OLDMUTUAL

INVESTMENT NOTE

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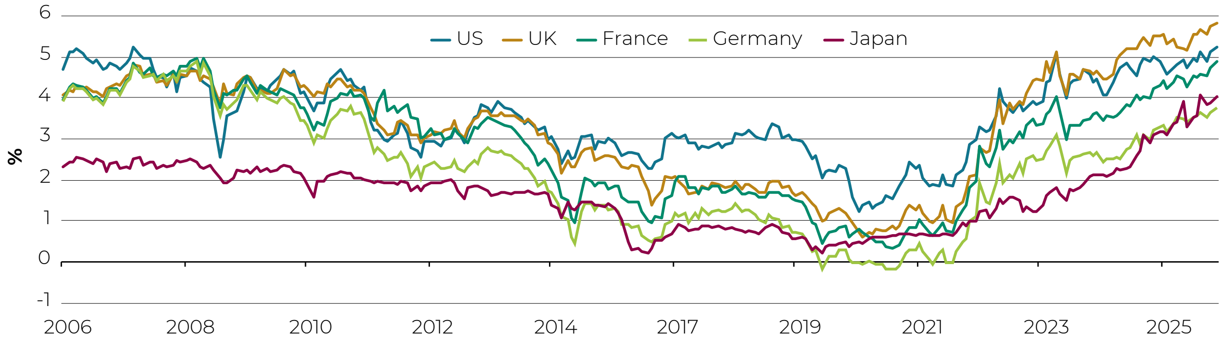
DON'T LOOK UP

Today, 20 years ago, Pluto was officially downgraded to a dwarf planet when the International Astronomical Union changed the definition of what constituted a planet. Something big and well-known suddenly became relatively small and unimportant. In markets, we often fear the opposite: something that was ignored for a long time becomes pressing, setting off a cascading series of events.

In the solar system of investing, the bond market is Saturn, with only currency markets being the larger Jupiter. Equities, corporate bonds, and commodities are the next three planets: Uranus, Neptune, and Earth. Crypto would barely qualify as Mercury.

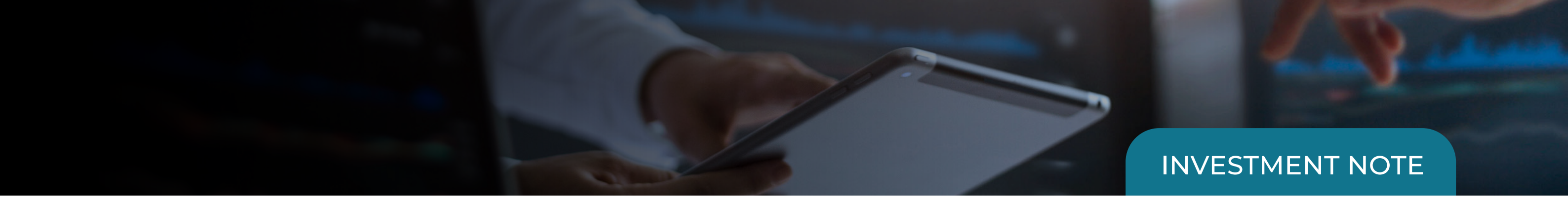
We'll focus on Jupiter another time. What has been happening on Saturn? Long-dated government bond yields have been moving higher across the large developed markets. Since bond yields and prices move in opposite directions, it implies losses for holders. They also mean rising borrowing costs for governments. And since private sector borrowing costs are often priced relative to government bond yields, it can have a broader impact. Chart 1 shows how 30-year bond yields have reached multi-year highs in several developed economies.

CHART 1: 30-YEAR BOND YIELDS, %



Source: LSEG Datastream

WEALTH



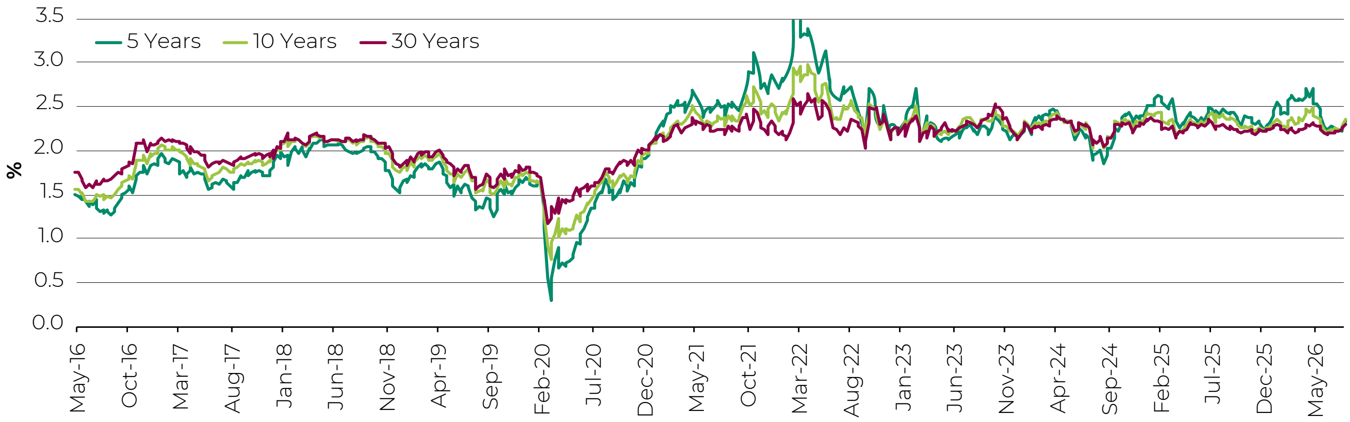
The rings around Saturn – the drivers of bond market performance – are typically inflation expectations, interest rate views and perceived creditworthiness.

The most recent bond sell-off was seemingly triggered by the risk of renewed inflation pressures due to higher oil prices. The 60-day ceasefire between the US and Iran has come and gone, with both sides seeming prepared to wait for the other to blink. The Strait of Hormuz remains effectively closed. Crude oil now costs more than $90 per barrel, while refined products like diesel have risen considerably more.

Unexpected inflation makes most bonds less valuable, since they pay a fixed interest rate meaning the purchasing power of those future payments is eroded as prices rise.

However, whatever inflation stems from the war is likely to be temporary, and the general climate of uncertainty should in theory benefit bonds. Therefore, the weakness is not about oil alone. Indeed, the market's expected future inflation rate can be derived by subtracting real (inflation-protected) yields from the headline (nominal) yields. This so-called breakeven inflation rate has been remarkably stable.

CHART 2: US BREAKEVEN INFLATION RATES ACROSS DIFFERENT MATURITIES



Source: LSEG Datastream

SUPPLY AND DEMAND

The more likely explanation for rising yields is market concerns that bond supply will keep rising, possibly faster than demand. Government debt keeps increasing, meaning that governments are issuing more bonds. In the case of the US, the Congressional Budget Office estimates that the current federal deficit (spending minus tax revenues) will rise from $1.8 trillion this year to $3.1 trillion ten years from now. The cumulative effect of these deficits will push the debt-to-GDP ratio to 120% by 2036, assuming the economy keeps growing steadily. Historically, deficits tend to widen when there is a recession. Indeed, one of the compelling reasons for getting debt levels under control today is to create "fiscal space" to respond to an economic shock.

At the same time as government debt levels are rising across many developed countries, companies are also issuing more bonds particularly at the longer end of the curve as the AI capex boom require hundreds of billions in funding over the next few years. Other forms of capex are also set to increase. With the expected supply of bonds rising while demand will probably be stable, it makes sense that prices would fall and yields rise. The market will eventually find a new equilibrium, but only when investors feel that they are adequately compensated for the risks they are taking on. It should also be remembered that we come from a period of ultra-low yields prior to 2022.

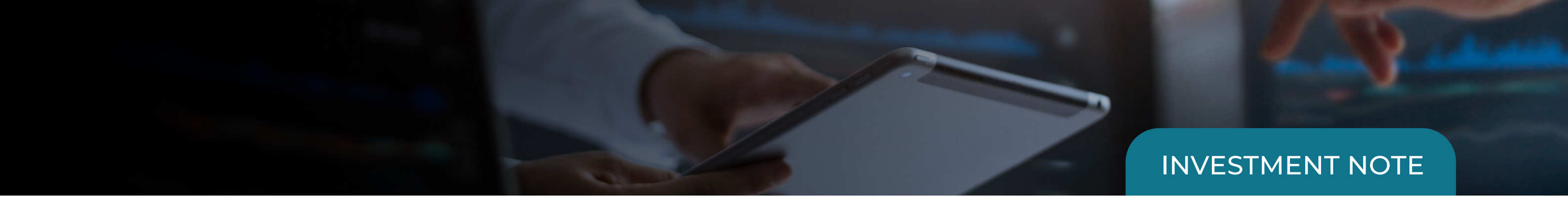
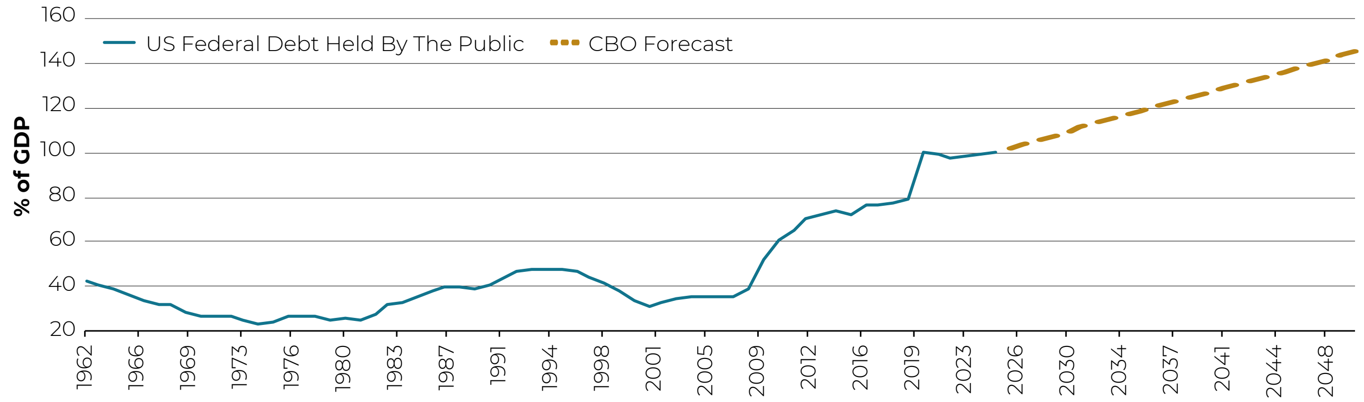


CHART 3: US DEBT TO GDP RATIO



Source: Congressional Budget Office

CRISIS WATCH

Should we worry about a full-scale crisis? At a basic level, no. US economic growth is still solid, and should easily generate enough tax revenues to cover interest obligations. However, last year's cuts in tax rates mean economic activity translates into less government revenue, A reversal of these cuts will be needed to return to fiscal sustainability. Notably, overall bond market liquidity seems fine. This is a repricing, not a rush for the exits. Importantly, big bond crises usually occur in countries that borrow in a foreign currency. Countries that borrow in their own currencies have various tools available to manage debt, including encouraging local banks, insurers and pension funds into buying bonds. The central bank can also buy bonds with newly created money to stabilise markets, though if pushed too far, it will lead to currency depreciation.

Over the years, therefore, sovereign debt defaults have overwhelmingly occurred in emerging markets that borrowed in dollars or euros. They often got into trouble and end up defaulting, usually when there is a balance of payments crisis. Recent examples are Argentina (2020), Ghana (2022) and Sri Lanka (2022). The eurozone bond crisis of 2012 was similar in the sense that Spain, Greece, Portugal and Italy borrowed in euros, which is not a currency those countries have individual control over. That crisis only stopped in 2012 when the European Central Bank promised to do "whatever it takes" to stabilise markets and prevent a breakup of the single currency. Its threat to intervene was enough to restore confidence and, in the end, it did not have to do much, practically speaking

That was perhaps the inspiration for the announcement that the US Treasury would expand an existing programme of buying back older long-dated bonds. It had been doing this for several years as these bonds tend to be less liquid but will now "at least double" this intervention. This sent a strong signal to the market that the Trump administration didn't like the rise in yields. For about 48 hours, yields declined (and bond prices rose).

While this move might discourage speculators from trying to push long bond prices down, it does not address the underlying debt problem. Unlike the Fed, which could buy bonds by creating money out of thin air, the Treasury can only use tax revenues or borrowing. In this case buy-backs are funded by issuing shorter-dated bonds, so the total amount of outstanding debt is unchanged.

INDEPENDENCE OR DOMINANCE?

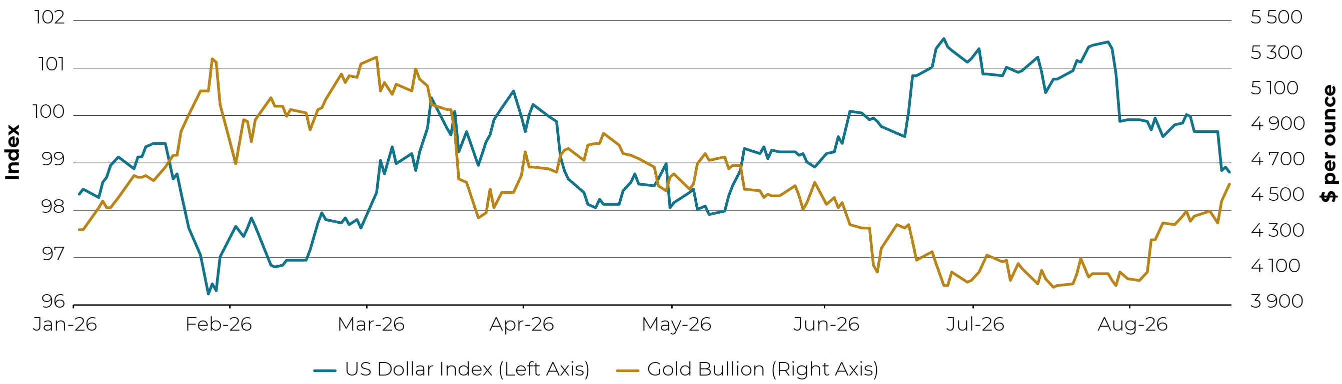
Short-dated bonds have lower yields, because they are anchored by central bank policy rates. However, if governments issue enough short-dated bonds, central bank decision-making could become constrained by concerns over government debt sustainability, rather than focusing on the inflation mandate. This is known as "fiscal dominance", a situation where fiscal policy considerations take precedence over monetary policy objectives.

The move towards central bank independence in recent decades was intended to shield central banks from this kind of political pressure, allowing them to do the sometimes-unpopular work of keeping inflation in check. Central bank independence is not inevitable, however, and can come into question. Debt levels have never been this high, apart from the brief period after World War II, when central banks deliberately kept rates low to help manage the war debt, an approach known as financial repression.

New Federal Reserve Chair Kevin Warsh has emphasised his commitment to central bank independence and price stability. However, he is also known to be close to the Trump administration, and has not yet fully established his credibility. He will have an opportunity to address these issues at a keynote speech at the annual Jackson Hole central banking symposium on Friday. It is shaping up to be a make-or-break moment for his term in office.

Meanwhile, the net result of the Treasury's actions last week was a weaker dollar and higher gold price. Governments can force domestic institutions to toe the line, but it cannot force foreigners, and a weaker currency is usually where the pressure escapes. A weaker dollar is likely part of how this story unfolds in the years ahead.

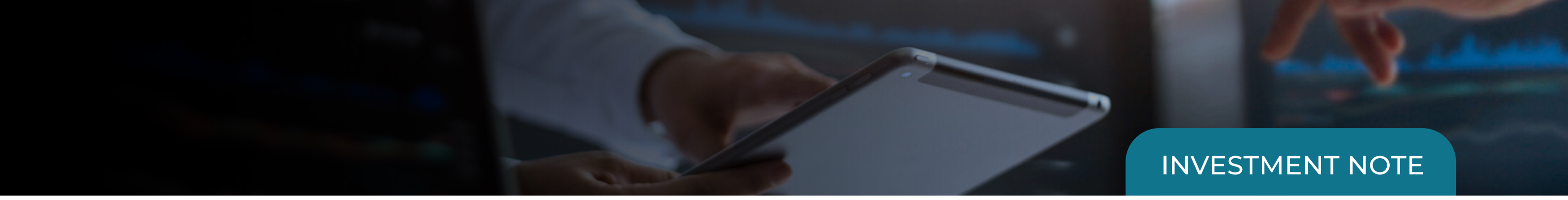
CHART 4: TRADE-WEIGHTED US DOLLAR INDEX AND GOLD



Source: LSEG Datastream

The South African rand was an obvious beneficiary, hitting the best level against the dollar since February. Further dollar weakness would see more support for the rand and the gold price. South African government bonds have been softer in line with global bond markets, but overall, have shown resilience. Unlike the US, South Africa is actively trying to stabilise its debt level. Like poor Pluto, South African government bonds were downgraded by ratings agencies into a new category: junk status. But in the past year, an upgrading cycle has started. Importantly, most of South Africa's government debt is denominated in rands, and while the country must pay significantly more to import oil, there are no balance of payments problems as exports have increased more than imports in the first half of the year.

In fact, the broader universe of emerging markets has held up well throughout the global uncertainty this year, far outperforming developed market bonds. This talks to better macroeconomic management in many of these countries, including South Africa, compared to years gone by. There is more focus on fiscal discipline and central bank independence. It is also simply a function of higher starting yields compared to developed markets.



A RECKONING

Sticking with the space theme, the 2021 movie Don't Look Up tells the story of a meteorite hurtling towards earth. While a group of scientists frantically warn about the impending danger, self-interested politicians urge people to not pay attention. Although the story is a metaphor for how special interests fuel climate change scepticism, it could also apply to public debt levels. The political class in the US, but also in countries like France and the UK, are in denial. One day a reckoning will come, though it does not necessarily mean that the meteorite crashes directly into the bond market. The crisis can show up in other places, such as in currency markets (i.e. a weaker dollar) or in the lives of ordinary people who experience cuts in government services. This is where South Africa's fiscal crisis has largely materialised. It could show up in higher tax rates, which would hurt economic growth. It could show up in deep cuts to military spending, leaving the country vulnerable. Pension or healthcare obligations could go unmet, pushing the fiscal crisis onto the streets as people protest.

Before we get too despondent, however, it is worth remembering that the big question for investors is ultimately not if the outlook is bad but whether the bad news is priced in. There is a level where developed market government bond yields will offer a margin of safety and decent real returns, although it is not yet clear that we have reached that point. It is also likely that some countries will look attractive sooner than the rest, while some will manage their finances well and emerge as outright winners. Given that the bond market is the Saturn of global markets, completely avoiding it would be an extreme position.

EQUITIES - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US$	4 970.0	-1.17%	2.52%	12.19%	20.28%
United States	S&P 500	US$	7 674.0	-1.44%	2.46%	12.09%	19.98%
Europe	MSCI Europe	US$	2 908.0	0.24%	2.32%	10.03%	17.83%
Britain	FTSE 100	US$	14 758.0	1.43%	0.75%	10.28%	18.20%
Germany	DAX	US$	2 584.0	0.08%	4.03%	8.09%	7.71%
Japan	Nikkei 225	US$	415.2	-1.24%	6.51%	29.23%	44.61%
Emerging Markets	MSCI Emerging Markets	US$	1 722.0	1.23%	3.36%	22.65%	36.45%
Brazil	MSCI Brazil	US$	1 802.0	2.80%	-4.56%	9.48%	27.26%
China	MSCI China	US$	76.0	2.92%	0.81%	-7.93%	-6.17%
India	MSCI India	US$	954.3	-0.75%	-0.60%	-9.55%	-8.68%
South Africa	MSCI South Africa	US$	788.0	6.49%	14.37%	6.06%	34.24%

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	117 748.0	3.23%	5.61%	1.65%	15.72%
All Share	All Share (Total Return)	Rand	22 764.0	3.50%	5.90%	3.98%	19.96%
TOP 40/Large Caps	Top 40	Rand	21 011.0	4.22%	7.22%	4.46%	21.31%
Mid Caps	Mid Cap	Rand	31 404.0	0.12%	-0.07%	-4.63%	9.77%
Small Companies	Small Cap	Rand	54 064.0	-1.20%	-2.79%	0.52%	14.22%
Resources	Resource 20	Rand	12 809.9	14.72%	32.23%	16.32%	65.11%
Industrials	Industrial 25	Rand	27 839.0	-1.35%	-6.21%	-10.31%	-10.75%
Financials	Financial 15	Rand	21 412.0	-1.68%	-1.75%	7.24%	25.19%
Listed Property	SA Listed Property	Rand	3 210.7	-2.52%	-4.39%	2.32%	16.50%

FIXED INTEREST - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
IBOXX Global Government Overall (USD Unhedged)	S&P	US$	74.9	0.13%	0.49%	-2.32%	-2.56%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Bond	BESA ALBI	Rand	1 411.6	-0.90%	0.23%	3.05%	16.34%
Government Bonds	BESA GOVI	Rand	1 384.5	-0.92%	0.22%	2.98%	15.98%
Inflation Linked Bonds	BESA CILI	Rand	459.9	0.02%	0.71%	5.80%	17.60%
Cash	STEFI Composite	Rand	667.3	0.13%	0.39%	4.35%	7.00%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US$	94.4	6.63%	7.26%	54.74%	38.81%
Gold	Gold Spot	US$	4 562.0	4.95%	12.84%	5.90%	36.63%
Platinum	Platinum Spot	US$	1 890.0	8.93%	13.92%	-5.92%	42.00%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	16.02	1.03%	3.41%	3.40%	10.64%
ZAR/Pound	ZAR/GBP	Rand	21.85	0.27%	2.20%	2.06%	8.79%
ZAR/Euro	ZAR/EUR	Rand	18.70	0.11%	2.14%	4.01%	10.00%
Dollar/Euro	USD/EUR	US$	1.17	-0.85%	-1.45%	0.34%	-0.85%
Dollar/Pound	USD/GBP	US$	1.36	-0.80%	-1.06%	-1.06%	-1.79%
Dollar/Yen	USD/JPY	US$	0.01	-0.19%	0.89%	1.48%	7.14%

Source: I-Net, figures as at 21 August 2026

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WEALTH