ALLAN GRAY

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2025: Risk remains heightened around the world

Following a year that saw political regimes shift in many parts of the world, investors need to brace themselves for a period of elevated risk as geopolitical dynamics remain in flux. This will, no doubt, influence global markets and shape the opportunity set for long-term investors. In his first investment update of 2025, Allan Gray's chief investment officer, Duncan Artus, reviews 2024 and discusses the risks and opportunities that may lie ahead — leaving us with the cautious parting words that he hopes the year turns out better than he is anticipating. Watch this 13-minute video to find out more and read the commentary below.

Review of 2024

2024 will go down in history as the year when the most people voted, according to Deutsche Bank. This is extraordinary, considering that the Chinese don't vote. As bottom-up, long-term investors, we normally don't pay a huge amount of attention to politics when managing our portfolios, but 2024 felt different to us. If we think about the rally in local bonds and domestically focused shares following the South African election and the formation of the government of national unity (GNU) in June, and the performance of US equities post the Republican Party's clean sweep, markets were repricing assets based on political change.

The shift in global leadership is taking place amid ever-rising geopolitical tensions and in an increasingly divided world. We have written about this on several occasions and continue to think about potential risks and opportunities it may bring. We are bottom-up investors, but we do want to be on the right side of long-term trends.

Turning to markets

The South African equity market, as represented by the FTSE/JSE All Share Index, returned 13.4% in 2024 – outperforming both cash at 8.2% and inflation of 2.9%[1]. This translated into a US dollar return of 10.2%. The FTSE/JSE All Bond Index returned 17.2%, as investors bought South African bonds aggressively in the wake of the national election results. Yields on the South African 10-year bond fell from a high of 12.2% to a low of 9.9%, finishing the year at 10.2%. The spread between South African yields and US government bonds also contracted significantly by more than 200 basis points. South African bonds outperformed the J.P. Morgan GBI-EM Global Core Index by a massive 15.6%. The rand weakened by 2.9% against the US dollar.

Internationally, the MSCI World Index returned 18.7% and the FTSE World Government Bond Index returned -2.9% in US dollars, respectively. The world index is close to all-time highs. The US dollar has been strong against almost all other global currencies.

Equity returns were again dominated by the large US technology shares, which continued their strong performance from 2023. The S&P 500 returned more than 25% two years in a row for the second time in over 65 years. Investor interest in artificial intelligence (AI) continued to grow significantly. Forecasts suggest that practical applications of AI will benefit not only technology businesses but also industries such as healthcare and banking, where AI can be used to increase efficiencies and, consequently, earnings. While the long-term impact of AI is difficult to predict, we are monitoring developments closely.

The equity market has been willing to discount this future at least partially via higher valuations. The election of Donald Trump as US president, alongside the Republican Party retaining its majority in the House and taking control of the Senate, further encouraged investors' belief in US exceptionalism. I best heard it described as the "Trump turning point".

Here are some examples of US dominance, courtesy of Morgan Stanley:

- 76 of the 100 largest listed companies globally are from the US
- US GDP estimates for 2024 have more than doubled
- After their worst relative underperformance since the euro crisis in 2012, European shares trade at a 40% price-to-earnings (PE) discount to US equities

While our portfolios do have exposure to US equities, we remain very underweight and are currently finding better value elsewhere in global markets. The US market has also become very concentrated with the top seven stocks accounting for more than 30% of the index. Our direct foreign exposure in the Balanced Fund is 36.7%.

Locally, as mentioned previously, the bull case played out for many local shares post the elections. A lower cost of capital, combined with higher forecasted growth, led to much higher valuations for local industrial and financial companies. Capitec now has a market cap that is R143bn greater than that of Gold Fields. As a citizen of South Africa, I hope these forecasts of a better future turn out to be correct, but we have been trimming some of the SA Inc winners and switching into multinationals that have underperformed them. The bulls will point out that there has been little foreign participation in the local equity rally and that foreigners' potential return to our market would bring considerable buying power. The bears will point out that the GNU has yet to be fully tested and that the ANC only really lost its majority because of the performance of the MK Party.

1. This is based on the latest available numbers published by IRESS as at 30 November 2024.

Performance

For the calendar year, relative performance lagged compared to the recent past across most of our funds, which were underweight many of the cyclical SA Inc shares that rallied significantly following the election. Our multi-asset funds were also underweight South African fixed income and, within fixed income, we had lower duration than many peers, which also hurt our relative performance.

The Balanced Fund returned 10.4%, underperforming its benchmark by 2.4%. The Stable Fund returned 10.4%, performing slightly ahead of its absolute benchmark. The Equity Fund returned 11.5%, underperforming its benchmark by 5.1%.

The Orbis Global Equity Fund returned 12.6% in dollars for the year, underperforming the world index by 6.1%. Orbis Global Balanced returned 12.3%, outperforming its 60/40 benchmark by 3.0%. Orbis' relative returns, which had been strong for most of the year, were impacted by a sell-off in Korean stocks, and being underweight mega-cap US tech shares and the US dollar.

Conclusions

As we enter 2025, the world appears to be in a period where risk remains heightened across the board. There are many things that could go wrong. The Investment team continues to apply the same philosophy and process we have adhered to for the last 51 years in managing our clients' hard-earned savings.

Over the decades, we have learnt the importance of sharing transparent, engaging information with our clients. This is particularly important during the cycles of underperformance that are inevitable when investing over the long term. As always, I encourage you to focus on your long-term financial plans and goals rather than worrying about the daily news cycle – as challenging as that is these days. Long-term investing proves most fruitful for those who manage to stay the course.

On behalf of the Investment team, I thank you for the ongoing trust you have placed in us.

Commentary contributed by Duncan Artus, chief investment officer, Allan Gray

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