of the locally focused stocks that performed well in 2024 into the more attractive global peers that struggled last year.

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Morningstar Awards were awarded to Truffle Asset Management (Pty) Ltd on 23 March 2022, 22 March 2023, and on 14 March 2024. Details available on request.

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