Consider This

Looking ahead to 2025: Key considerations for SA investors

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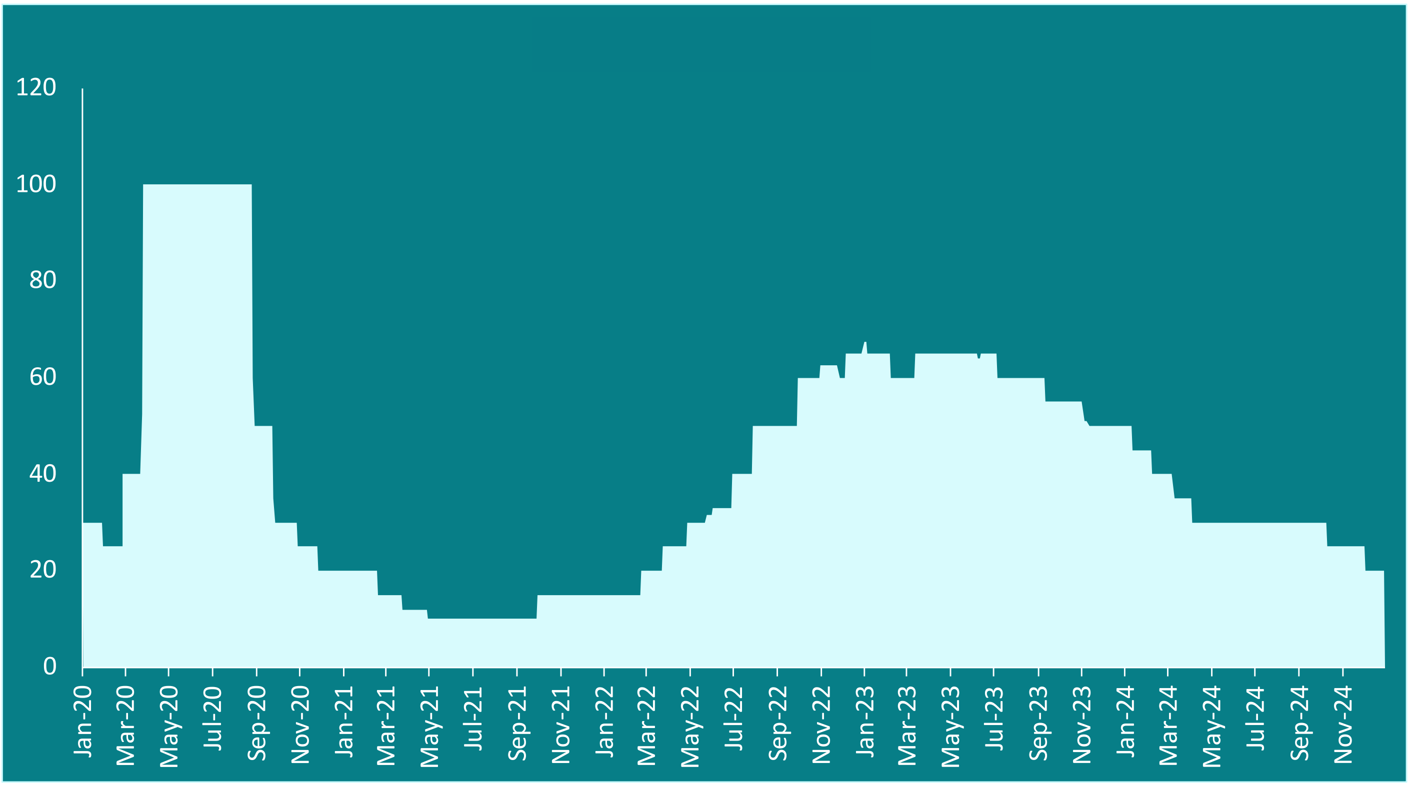
As we look ahead to 2025, South African investors are naturally faced with a rapidly evolving global and domestic investment landscape. While we typically avoid making predictions about the year ahead, we have taken the festive season to indulge in more than mince pies and sunshine. In this article, we discuss our concerns going into 2025, areas where we see the risks of asset prices not fully accounting for certain factors and share insights on how we use our proprietary valuation framework to identify mispriced opportunities with profitability potential in the medium to long term.

Reflecting on 2024

The year 2024 was marked by three key factors: the absence of a recession, well-behaved inflation and surprisingly strong equity market performance across most sectors.

Figure 1.1 – Expectations of a US recession faded during 2024



Source: Bloomberg, 31.12.2024

As evidenced in figure 1.1, the expectations of a recession diminished quite significantly from mid-year in 2023 to the end of 2024. In fact, expectations halved in the 12-month period to 30 June 2024 and ended the year at an 18-month low of 20%. Fading recession expectations was driven by steadily improving global growth estimates, across regions including the US, UK and China (shown in figure 1.2).

Figure 1.2 – Steadily improving global GDP estimates

2024 GDP estimates

		Sep-23	Oct-23	Nov-23	Dec-23	Jan-24	Feb-24	Mar-24	Apr-24	May-24	Jun-24	Jul-24	Aug-24	Sep-24
World		2.60	2.60	2.65	2.60	2.70	2.80	2.80	2.90	3.00	3.00	3.05	3.10	3.05
U.S.		0.90	1.00	1.20	1.30	1.50	2.00	2.20	2.40	2.40	2.30	2.30	2.50	2.60
U.K.		0.40	0.40	0.40	0.30	0.40	0.40	0.30	0.30	0.60	0.70	0.80	1.00	1.10
Eurozone		0.80	0.75	0.60	0.55	0.50	0.50	0.50	0.50	0.70	0.70	0.70	0.70	0.70
Germany		0.60	0.50	0.40	0.30	0.30	0.20	0.10	0.10	0.20	0.20	0.20	0.10	0.00
France		0.80	0.75	0.85	0.70	0.70	0.70	0.70	0.70	0.90	0.90	0.90	1.10	1.10
Italy		0.60	0.60	0.50	0.50	0.50	0.50	0.60	0.60	0.75	0.85	0.90	0.80	0.80
Japan		1.00	1.00	1.00	0.80	0.80	0.70	0.70	0.70	0.40	0.30	0.10	0.10	0.00
China		4.50	4.50	4.50	4.50	4.60	4.60	4.60	4.83	4.90	4.97	4.90	4.80	4.80
Hong Kong		3.00	3.00	2.80	2.70	2.70	2.70	2.70	2.70	2.70	2.65	2.70	2.80	3.00
Taiwan		2.94	2.90	2.90	3.10	3.05	3.10	3.20	3.20	3.30	3.70	3.80	3.90	4.00
South Korea		2.20	2.05	2.10	2.10	2.10	2.10	2.20	2.20	2.50	2.50	2.50	2.50	2.50
Indonesia		5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00
India		6.20	6.20	6.30	6.60	6.80	6.90	7.50	7.61	7.80	7.80	7.80	7.80	7.80
Brazil		1.55	1.60	1.60	1.60	1.60	1.63	1.70	1.90	2.00	2.10	2.10	2.12	2.80
Mexico		1.70	1.80	2.00	2.12	2.20	2.30	2.40	2.20	2.10	2.10	2.00	1.85	1.50
Turkey		2.70	2.75	2.95	2.70	2.80	2.80	3.00	3.00	3.00	3.00	3.10	3.35	3.20
South Africa		1.24	1.30	1.30	1.30	1.30	1.20	1.10	1.10	1.10	1.00	1.00	1.00	1.00

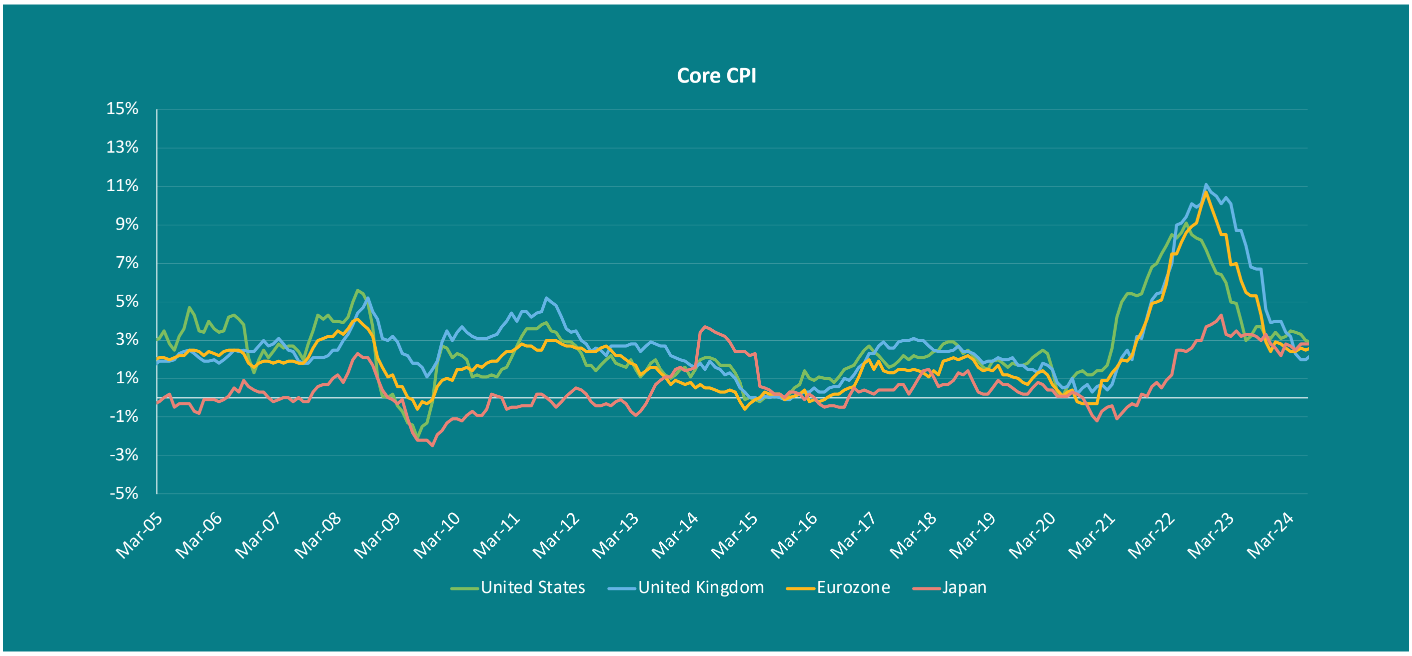
2025 GDP estimates

		Sep-23	Oct-23	Nov-23	Dec-23	Jan-24	Feb-24	Mar-24	Apr-24	May-24	Jun-24	Jul-24	Aug-24	Sep-24
World		3.00	3.00	2.95	3.00	2.90	2.90	3.00	2.90	3.00	3.00	3.10	3.10	3.05
U.S.		1.90	1.80	1.70	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.70	1.70	1.80
U.K.		1.50	1.30	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.40
Eurozone		1.45	1.50	1.50	1.40	1.40	1.40	1.30	1.40	1.40	1.40	1.40	1.40	1.30
Germany		1.40	1.50	1.40	1.15	1.20	1.20	1.10	1.10	1.20	1.20	1.20	1.00	1.00
France		1.35	1.30	1.35	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.20	1.20	1.10
Italy		1.20	1.20	1.20	1.10	1.10	1.10	1.10	1.10	1.10	1.05	1.10	1.00	0.95
Japan		1.05	1.00	1.00	1.00	1.00	1.10	1.10	1.10	1.10	1.10	1.20	1.20	1.20
China		4.50	4.50	4.50	4.30	4.40	4.30	4.30	4.44	4.50	4.50	4.50	4.50	4.50
Hong Kong		2.90	2.90	2.80	3.00	3.00	2.80	2.70	2.80	2.80	2.80	2.75	2.70	2.50
Taiwan		2.50	2.50	2.50	2.50	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60
South Korea		2.45	2.35	2.20	2.20	2.20	2.20	2.20	2.20	2.15	2.10	2.20	2.10	2.20
Indonesia		5.19	5.20	5.10	5.10	5.07	5.10	5.10	5.10	5.10	5.10	5.10	5.10	5.08
India		6.40	6.30	6.30	6.20	6.30	6.35	6.50	6.70	6.80	7.00	7.00	6.90	6.90
Brazil		2.00	1.98	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	1.98	2.00
Mexico		2.21	2.26	2.20	2.05	1.96	2.00	1.90	1.80	1.80	1.80	1.75	1.70	1.50
Turkey		3.10	3.45	3.30	3.40	3.50	3.50	3.40	3.25	3.30	3.20	3.20	3.10	3.00
South Africa		1.70	1.70	1.70	1.70	1.60	1.60	1.60	1.60	1.50	1.60	1.60	1.64	1.70

Source: Bloomberg 30.09.2024. Tables show month-on-month change in calendar year 2024 and 2025 GDP estimates.
Green = estimates revised up. Red = estimates revised own

Figure 2 – Inflation coming off historic highs

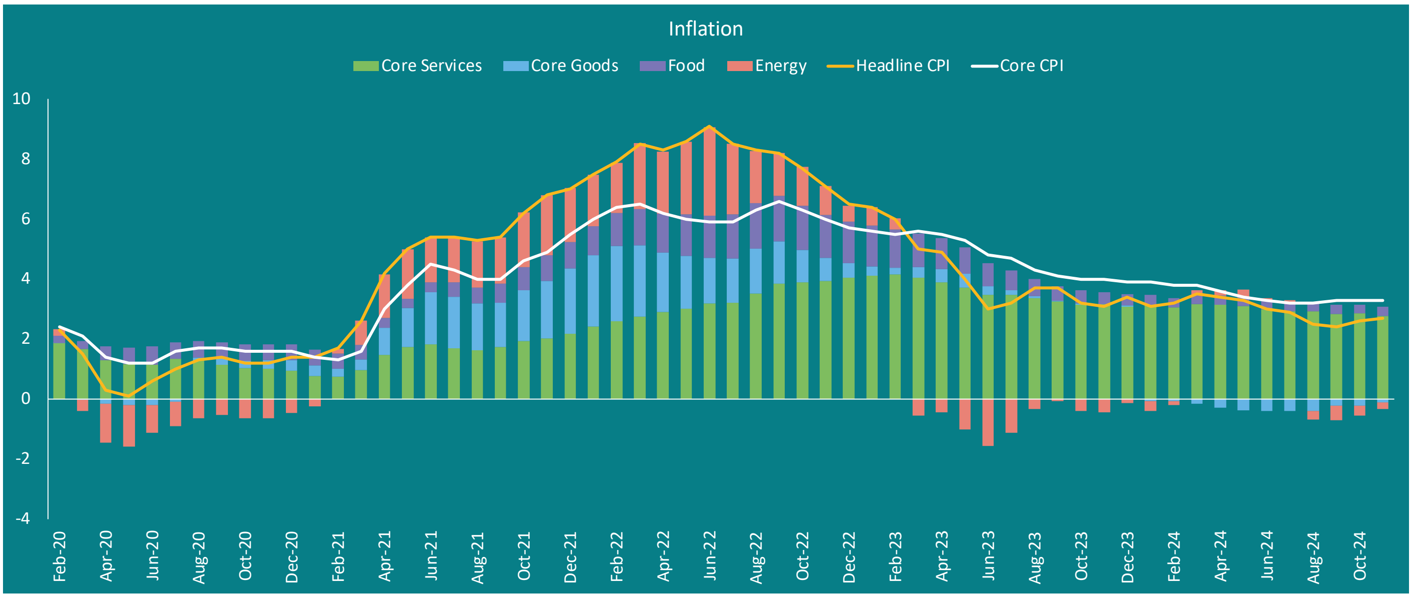
Core CPI (% YoY)



Source: Bloomberg 08.10.2024

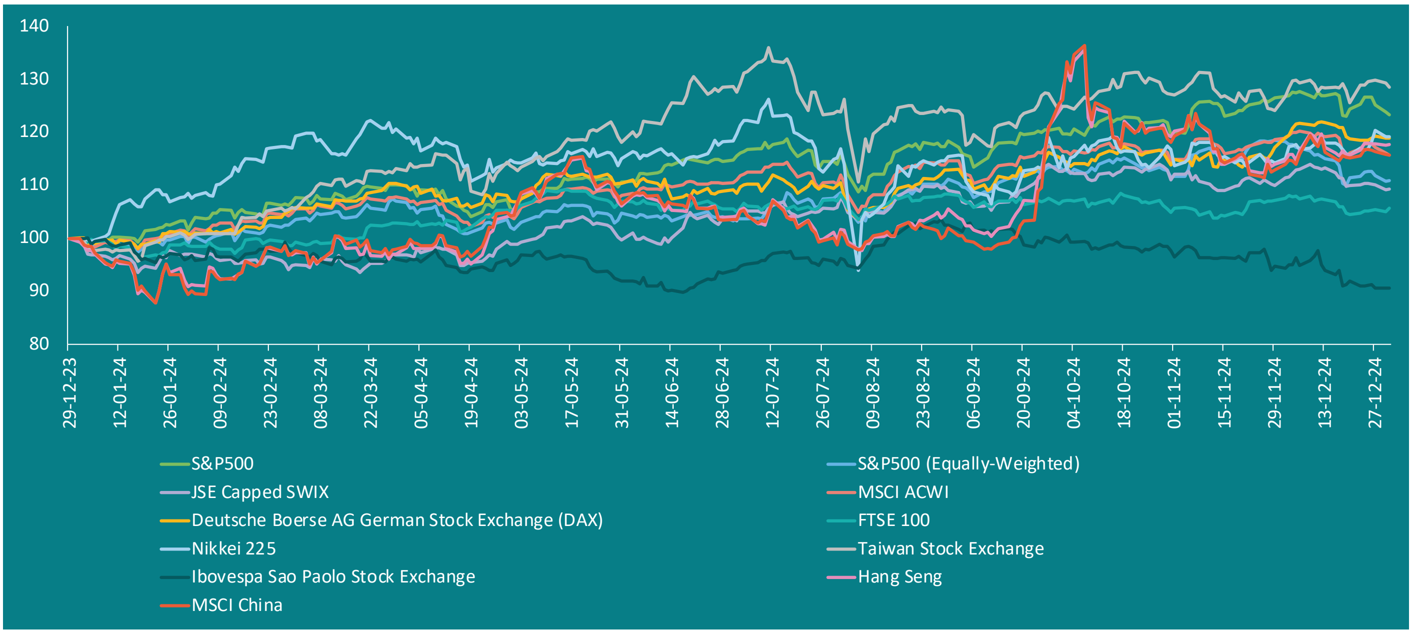
Inflation was contained and well-behaved in most regions and has moderated from the steep sticky highs experienced during 2022 and 2023 (shown in Figure 2).

Figure 3 - US CPI was well-behaved in 2024



Source: Bloomberg 31.12.2024

Figure 4 - Strong equity market performance in 2024



Source: Bloomberg 31.12.2024

One of the more surprising factors was the strong equity market performance across most sectors (shown in figure 4. Strong equity market performance (in local currency).

Factors to watch in the year ahead

We believe that fiscal stimulus could be one of the key macroeconomic drivers in 2025, particularly as it is a key tenet of the Trump 2.0 policy agenda. This could trigger potential retaliatory action from Europe, China and other affected countries. The fiscal and macroeconomic consequences of these developments on currency, bond and equity markets are currently underpriced and presenting a significant opportunity in our view.

Inflationary impact of fiscal expansion

Fiscal expansion is inherently inflationary[1,2,3] – when delivered into an economy without much economic slack. Fiscal expansions drive growth, through consumption and 'animal spirits,' and could be turbocharged by further monetary easing globally. While asset prices are currently discounting the latter, they have yet to contend with the impact of expanding budget deficits in the US, from the current expectation of 7% of GDP. CBO estimates fiscal deficits of 7-9%[4] in the early years of the Trump administration. This is especially significant as these deficits are likely to come from tax cuts rather than severe economic contraction.

Macroeconomic environment is expected to remain benign

One of the key trends to watch into 2025 would be the inflation outlook. Inflation has cooled globally from highs of around 11% y/y in some regions, such as the UK and Eurozone.

Inflation expectations for 2025 remain relatively well-anchored and trending downwards, but inflation could surprise either to the upside or downside, depending on macroeconomic shifts, trade tariff changes, if global supply chains are disrupted, or geopolitical tensions escalate.

Locally, South African inflation has also remained moderate, with core CPI expected to stay below 5% for the year. However, the risk of external shocks (such as higher global commodity prices) could lead to inflationary pressures in the domestic market.

Most central banks globally have commenced a rate-cutting cycle, including the Fed and SARB, which is largely expected to continue into 2025, provided inflation remains subdued. This will be challenged directly by expansionary fiscal policy if it comes to pass.

Political shifts and market implications

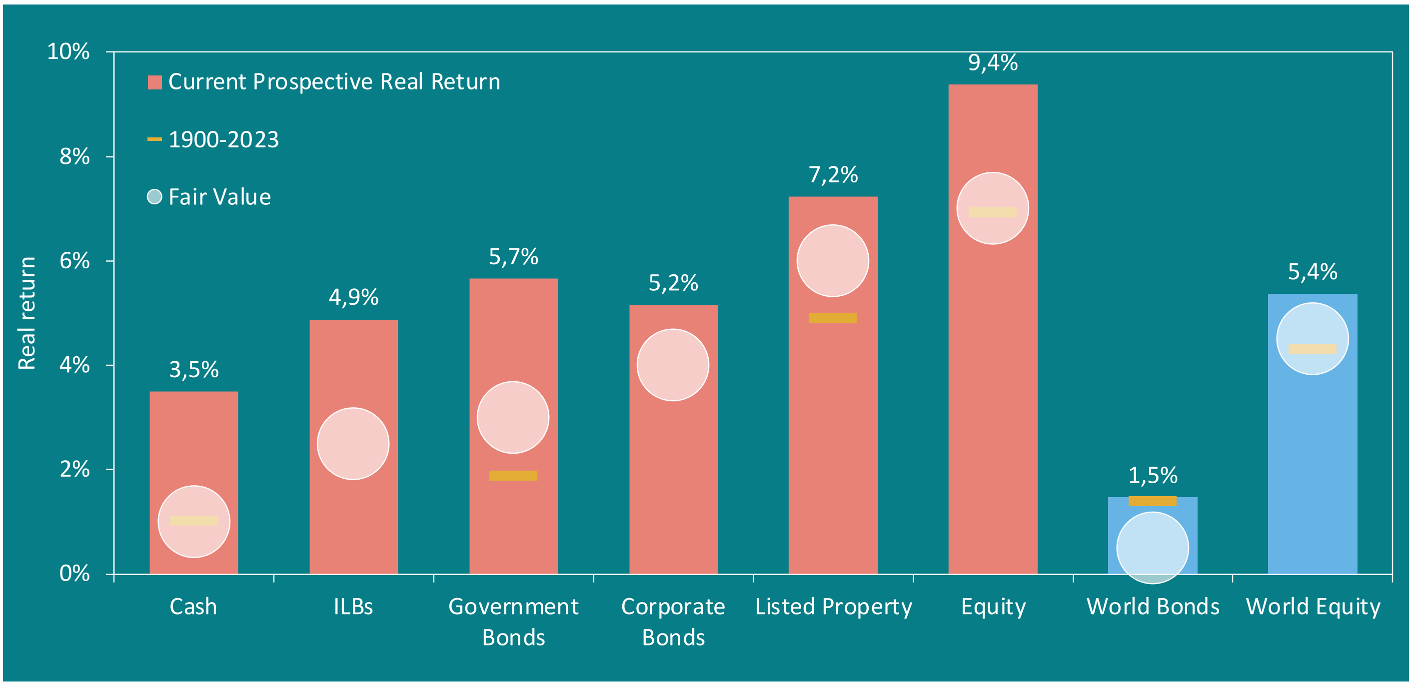
2024 was significantly framed by global political regime shifts. We anticipate that the year ahead will see policy changes across many economies in both developed and emerging markets, from the US to South Africa. The potential impact of these shifts on market sentiment and growth prospects is something to watch into 2025. Radical policy changes in key economies could lead to shifts in industrial policies (tariffs, lower immigration, manufacturing on-shoring etc). It is our observation that asset markets have barely priced this in. We will be watching the macroeconomic effects closely, particularly any moves related to these radical changes in policy and their second-round effects on equities, bonds and currencies.

In South Africa, the post-election period has brought some positive sentiment with the formation of a new government and renewed focus on economic reforms. However, the global political environment remains uncertain, which could lead to further market surprises locally.

Global markets and valuations

To navigate this environment, we rely on our proprietary valuation framework, which serves as a critical tool for identifying opportunities in both local and international markets. Below, we explain how this framework enables us to assess the relative value of various asset classes.

SA assets attractively priced
Prospective real returns remain above long-term historical averages



Source: Bloomberg, Credit Suisse, M&G Investments 09.01.2025

Global equities have delivered strong returns in recent years, particularly in areas with robust fundamental earnings growth. However, valuations in the US and some other regions are becoming increasingly stretched and the expensiveness of some assets may persist. US equities has seen extraordinary returns, with some indices such as the S&P 500 approaching 30% return in 2024. This strong performance was quite narrow, with the equally weighted S&P underperforming the market cap-weighted S&P by over 12 percentage points. Much of this growth can be attributed to the excitement in AI and large technology companies (the "Magnificent Seven"). As expectations for earnings growth continue to rise, investors must question whether these gains will be supported by actual earnings delivery in future. Going into 2025, the key risk lies in whether these so-called hyper-scaling AI companies can meet earnings expectations to justify their lofty valuations. If they fall short, the market fallout could be severe given the current high valuations.

In contrast to global equities, we continue to maintain our preference for South African equities. The South African equity market experienced a period of rerating, but the real story has been the recovery in fundamental earnings. We expect continued positive earnings growth in 2025, though at a more moderate pace compared to recent years. The resilience of local businesses and recovery in sectors such as banking, resources, and consumer staples will continue to drive equity returns. We continue to believe that SA equities are undervalued compared to global peers.

The strong SA equity performance was driven by listed property, which has been a standout performer since the rebound in November 2023 and has delivered steady outperformance and outsized returns relative to global peers and other asset classes. SA listed property continues to offer significant opportunities, particularly in real estate investment trusts (REITs), which have shown strong performance. Despite the historic challenges in the property market, the improving fundamentals cements SA listed property as an attractively priced asset class.

Global bonds have faced a challenging environment, with rising yields and a strong US dollar. The spectre of inflation, which continued to haunt fixed rate bonds in 2024, could be amplified by inflationary fiscal expansion. However, we continuously look for opportunities in undervalued global bonds, particularly in emerging markets and areas of the Eurozone. Value has been restored in real yields across the bond universe and provides some comfort that future returns are supported by currently positive real yields.

Despite a challenging year for global bonds, South African bonds continue to offer attractive yields, particularly in the nominal bond space. We have seen significant capital gains from SA bonds, and while returns have moderated somewhat, they remain strong. Forward-looking valuations for government bonds are still favourable. Our stance remains positive on nominal bonds, with the expectation that these will continue to outperform inflation-linked bonds (ILBs).

As South African government bonds continue to offer strong returns relative to global benchmarks, we remain constructive on this asset class. The potential for further yield compression and price appreciation in the local bond market remains attractive.

In commodities, 2024 was a strong year for gold, while other commodities such as copper remained relatively flat. Going into 2025, gold may continue to be a favoured asset class, particularly as a hedge against inflation and geopolitical risks. We continue to strategically manage our underweight portfolio positioning in quality gold stocks, such as Anglogold Ashanti, Gold Fields, and Harmony Gold.

Approach with cautious optimism

The consensus in the market is one of comfort with hopeful expectations on return prospects into 2025. The preference for equities is widespread particularly for US equities over other regions and the expectation is for US equity performance to continue to gain momentum. While global equities remain expensive in some areas, select opportunities still exist, especially in emerging markets. We encourage investors to exercise caution against being lulled into a sense of comfort by the benign macroeconomic environment and seeking to justify investing in overpriced asset classes.

As always, we remain focused on our valuation-driven investment process. We seek opportunities where the current market pricing is misaligned and appears to either underestimate or overestimate changing fundamentals. Our focus is on asset classes that are currently undervalued relative to their global counterparts, such as SA equities, SA bonds, and SA listed property, where strong fundamental earnings growth is expected.

Sources:

1. Blanchard, Olivier (2009), Macroeconomics (5th Ed)
2. Blinder, Alan (1982), The Anatomy of Double-Digit inflation in the 1970s.
3. De Vroey, Michel (2016), A History of Macroeconomics from Keynes to Lucas and Beyond
4. US Budget Watch (2024), Chartbook: The Fiscal Impact of the Harris and Trump Campaign Plans.
   Link: https://www.crfb.org/papers/chartbook-fiscal-impact-harris-and-trump-campaign-plans