Melville Douglas Focused Quarterly Commentary

/ Q2 2025

Navigating beyond peak volatility: A more constructive outlook amid residual uncertainty

Bernard Drotschie
/ Chief Investment Officer

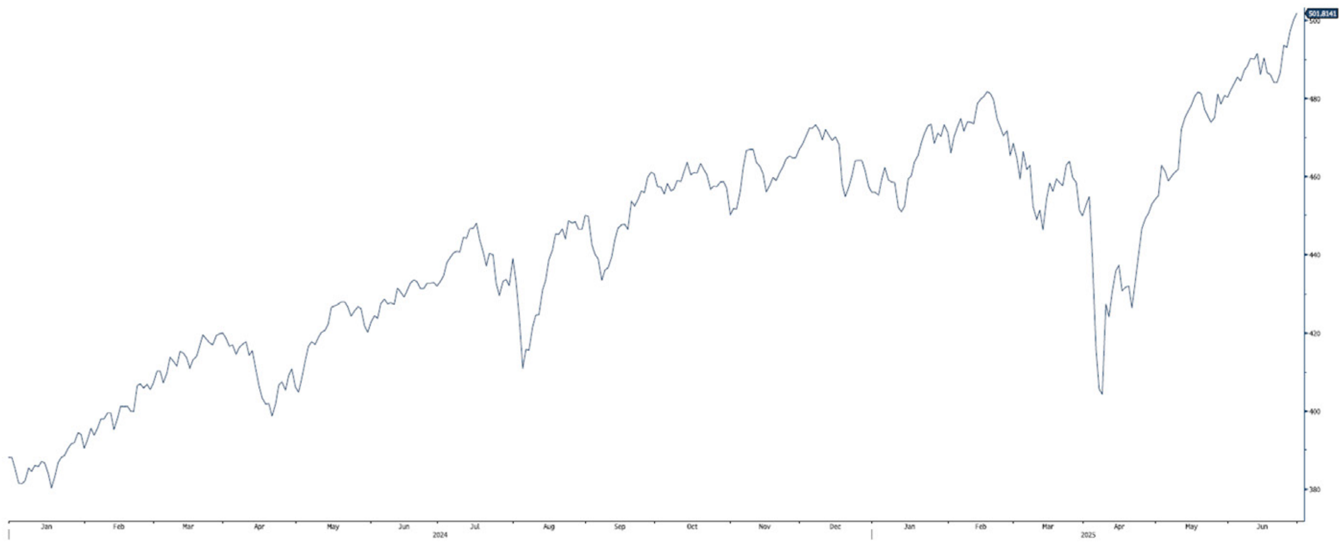
At the start of the year, we positioned client portfolios with a more cautious tilt, anticipating heightened levels of uncertainty and volatility under the leadership of President Trump, who has often emphasised the strategic value of unpredictability. While we expected a turbulent environment, the scale and nature of geopolitical developments and trade tensions that have unfolded since were difficult to foresee.

Despite persistent eye-catching headlines and market noise, underlying economic fundamentals have remained relatively stable. The divergence between soft data (such as subjective sentiment surveys and leading indicators) and hard data (actual economic performance) has widened, yet investors have increasingly focused on a more constructive outlook for the coming year. This optimism is underpinned by a supportive monetary and fiscal policy environment globally.

Global equity markets reached new highs by the end of the second quarter, completing a notable rebound from the sharp sell-off triggered by the initial 'Liberation Day' announcement of US tariffs on April 2nd. Since hitting a 17-month low on April 8th, the MSCI All Country World Index (ACWI) has risen by 24%, regaining all the lost ground and more.

Trump's 'reciprocal tariff' announcements initially generated significant market volatility

GLOBAL EQUITY MARKETS REBOUND POST THEIR APRIL LOWS



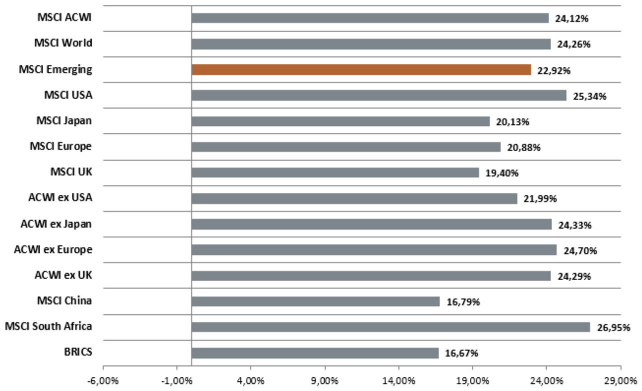
Source: Bloomberg

Trump's 'reciprocal tariff' announcements initially generated significant market volatility and prompted many economists to rapidly revise global growth forecasts downward. The revisions were largely driven by expectations of higher inflation, which was anticipated to erode consumers' disposable income and dampen spending on discretionary goods such as vehicles, travel, and leisure activities.

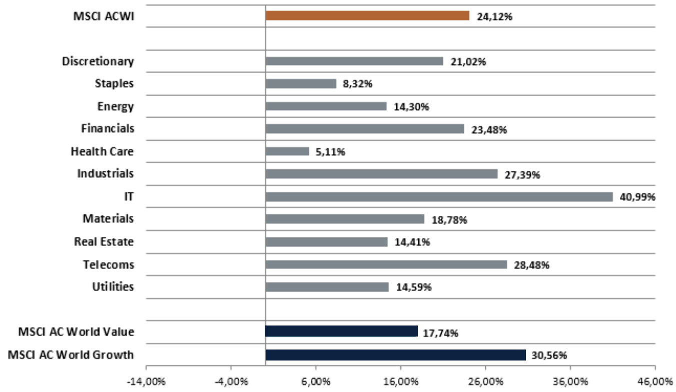
However, after a string of policy reversals and delays in tariff implementation, combined with resilient 'hard' economic data, investor confidence was quickly restored. The equity market rebound has stood in contrast to continued pressure on the US dollar, which has fallen to a three-year low amid growing concerns over the sustainability of US fiscal metrics and decelerating growth momentum. Measures of US consumer and business sentiment have also been affected by the unpredictability of trade policy, particularly tariffs on metals, semiconductors, automobiles, and consumer goods. Nevertheless, equity markets have found support in strong corporate earnings, particularly among large-cap Technology companies. Moreover, fears that aggressive trade policy shifts would reignite inflation or disrupt the labour market have not yet materialised. The administration's landmark tax reform is also expected to provide a tailwind to economic growth and corporate profitability.

Technology stocks, which experienced a sharp correction earlier in the year, have led the recent recovery—rising over 40% since the tariff policy reversal on April 9th. The narrative has since shifted back towards innovation and growth, particularly in areas such as artificial intelligence. US equities have outperformed both developed and emerging markets over this period, highlighting investor confidence in the resilience of the US economy and corporate sector.

MSCI REGIONS - SINCE 9TH APRIL



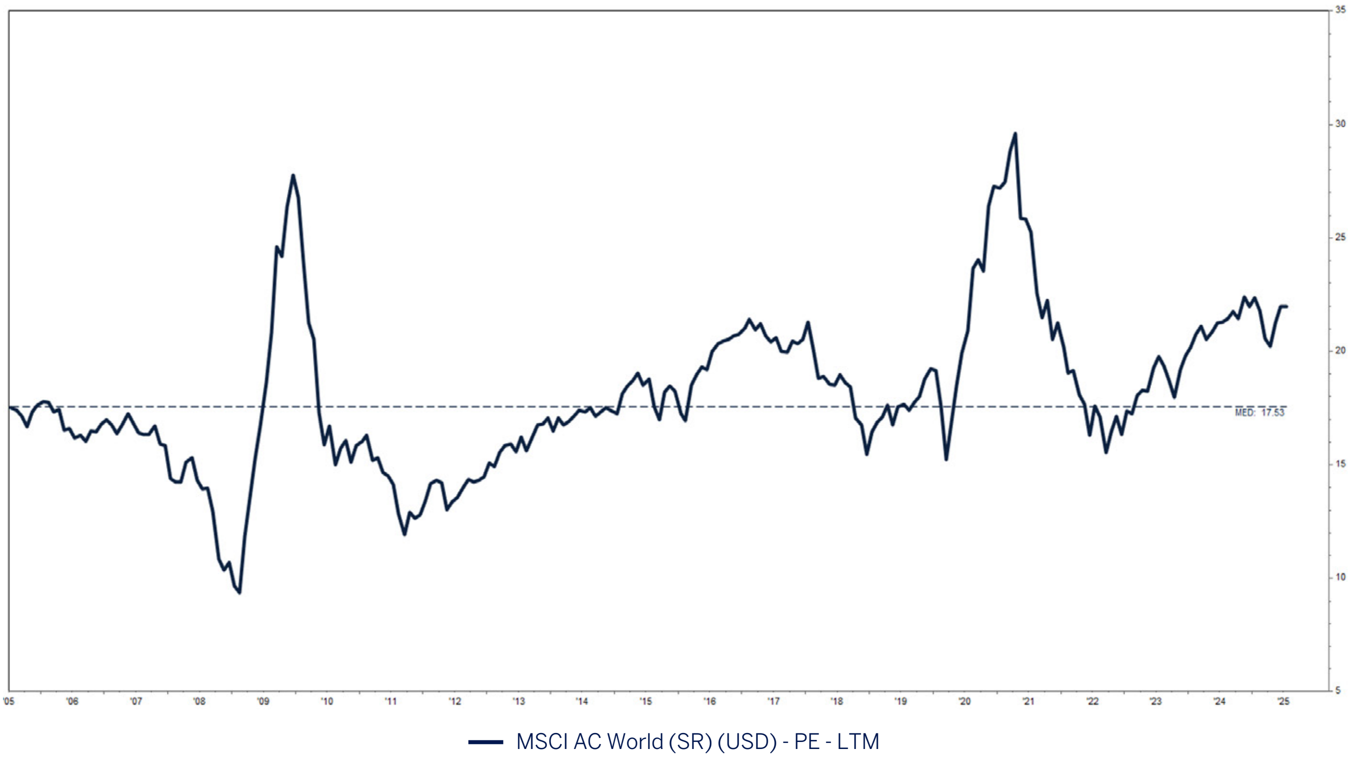
MSCI ACWI & SECTORS - SINCE 9TH APRIL



Source: FactSet

However, current market pricing reflects a highly optimistic outlook, offering limited margin of safety given the ongoing uncertainties around elevated and growing sovereign debt levels, global trade and geopolitical tensions.

GLOBAL EQUITY VALUATIONS REMAIN ELEVATED



Source: FactSet

South Africa

Weathering the storm

Despite ongoing global volatility, South African financial markets delivered a notably strong performance in the second quarter. The All-Share Index rose by 10.2%, outperforming the MSCI All Country World Index, which gained 7.8% in Rand terms. This brings the year-to-date total return for South African equities to 17% - marking the strongest first-half performance since 2006.

SA ASSET CLASS PERFORMANCE TOTAL RETURN, YEAR-TO-DATE

Cash — JSE All Bond Index (ALBI) — JSE All-Share Index — Global Equity (MSCI ACWI) in ZAR

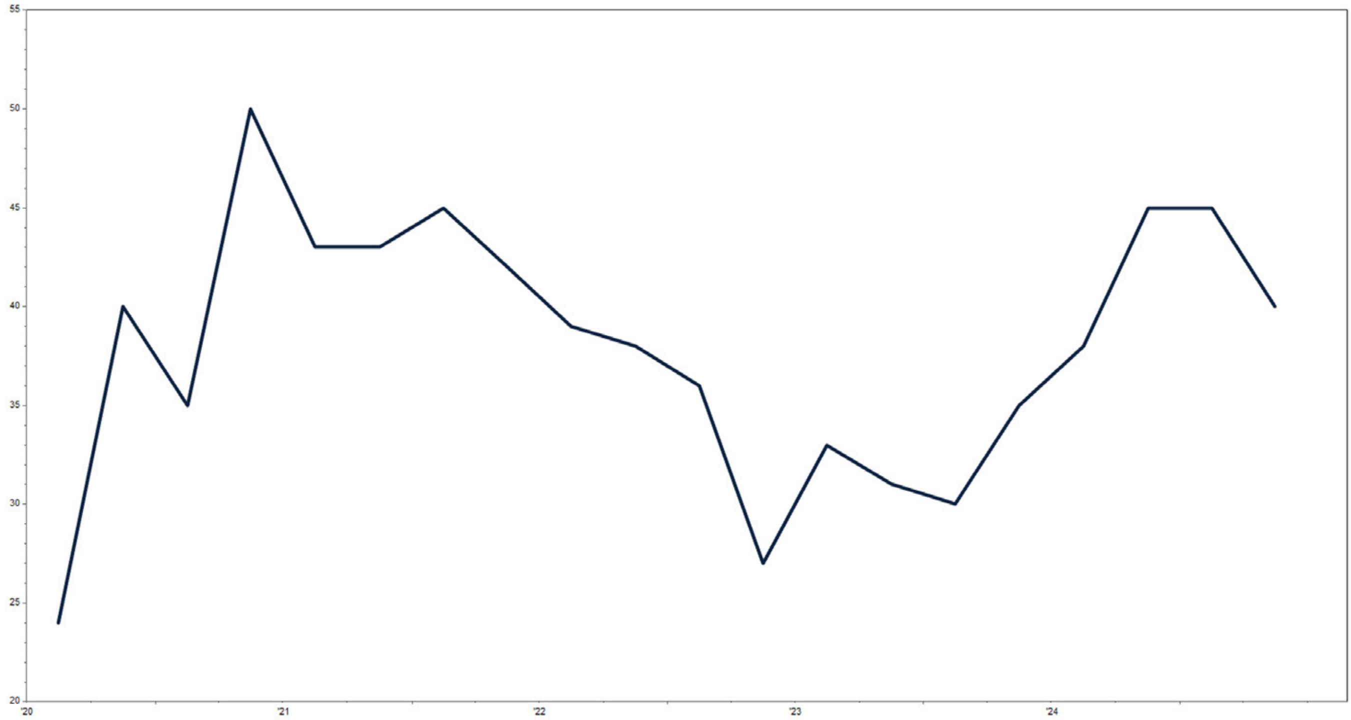
Source: FactSet

The Industrials sector led the way, returning 12%, largely driven by robust rallies in Naspers and Prosus. The Resources sector followed closely, delivering a 9.2% return, supported by gold's continued strength and a sharp 37% rally in platinum. The latter was buoyed by expectations of tighter supply, increased jewellery demand, and a weaker US dollar. In contrast, the Financial sector lagged, posting a more modest return of 8%.

While overall market returns have exceeded expectations, it's important to note that performance has been concentrated in a few key areas—namely gold, platinum, technology, and telecommunications. Domestically focused stocks have underperformed, weighed down by elevated valuations at the end of last year and slowing earnings momentum amid a challenging geopolitical and economic backdrop. The recent executive orders from the US administration to halt aid to South Africa and increase import tariffs highlight the risk of further country-specific headwinds, has manifested in lower confidence across various sectors.

> a consistently lower inflation environment could benefit the broader economy in the medium term by reducing nominal interest rates

BER BUSINESS CONFIDENCE



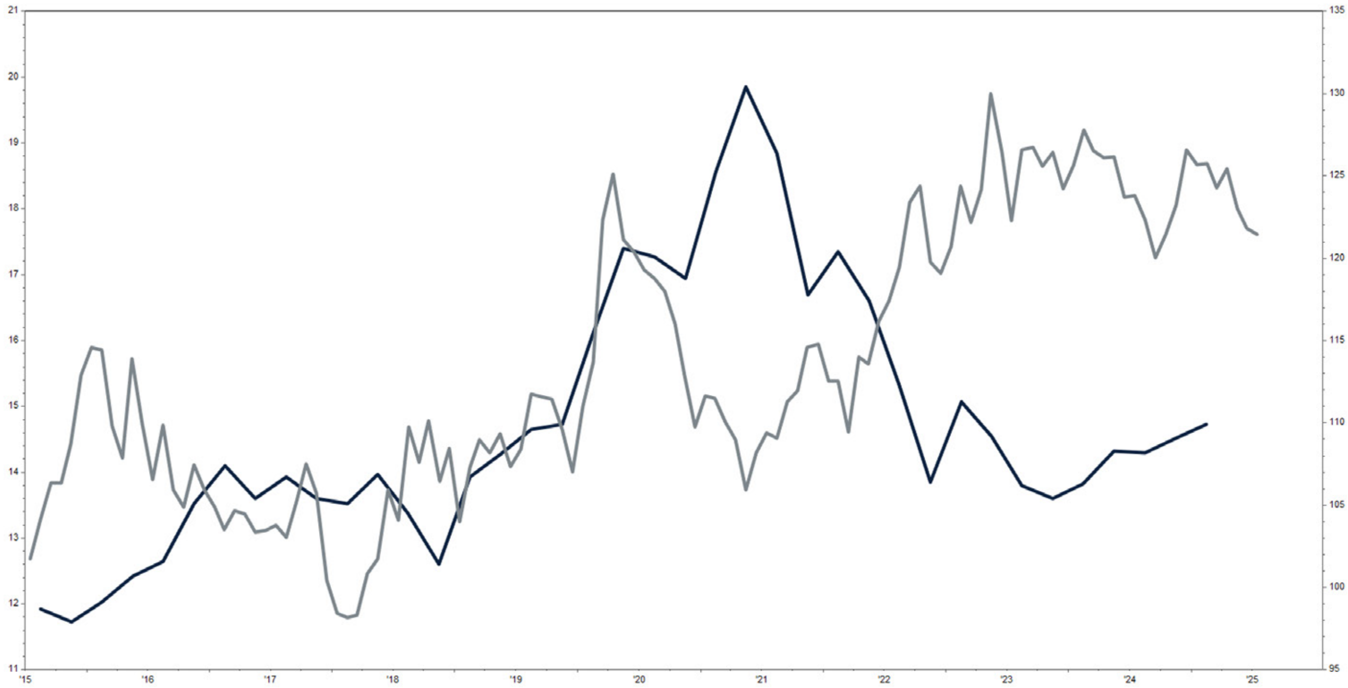
BER Business Confidence South Africa

Source: FactSet

South African bonds delivered strong performance during the quarter, with the All Bond Index (ALBI) gaining 5.9%. This was largely supported by declining interest rates and inflation coming in lower than expected as a result of subdued domestic demand, softer oil prices, and a firmer Rand. In addition, as outlined in more detail below, the South African Reserve Bank has signaled interest in encouraging National Treasury to lower the official inflation target to 3%, with a 1% tolerance band. If implemented, a consistently lower inflation environment could benefit the broader economy in the medium term by reducing nominal interest rates and contributing to currency stability.

In the interim, South Africa's improved Terms of Trade — reflected in stronger export commodity prices relative to imported goods — should continue to lend support to the Rand.

TERMS OF TRADE VS SOUTH AFRICAN RAND



Trade Price, Terms of Trade, Including Gold, 2010=100, SA, Index - South Africa   USD/ZAR - Price

Source: FactSet

In summary, the first half of the year has been rewarding for investors, despite a turbulent global backdrop. However, the concentration of returns and emerging geopolitical risks warrant a cautious and selective approach going forward, and we will continue to invest in a combination of global multinational as well as domestically oriented companies in South Africa that demonstrate the ability to grow earnings despite a subdued economic environment. In our view, periods of low growth tend to highlight the contrast between high-quality businesses and those with weaker fundamentals.

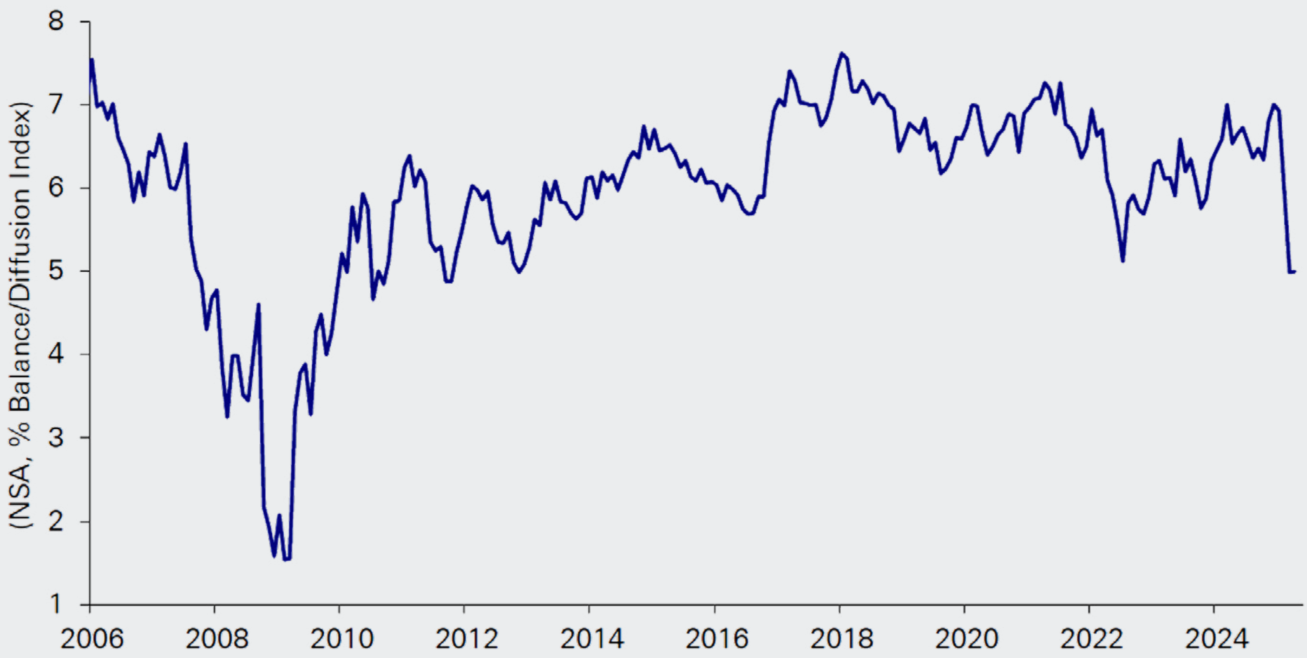
Conclusion

The Chairman of the US Federal Reserve Jerome Powell perhaps captured the current sentiment best at the latest FOMC meeting when he remarked, 'Uncertainty about the economic outlook has diminished, but remains elevated.' The global economic landscape is currently shaped by a complex mix of conflicting signals and broader macro themes. While shipping volumes have improved, suggesting a rebound in global trade, this is offset by declining capital expenditure and weakening business confidence. Major consulting firms like Accenture are reporting a slowdown in their order books, hinting at growing corporate caution. At the same time, macroeconomic data is taking a back seat to more dominant narratives, particularly the erratic flow of news around global tariffs and escalating geopolitical tensions, especially in the Middle East. Despite the uncertainty, there are signs of progress in global trade negotiations. The 90-day tariff extension periods are being interpreted as evidence that the US administration has a threshold for economic (and market) pain, raising hopes for more balanced trade deals. This has significantly reduced the perceived risk of a US or global recession. Although growth forecasts have been revised lower, they remain far from signalling a contraction.

Risk markets have responded positively, with corporate bond spreads tightening and equity markets rebounding from earlier volatility. This recovery supports the wealth effect and reduces the likelihood of a self-fulfilling economic downturn. Hard data, particularly in the labour market, remains resilient – unemployment is low, and wage growth is outpacing inflation. Even soft data, such as consumer confidence, is showing signs of stabilisation.

Looking ahead, some slowdown is expected as businesses and consumers adopt a cautious stance ahead of potential tariff changes. However, this is unlikely to prompt aggressive monetary easing. The US Federal Reserve is expected to maintain a "wait and see" approach, with only two rate cuts forecast for the second half of the year. Inflation may edge above 3% in the coming six months due to tariff effects, justifying a "higher for longer" stance on interest rates. Ultimately, while the outlook remains uncertain, the base case points to slower growth, sticky inflation, and narrower profit margins. A more definitive resolution on tariffs will be key to shaping market direction and policy responses in the months ahead.

US CEO CONFIDENCE IN THE ECONOMY 1 YEAR FROM NOW



Source: Bloomberg Finance LP. Deutsche Bank

Despite recent market strength, current pricing of risk assets such as US equities and credit reflects a notably optimistic outlook, leaving limited margin for error amid persistent uncertainties surrounding global trade and geopolitical tensions. In light of these risks, we maintained a cautious stance throughout the second quarter, with an underweight allocation to Global Equities, a neutral allocation to Fixed Income and an overweight Cash Plus position. However, with the temporary freeze on reciprocal tariffs set to expire shortly, a positive resolution could warrant an increased allocation to Global Equities.

While South Africa remains influenced by global developments and external economic pressures, there is a growing sense of cautious optimism regarding its domestic outlook. The country is not entirely insulated from international trends, but recent initiatives suggest a meaningful shift in direction. A renewed emphasis on implementing structural reforms—particularly those focused on infrastructure development—is beginning to take shape. These reforms, coupled with increased participation from the private sector and more robust oversight from the newly formed Government of National Unity (GNU), present a promising opportunity to reshape the trajectory of the South African economy.

This combination of factors could help place the country on a more sustainable and upward growth path, potentially allowing it to outperform its historical economic performance. The focus on infrastructure is especially noteworthy, as it tends to have a multiplier effect across various sectors, stimulating job creation, improving productivity, and attracting investment. The involvement of the private sector adds further credibility and momentum to these efforts, while the GNU's oversight may help ensure that reforms are implemented effectively and transparently.

However, it is important to acknowledge that South Africa can no longer rely on external support mechanisms to drive its progress. Preferential trade agreements, international aid, and foreign funding are no longer guaranteed sources of growth. The country must now look inward and develop self-sustaining strategies to achieve long-term prosperity. Monetary policy, while still a useful tool, will not be sufficient on its own to alter the broader economic trajectory. Structural changes and policy reforms will be essential.

In the short term, South Africa is likely to face several challenges as it adjusts to this new reality. Businesses will need time to adapt to revised tariff structures and may have to seek alternative markets for their goods and services. This transition period could be marked by uncertainty and disruption, particularly for export-oriented industries. On a more positive note, interest rates have been trending lower, which should provide some relief to the domestic economy. Lower borrowing costs can stimulate consumer spending and investment, offering support to financial markets.

ALL SHARE INDEX TOTAL RETURN YOY; PRIME OVERDRAFT RATE

Source: Bloomberg Finance LP. Deutsche Bank

From a market perspective, many of the risks mentioned appear to be already factored into current asset valuations. South African government bonds are yielding around 10%, which reflects a significant risk premium. Similarly, several domestically focused equities—often referred to as "SA Inc."—are offering dividend yields in excess of 5%. These figures suggest that investor sentiment may already be somewhat pessimistic, and that current market levels could present opportunities for long term and patient investors.

While challenges remain, the combination of structural reform, private sector engagement, and supportive monetary conditions offer a pathway toward a more resilient and dynamic South African economy. The road ahead may be complex, but the foundations for meaningful progress are beginning to take shape.

> The road ahead may be complex, but the foundations for meaningful progress are beginning to take shape

South Africa's shift to a 3% inflation target

South Africa's National Treasury, together with the South African Reserve Bank (SARB), has recently confirmed its intention to lower the country's inflation target to 3%. This marks a notable shift from the current 3–6% range (with a midpoint of 4.5%) and reflects a broader commitment to strengthening price stability and aligning with international monetary policy standards.

This change has important implications for the direction of interest rates. With headline inflation currently below 3% and core inflation near the lower end of the existing target range, the SARB sees an opportunity to reinforce low inflation expectations. According to modelling presented at the May 2025 Monetary Policy Committee (MPC) meeting, a 3% target could accelerate the decline in inflation expectations, potentially allowing for a more accommodative interest rate stance over the medium term.

SA INFLATION: HEADLINE AND CORE

Source: FactSet

In the short term, however, the SARB is expected to remain cautious. The repo rate currently stands at 7.25%, and while inflation is subdued, the MPC has emphasized the need to firmly anchor expectations before considering any easing. Over time, as credibility in the new target builds, we anticipate a gradual reduction in policy rates. This would support investment and consumption, particularly in interest-sensitive sectors such as housing, durable goods, and capital-intensive industries.

The broader economic impact of a lower inflation target is multifaceted. On the positive side, tighter inflation control enhances macroeconomic stability, reduces risk premiums, and can attract foreign investment. It also helps protect the purchasing power of consumers, especially lower-income households, who are most vulnerable to inflation volatility. That said, the transition may involve some short-term trade-offs. Achieving the lower target could require a more restrictive monetary stance initially, which may weigh on growth. This is particularly relevant given South Africa's modest growth outlook. However, if the new inflation framework is supported by credible fiscal consolidation and meaningful structural reforms, the long-term benefits could be substantial.

From a market perspective, the implications are broadly constructive. Fixed income markets may benefit from a decline in long-term yields as inflation risk premia compress, and equities, particularly in consumer-facing and interest-sensitive sectors, could see improved valuations if lower rates stimulate demand.

While the exact timing of implementation remains uncertain, this policy shift represents a proactive step toward building a more stable and competitive economic environment. If executed effectively, it could lay the foundation for stronger, more sustainable growth in the years ahead.

Investment performance

After many years of favourable absolute and relative returns, our equity strategy, represented by the Melville Douglas Global Equity Fund in most client portfolios, has seen a marked deterioration in relative returns, underperforming both benchmark and peer group over the past year. This short-term underperformance has impacted both equity and multi-asset client portfolios for the quarter, particularly USD mandates. Despite the highly disruptive economic and geopolitical environment over the period, and the concentration of equity market returns (Magnificent 7), this outcome has prompted us to take a thorough and honest interrogation of all our investment decisions, which has resulted in increased activity.

Since its inception in March 2012, the Melville Douglas Global Equity Fund has delivered very attractive absolute returns and has broadly kept pace with the MSCI ACWI, while outperforming peers over the long-term, and we have navigated similar periods of short-term underperformance in the past. In each case, we made necessary adjustments where the facts changed, while remaining anchored to our core philosophy: investing in global companies, that are high-quality compounders, at reasonable valuations.

We are confident that the actions we have taken will position our equity strategy to again deliver favourable index-relative returns going forward.

Our fixed income strategies and weightings within multi-asset client portfolios again delivered positive returns in the quarter, broadly in line or above their respective benchmarks. Overall, duration and investment grade corporate exposure remain broadly neutral to benchmark as we wait for further clarity on the tariff impact on both the US and global economy.

Global asset allocation

Global Equity - Underweight

- Monetary policy is expected to remain supportive, with interest rates likely to ease further in the 2nd half of the year.
- Although earnings revisions have turned negative in 2025, corporate earnings growth is projected to regain momentum and broaden across sectors in 2026 and 2027. This recovery is expected to be driven by favourable base effects, lower interest rates, and continued fiscal support.
- Equity markets have already delivered strong performance this year, with the MSCI ACWI and MSCI ACWI ex-US rising by 10% and 18%, respectively —largely due to valuation re-rating.
- However, current market pricing reflects a highly optimistic outlook, offering limited margin of safety given the ongoing uncertainties around global trade and geopolitical tensions.
- We are closely monitoring the outcome of trade negotiations, particularly as the temporary freeze on reciprocal tariffs is set to expire in July. A constructive resolution could warrant an increased allocation to global equities.

Sector views

Consumer Discretionary	Underweight
Consumer Staples	Underweight
Energy	Underweight
Financials	Overweight
Healthcare	Underweight
Industrials	Underweight

Information Technology	Overweight
Materials	Underweight
Communications Services	Overweight
Utilities	Underweight
Real Estate	Underweight

Global Fixed Income – Neutral

- We anticipate yields to stay rangebound in the near term, with increased daily volatility due to heightened and erratic news flow.
- Given the prevailing tariff uncertainty and the lack of a clear economic outlook, we are comfortable maintaining a neutral weighting to fixed income in multi-asset portfolios.
- The interest rate easing cycle is likely to conclude sooner than expected, with terminal interest rates in the US projected to settle in the 3% to 3.5% range.
- Longer-dated bond yields are expected to remain elevated, offering a real yield around 2%, aligned with current inflation data.
- The bond market is anticipated to deliver positive returns in 2025, though it is uncertain whether these will outperform cash rates.
- In the meantime, any further rises in yields should be viewed as medium to long-term buying opportunities, something we intend to exploit in the coming months as volatility persists.

Sector views

G7 Government	Underweight
Investment Grade - Supranational	Overweight
Investment Grade - Corporate	Neutral
High Yield - Corporate	Overweight

Cash Plus – Overweight

- Real, after inflation returns are being achieved as we await increased conviction of better investment opportunities.
- A prudent split between Enhanced Income, Liquidity and Absolute Return funds is being deployed.
- Weightings dependent on base currency of portfolio.

Domestic asset allocation

Domestic Equity - Neutral

- While political risks remain, the favourable and market friendly outcome from the elections with the formation of the GNU is expected to unlock value for shareholders over the medium term as the growth reforms are implemented.
- Local valuations remain supportive and EPS growth over the next two years is expected to be 12-15%.
- Earnings growth is expected to benefit from favourable base effects and lower interest rates.

Sector views

Consumer Discretionary	Overweight
Consumer Staples	Overweight
Basic Materials	Underweight
Financials	Overweight
Healthcare	Underweight

Industrials	Overweight
Information Technology	Neutral
Resources	Underweight
Real Estate	Overweight

Domestic Fixed Income - Neutral

- With yields of 10%, we expect this asset class to outperform cash over the next year.
- An enhanced medium term growth outlook for South Africa, coupled with prudent fiscal management, could eventually lead to an upgrade in the country's credit rating.
- South Africa's greylisting status is currently under review. A favorable outcome could provide meaningful support for both the rand and the local fixed income market.
- SA's inflation target could be lowered in the medium term and should drive interest rates and bond yields lower over time. In the medium term, a potential lowering of South Africa's inflation target may contribute to a gradual decline in interest rates and bond yields.

Sector views

Government	Neutral
Duration	Neutral

Global Equity – Underweight

GO TO PAGE

Global Fixed Income – Neutral

GO TO PAGE

SA Cash – Overweight

- An overweight position in cash will allow us to exploit potential opportunities that may arise in the coming quarters.

Market performance / as at 30 June 2025

EQUITIES	JUNE	Q2	12M
All Share Index	2.4	10.2	25.2
Capped SWIX Index	2.2	9.7	24.6
Resources	4.2	9.2	25.1
Financials	1.1	8.0	19.2
Industrials	2.2	11.8	29.0
All Bond Index	2.3	5.9	18.4
MSCI US	3.4	7.5	12.2
MSCI UK	0.3	6.8	17.1
MSCI Emerging	4.3	8.2	12.2
MSCI AC World	2.8	7.8	13.1

US DOLLAR RETURNS	JUNE	Q2	12M
MSCI US	5.1	11.2	15.3
MSCI UK	1.9	10.5	20.3
MSCI Japan	1.7	11.4	13.9
MSCI Emerging	6.0	12.0	15.3
MSCI AC World	4.5	11.5	16.2
Citigroup WGB Index	1.9	4.6	8.5

CURRENCY VS US DOLLAR	JUNE	Q2	12M
Rand	1.6	3.3	2.6
Euro	3.9	9.0	10.0
Yen	0.0	4.1	11.7
Sterling	2.0	6.3	8.6

It's Personal.

MelvilleDouglas
Standard Bank Group