

INVESTMENT NOTE

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THE DELUGE AND THE DELUSIONS



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**“If it keeps on raining, levee's going to break
If it keeps on raining, the levee's going to break
When the levee breaks, have no place to stay”
– Led Zeppelin**

Flood warnings were issued downstream of the Vaal Dam last week after authorities opened its sluice gates. Floodwater travels at a speed of 10 to 20 kilometres per day, depending on the topography of the land, meaning that it takes a few days to hit the towns a few hundred kilometres downriver. This is a useful metaphor to think about US President Donald Trump's trade war. The immediate impact of heavy rain can do a lot of damage on the area where it falls, sometimes in surprising ways. In this case, it is the world's financial markets that took the first blow. But all that water still needs to go somewhere, and swollen rivers can wreak

havoc days away from where the deluge was. Economic activity, the decisions of companies and consumers, sit downstream of Trump's tariff announcements, and it will take time to see how much destruction the floodwaters cause.

There are a number of factors to think about here. As in the 1971 Led Zeppelin classic, the first question we need to ask is whether it will keep on raining – or will Trump offer some respite?

The answer we got last week was yes and no. The “reciprocal” tariffs on most nations were suspended for 90 days, much to the relief of everyone. It means that South Africa, for instance, will not face 30% tariffs but only 10%. For a country like Lesotho, faced with 50% tariffs and with exports to the US accounting for 10% of GDP, the relief is even greater.



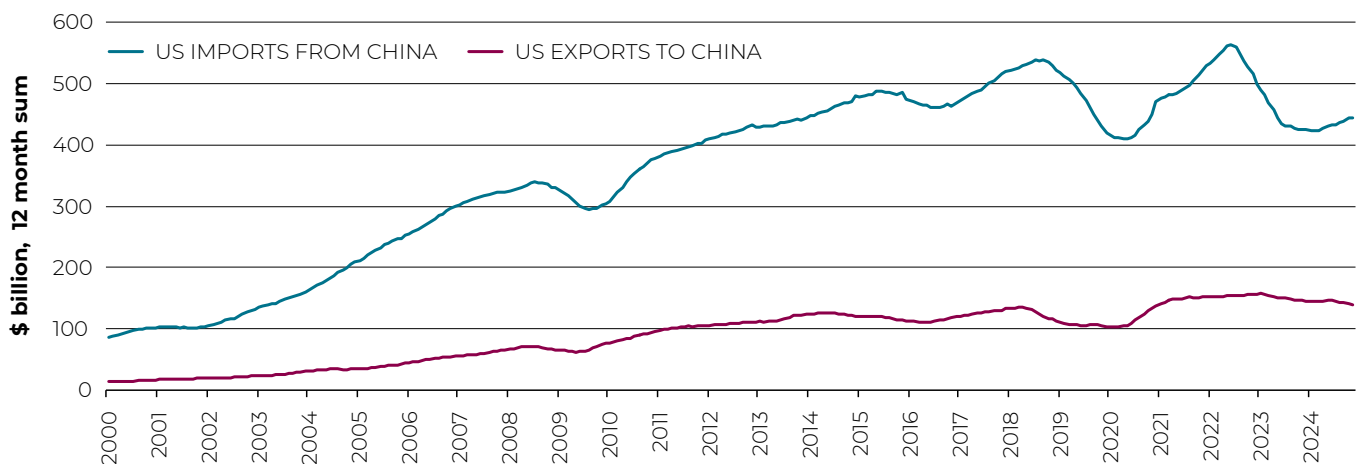
COMMUNICATION BREAKDOWN

However, since China retaliated to the initial 34% reciprocal tariff, Trump raised import taxes on Chinese goods to 145%. This is such a high trade barrier that its imports from China will mostly become unaffordable. Except in rare cases, it is too high for companies to absorb in their margins, and it similarly cannot be offset by exchange rate movements. And unlike other countries, China seems in no mood to bend the knee and negotiate, at least not yet. In fact, on Friday Beijing retaliated to the retaliation with a further retaliation of its own.

The US imported more than \$400 billion in goods from China last year, and China is more vulnerable to a trade war

than the US. However, China also imported \$140 billion in goods from the US last year, and \$40 billion in services. It can inflict serious damage on American businesses. Moreover, it will be difficult for the US to replace Chinese goods quickly. China is the source of 90% of microwaves, 80% of smartphones and 75% of toys, and 66% of laptops sold in the US, according to an analysis by the Financial Times. Trump has temporarily exempted phones and computers from his tariffs. Either way, trade between the world's largest economies grew massively over the past 25 years, but now looks set to shrink with potentially devastating consequences.

CHART 1: MERCHANDISE TRADE BETWEEN THE US AND CHINA



Source: LSEG Datastream

Trump's abrupt change of heart, postponing most of the tariff increases, was probably the result of the market turmoil, bond market turmoil to be precise (though the S&P 500 is now almost 13% below its peak). US Treasury bond yields predictably declined in response to the "liberation day" tariff announcement given the negative. But in the subsequent days, yields shot up again, implying that investors were dumping bonds, the safest of safe assets (bond prices and yields move in opposite directions). Reasons vary, of course. For some investors it was about raising cash, which can be done by selling the most liquid investment. But for others, notably hedge funds, it was the unwinding of several popular but highly leveraged trades. A third theory is that foreign investors have finally decided that the US is untrustworthy, and it has become risky to own its debt. Despite the higher

yields, the dollar has weakened against the euro, Japanese yen and Swiss franc, adding credence to the latter argument.

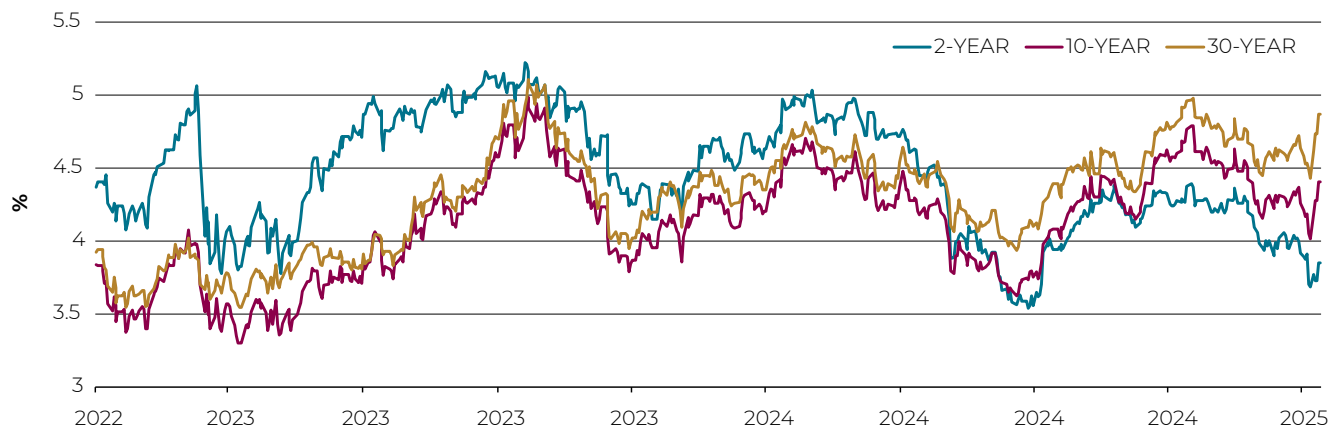
The bottom line is that the negative bond market reaction would have spooked officials in the Trump administration. An equity sell-off rarely leaves much of an economic trace, apart from shareholders being poorer. But a bond market meltdown can damage the entire financial system, from banks to insurance companies and pension funds. Bond yields are not dangerously high at all, but the speed of the moves certainly caused alarm.

Economist Ed Yardeni memorably coined the term "bond vigilantes" in the early 1980s, referring to the bond market's role in disciplining wayward politicians, particularly in the context of excessive fiscal deficits. This evokes the image of a pitchfork-wielding mob seeking vengeance, but of

course they are actually running away from the market, since they are selling the bonds. Either way, the net result is that ructions in the bond market can force presidents to back track. A bond market blow-up ensured that Liz Truss

had the shortest ever reign as UK Prime Minister, while a local example would be Jacob Zuma's forced reversal after the "Nenegate" debacle.

CHART 2: US TREASURY YIELDS, %



Source: LSEG Datastream

The ultimate vigilantes would be the voters. Trump won the election mostly because of the sharp cost of living increase during Joe Biden's term in office. While Trump's core supporters will back him to the bitter end, swing voters definitely did not sign up for more price increases. The mid-term election is only in November 2026, but nervous Republican politicians could start putting pressure on Trump to change course well before then.

If it doesn't stop raining, and the levee breaks, the economic impact could be severe. The risk of a US recession is material. These tariffs are effectively a giant tax hike that will eat into the disposable income of consumers. Since they will spend more on imported goods, there will be less money to spend on everything else. If clothing, stationery and sports equipment for your children costs more, for instance, there will be less money to take them to a restaurant.

Importantly, however, US households have not been gorging on debt, so there won't be the deleveraging shock we often see in other economic cycles. Consumers and companies have healthy cash balances in total, but there are many smaller firms and low-income households who were struggling even before the tariff announcements. Even for healthy businesses, the ongoing uncertainty means they are likely to scale back on hiring and investment plans, until they have a better idea of where these policies will settle.

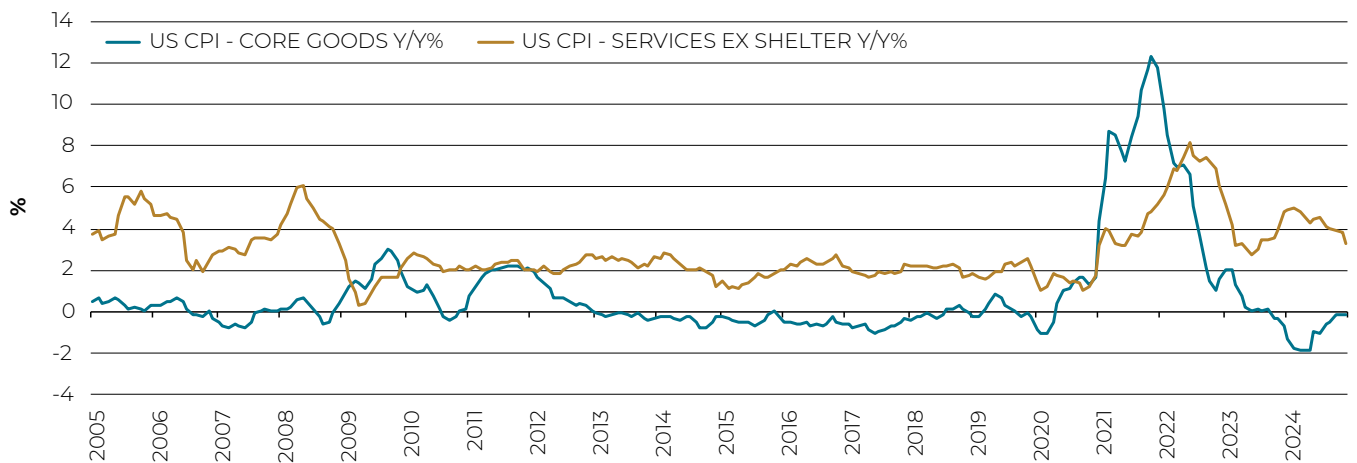
It has become almost impossible to plan, so the natural response might be to do nothing.

For other countries, the impact is largely a function of where the tariff rate ultimately settles, and what share of total economic activity is devoted to exporting to the US. For a country like Vietnam, who faces 46% tariffs (suspended for 90 days), exports to the US amount to almost a third of its GDP. No wonder it was the first to offer concessions to Trump.

Finally, if the rain keeps falling and the levee breaks, there is the question of whether there are any rescue craft on the water. Will there be any policy relief?

The US central bank, the Federal Reserve, is clearly in a very difficult position as the US faces both weaker growth and higher prices. Interest rates as a policy tool can only tackle one at a time.

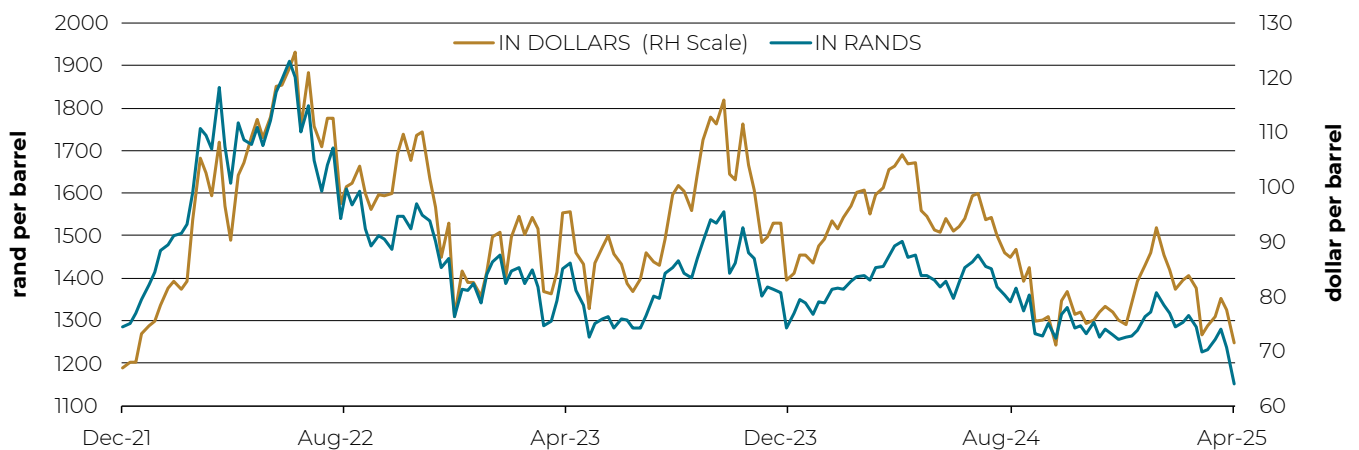
Higher import tariffs should result in only a once-off increase in prices, but we cannot be sure. Inflation was already proving sticky in recent months. The Fed will worry that higher goods prices could spill over into higher service inflation and ultimately higher inflation expectations. Over the past two decades, goods inflation has mostly been negative, containing overall inflation levels. What lies ahead is difficult to know.

CHART 3: GOODS AND SERVICES INFLATION IN THE US

Source: LSEG Datastream

For other central banks, it is more straightforward. There is little reason to fear higher inflation in places like Germany, India or Australia as a result of US tariffs. On the contrary, all the goods previously destined for the US must now find a home somewhere else. This could turn out to be a disinflationary episode, especially considering the sharp oil price declines. Therefore, central banks can cut rates aggressively. In emerging markets with volatile currencies, like South Africa, central banks might worry more about

exchange rate stability and hold off on interest rate reductions. The South African Reserve Bank is likely to sit on its hands for the next few months, until there is greater clarity over US trade and monetary policies. The rand at R19 to the dollar could put some upward pressure on domestic inflation, but not much, given that the price of Brent crude has fallen faster than the rand. Meanwhile, the weaker currency will offset some of the impact of higher tariffs for local exporters.

CHART 4: BRENT CRUDE OIL PRICE

Source: LSEG Datastream

As for fiscal policy, the tariffs will raise substantial tax revenues for the American government, and this can be used to fund income tax cuts in part. Perish the thought that this might actually be used to reduce its massive debt pile! When they are implemented, the tax cuts will provide an economic boost, but they might only be forthcoming later this year.

Uncertainties over the sustainability of government debt could also further drive up long bond yields, which in turn will offset some of the impact of these tax cuts. There are no free lunches in economics and finance (except portfolio diversification, as Nobel Prize winner Harry Markowitz noted).

How China responds to shield its domestic economy from this massive blow will also be crucial. It is an ideal moment to finally implement reforms to boost household incomes and spending power. Lower interest rates are likely, but unlikely to stimulate the economy much, given that the property sector remains under significant pressure (though it does seem to be bottoming out). It would be a mistake to continue the approach of recent years which was to add

yet more manufacturing capacity and raise exports further. If the US is lost as a market for Chinese exports, the rest of the world will not have the capacity to absorb more and more Chinese products. Other countries will also ultimately turn to higher trade barriers. China therefore needs stronger domestic demand to rebalance its economy and play a healthier role in the overall global system.

THE SONG REMAINS THE SAME

The wild market swings have left investors dazed and confused. Is there higher ground to move to avoid the rushing floodwaters? Of course, it is tempting to sell now and hide in cash, especially given relatively high real yields in South Africa. A few months from now, hindsight might show that was the right call. But consider that, unlike previous market crashes, where the culprit has been a virus, or the complex interaction of various economic and financial forces, this one is purely man-made. One man, Donald Trump, caused this, and he is the one man who can unwind some of the damage (perhaps he will quietly whistle another Zeppelin tune “Nobody’s Fault but Mine”).

If Trump removes the tariffs tomorrow, markets will rocket higher. We’ve already had a taste of that in recent days. Whether he will do so probably depends on psychology more than economics – it is more a case of id than ideology, as one commentator noted. If it does happen, investors

who fled to cash will not only have crystallised paper losses but also missed out on the recovery. The dilemma is that no-one knows, perhaps not even Trump himself. This does not appear to be a good time for making big tactical bets on a very uncertain future outcome.

Rather, the question investors should ask themselves is the same as before all this drama started: do I have a portfolio whose targeted asset allocation balances my expectations for return and tolerance for risk? The problem is often that the expectation for return tends to rise with the equity market, while the tolerance for risk falls with it. But ultimately, if your personal circumstances and your financial goals remain the same, your portfolio allocation should be broadly unchanged. This will not shield you from any market volatility that lies ahead, but it should give comfort that you will still be moving in the right direction. It is a bridge over troubled water, to quote another song title from the same era.

EQUITIES - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US\$	3,471.0	4.36%	-4.35%	-6.39%	2.36%
United States	S&P 500	US\$	5,363.0	5.70%	-4.44%	-8.82%	3.15%
Europe	MSCI Europe	US\$	2,104.0	1.11%	-4.36%	5.04%	2.04%
Britain	FTSE 100	US\$	10,421.0	0.32%	-6.00%	1.89%	4.77%
Germany	DAX	US\$	1,988.0	2.95%	-2.64%	8.20%	19.47%
Japan	Nikkei 225	US\$	234.1	1.84%	-1.45%	-7.77%	-9.07%
Emerging Markets	MSCI Emerging Markets	US\$	1,045.0	-3.95%	-5.09%	-2.79%	-0.95%
Brazil	MSCI Brazil	US\$	1,258.0	-0.47%	-4.91%	6.88%	-22.20%
China	MSCI China	US\$	67.1	-7.91%	-9.29%	4.00%	20.69%
India	MSCI India	US\$	957.8	-1.15%	-3.45%	-6.47%	-4.32%
South Africa	MSCI South Africa	US\$	458.0	6.76%	-5.95%	6.51%	16.54%

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	86,406.0	5.95%	-2.52%	2.75%	14.74%
All Share	All Share (Total Return)	Rand	16,005.0	6.44%	-1.73%	4.11%	18.95%
JSE Capped SWIX	Capped SWIX (Total Return)	Rand	39,205.8	6.86%	-1.57%	4.18%	19.05%
TOP 40/Large Caps	Top 40	Rand	14,542.0	6.60%	-1.60%	6.75%	18.94%
Mid Caps	Mid Cap	Rand	24,141.0	6.76%	-4.05%	-3.99%	11.71%
Small Companies	Small Cap	Rand	40,233.0	4.20%	-2.23%	-9.15%	23.43%
Resources	Resource 20	Rand	6,506.6	20.18%	7.87%	44.27%	22.36%
Industrials	Industrial 25	Rand	26,190.0	1.30%	-3.52%	0.60%	18.70%
Financials	Financial 15	Rand	14,542.0	4.73%	-5.76%	-7.39%	20.70%
Listed Property	SA Listed Property	Rand	2,250.3	1.85%	-2.96%	-6.35%	16.30%

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\$	76.5	-0.44%	1.60%	3.58%	3.02%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Bond	BESA ALBI	Rand	1,088.2	0.51%	-1.99%	-1.31%	17.35%
Government Bonds	BESA GOVI	Rand	1,072.6	0.49%	-1.94%	-1.21%	17.42%
Inflation Linked Bonds	BESA CILI	Rand	376.9	-0.66%	-0.64%	0.06%	7.50%
Cash	STEFI Composite	Rand	607.4	0.14%	0.23%	2.12%	8.26%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US\$	64.8	-1.25%	-13.65%	-13.65%	-28.04%
Gold	Gold Spot	US\$	3,237.0	6.59%	3.62%	23.74%	38.51%
Platinum	Platinum Spot	US\$	938.0	3.99%	-6.39%	2.51%	-4.67%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	19.16	-0.15%	-4.37%	-1.67%	-2.19%
ZAR/Pound	ZAR/GBP	Rand	25.02	-1.52%	-5.44%	-5.56%	-6.00%
ZAR/Euro	ZAR/EUR	Rand	21.74	-3.83%	-8.85%	-10.09%	-7.56%
Dollar/Euro	USD/EUR	US\$	1.14	-3.51%	-5.09%	-9.21%	-6.14%
Dollar/Pound	USD/GBP	US\$	1.31	-1.44%	-1.41%	-4.47%	-3.71%
Dollar/Yen	USD/JPY	US\$	0.01	-2.37%	-4.32%	-8.72%	-6.36%

Source: I-Net, figures as at 11 April 2025

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