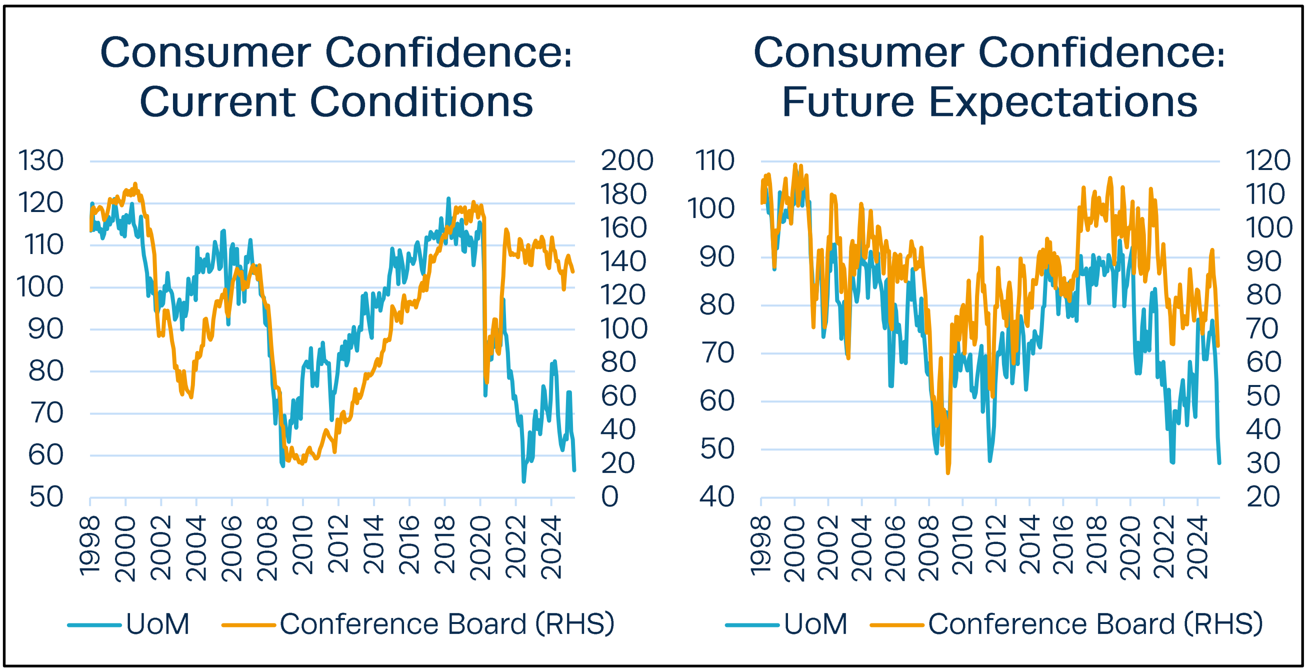
The volatility caused by the Trump administration's tariffs have roiled global financial markets. On the 2nd of April, Trump announced "reciprocal" tariffs on about every nation on earth, whether inhabited or not. Markets hate uncertainty and with the range of potential outcomes and moving of goalposts, it has created one of the most uncertain periods we can remember. However, this is not uncertainty caused by systemic events but rather self-imposed by an administration that is aggressively looking to re-write the global trade order.

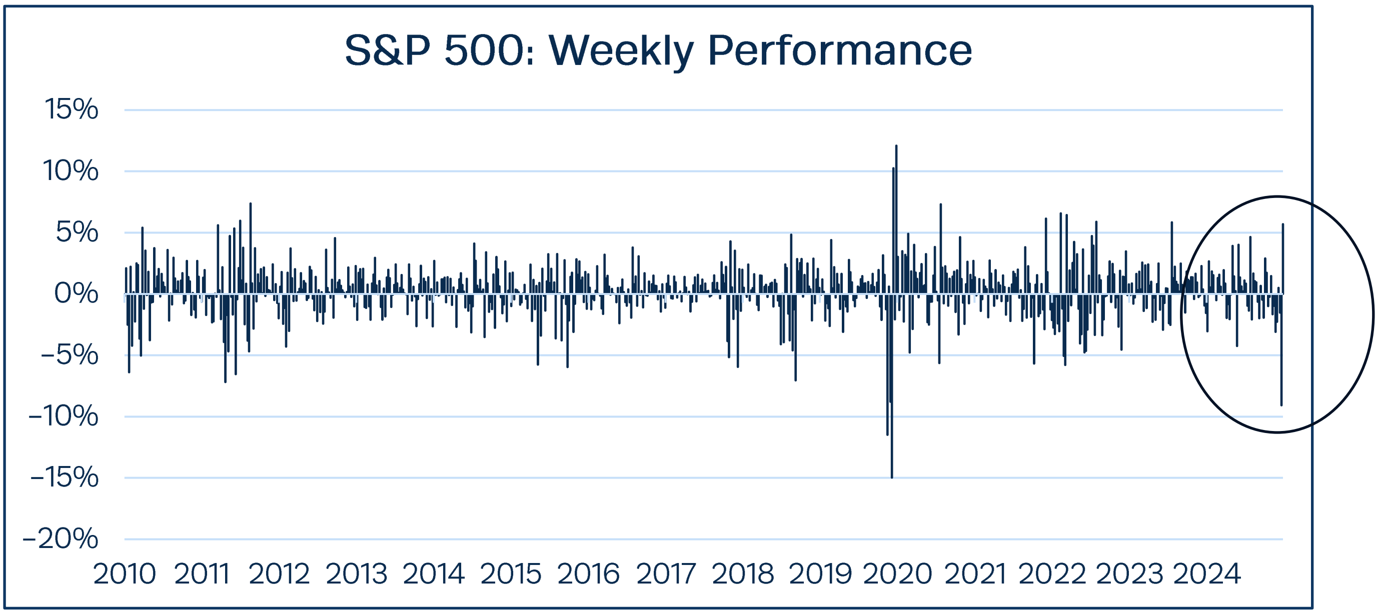
The events that shaped most of the first quarter are but a distant memory as nothing much matters outside of gauging the implications and next steps in this tariff war. The first order impact of tariffs is reasonably well understood – lower growth and higher inflation. The second order effects are going to be far more consequential, whether tariff levels land anywhere near currently (caveat being that this was written on the 14th of April) proposed levels or are scrapped entirely.

The expectation of, and subsequent tariff announcement, have already dented consumer confidence in America. The average consumer is staring down an almost overnight shuttering of Chinese imports into the US following the escalation to a 125% tariff rate. How the tariffs are paid: total tariff passed onto US consumers; importers absorb the tariffs; or a combination of the two – has not mattered, as consumers overwhelmingly expect to bear at least some of the burden. Not only has this expectation been reflected in lower confidence levels today and in the future, but inflation expectations over the next year have spiked. The jump in inflation considerations complicate the Federal Reserve's (FED) mandate as tariffs would put upward pressure on both inflation and the unemployment rate. The FED has proved adept at supporting markets when liquidity has dried up and we anticipate it they will be ready to support and ensure proper functioning of the bond market should the need arise.



Another significant factor that we believe is causing wider gyrations is the substantial levels of leverage across a range of risky and traditionally safe assets. If you are leveraged to benefit from a rise in stock prices and they fall sharply, there will be pressure to sell securities that are not declining to cover losses. This creates a knock-on effect across other leveraged market participants, resulting in broad-based selling of **all** assets. We experienced just such an event following the announcement of reciprocal tariff levels on the 2nd of April. Gold, which has proven to be the ultimate safe haven this year, fell 3% despite conditions being very conducive to gold demand. Another traditional safe haven, US Treasuries, were also caught up in the sell-off albeit with a broader range of factors that could have contributed to the rise in yields. Without getting into too much detail, there are leveraged players in the Treasury market, with reports of certain players being leveraged 60x. On top of that, countries with large trade surpluses with the US have historically reinvested the dollars received into US Treasuries. Japan holds over $1.1 trillion of US Treasuries while China still holds over $700 billion. As America weaponizes tariffs against its trade frenemies, there is concern that the countries could retaliate by selling some of their Treasuries. Lastly, on a fundamental basis, bond yields are influenced by the short-term interest rates (Fed Funds Rate in the US). Unlike a normal growth shock which should result in central banks reducing interest rates, the inflationary impact of tariffs has hampered the ability of the FED to reduce rates in the near-term. This too would have put upward pressure on yields.

Amidst an incredibly uncertain backdrop with a range of potential outcomes, the best thing an investor can do is ensure they are invested in quality companies that possess the balance sheet flexibility to weather short-term volatility and come out the other side in a stronger position. The fluidity of the current environment should also provide pause to making wholesale changes in portfolios. Much like the inflation spike of 2022, companies that have sufficient pricing power to offset raw materials inflation are real safe havens during periods like this.



There's an oft quoted statistic that missing the ten best days in the market can halve actual returns. We saw that play out in real time on the 8th of April when Trump announced a 90-day pause on reciprocal tariffs (except China) and the S&P 500 surged 10% on the day. Entering the week, you would have been a very lonely optimist had you expected the S&P 500 to end the week higher following a 9% fall in the prior week, and considered delusional had you predicted that the S&P 500 would finish nearly 6% higher. You have a far better chance to benefit when you are already in the market rather than attempting to time the market.

Where to from here?

We expect to see a softening of tariff levels as bilateral negotiations take place between America and its key trading partners. It is in every country's best interest to promulgate a deal that addresses the Trump administration's concerns while maintaining free or close to free trade access to the US economy. China has been the outlier in the opening salvos, choosing to retaliate and match the tariff levels imposed on them. It is next to impossible to speculate how long China are willing to play hardball and more importantly, how prepared China are to the imposition of US tariffs. China is certainly able to divert their purchases away from America, making the level of tariffs imposed on US goods more symbolic than anything.

The primary question should then be, where can China divert their goods if US import tariffs are retained at over 100%. Europe and Japan? A flood of Chinese goods would do irreparable harm to local industry, imposing the same impact on their economies as the US is looking to reverse. Should Chinese good be diverted to Europe and Japan, they themselves would also need to raise tariffs on Chinese goods. It is that fact that gives us some optimism that tariff levels anywhere near those originally proposed would be too devastating to all countries, making their ultimate imposition highly unlikely, in our view. Until such time as the probability of tariff levels being retained at current levels falls to zero, newsflow will remain a source of volatility, particularly given the hard negotiating stance taken by Trump since assuming office.

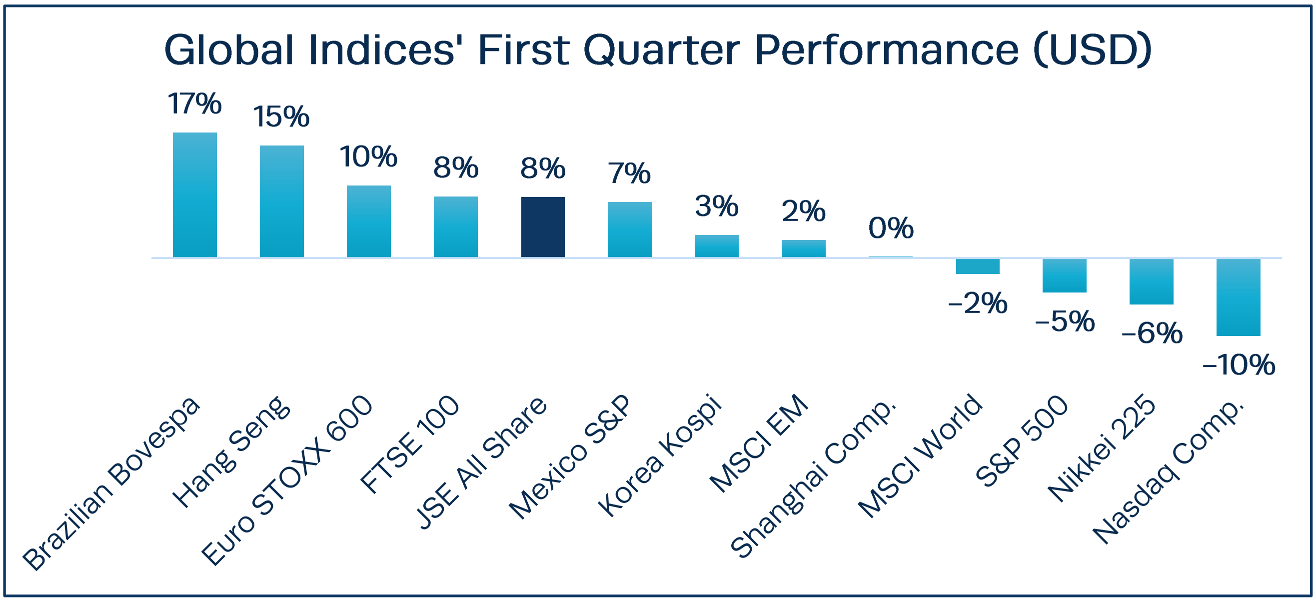
Instead, we believe the focus should be shifting to the second order impact of current tariff uncertainty rather than the tariffs themselves. Regardless of whether tariffs of any level ultimately transpire, the uncertainty created over the last month is expected to have an impact on economic growth over at least the next several months. For those companies sourcing a considerable proportion of components from China or reliant on the sale of goods emanating from China, the level of tariffs in effect today, are enough to result in early job losses and/or the immediate pass through of the tariffs to end consumers. The 90-day reprieve is by definition, temporary, meaning that companies have been given additional time to put in contingency plans rather than going back to business-as-usual. These contingency plans could pre-emptively entail layoffs, cancelled orders, reduced stock holdings, sourcing from higher cost (but lower tariff) jurisdictions or at worst, closing the business.

At the consumer level, the prospect of higher costs in the future are likely to dampen spending on discretionary items as consumers look to increase savings. With US consumer spending representing nearly 70% of the country's GDP, arresting the decline in sentiment is an imperative to limit the impact on reported GDP. While this will ultimately reverse when some semblance of certainty emerges, the important factor will be the enduring impact to citizens' view and sentiment on the presiding administration. With the Mid-Terms in 2027, Trump and the broader Republican party will need to be confident that they can turn sentiment back in their favour as the trade climate settles.

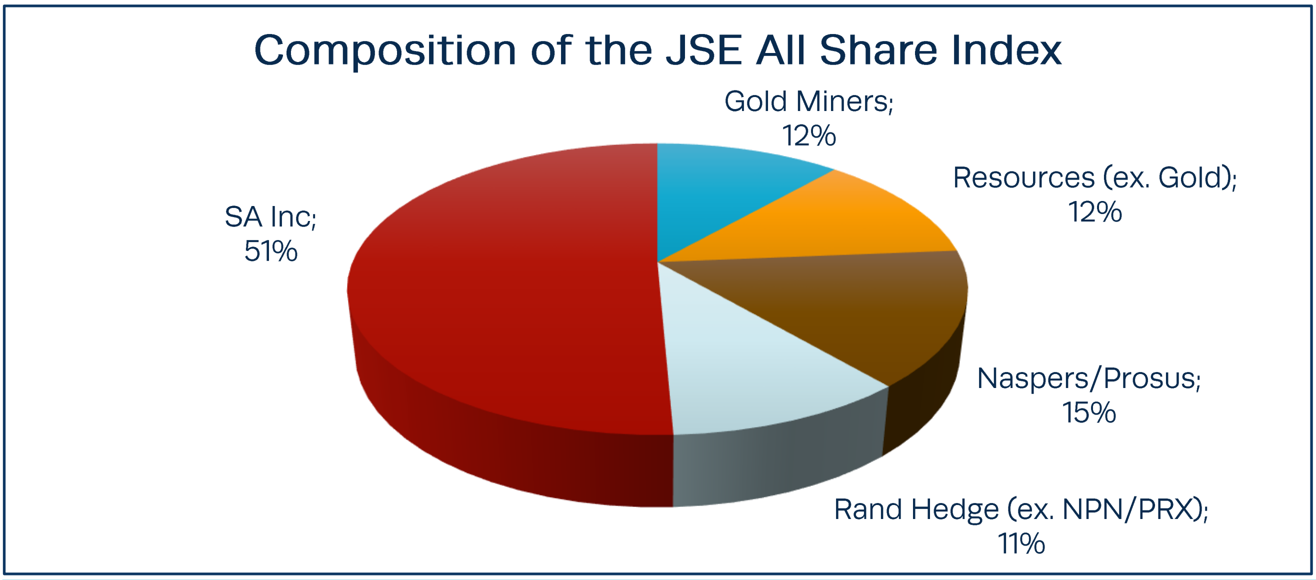
The best defence during periods like this comes from owning the best companies. The "best" companies all possess strong balance sheets with lower relative levels of debt; high returns on invested capital, pricing power, and a management team with a strong through-the-cycle track record. Odyssey Capital's overarching investment strategy has been to invest in companies that possess these "quality" attributes.

Domestic Review:

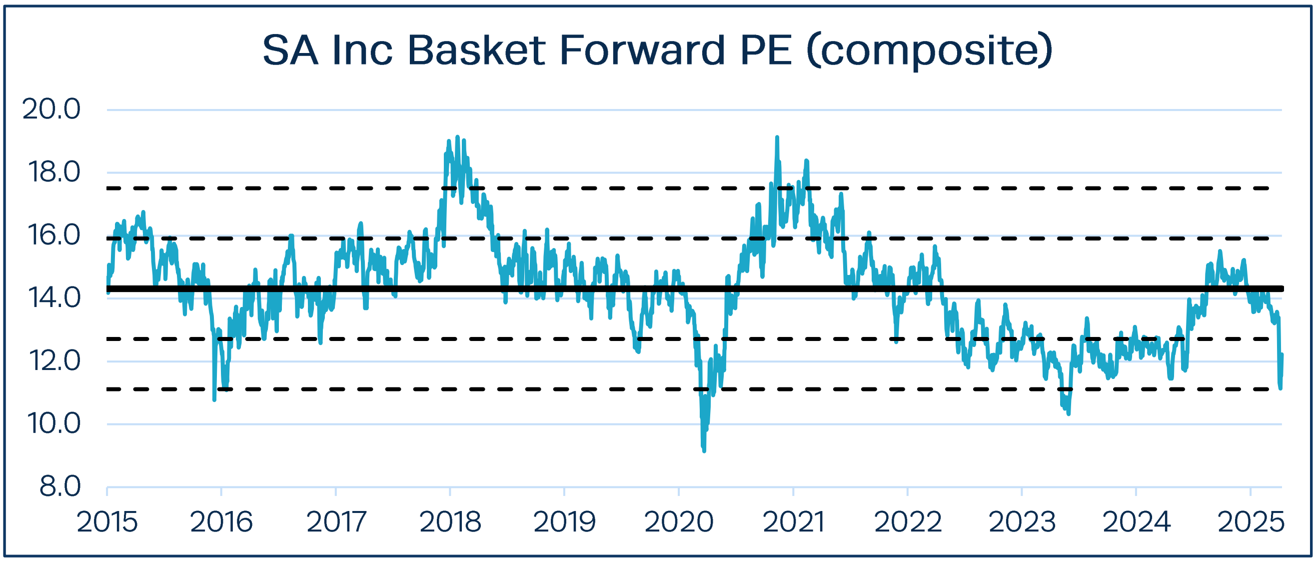
"Never let a good crisis go to waste." In the South African political context this should be construed as let's add a domestic crisis to the prevailing global one. The delay in the budget following the ANC's proposed 2% VAT hike, and subsequent public spat between GNU partners, was an unfortunate, but necessary hurdle to set the GNU on a more representative and cohesive path. In the near-term, however, it highlighted the inherent uncertainty of coalition politics in an immature democracy. Again, markets hate uncertainty. Throw in Trump's regular criticism of South Africa's expropriation bill and farm murders and the purported sanctions on key political individuals, the newsflow has been about as one-sided as the height of the Zuma days.



Despite the domestic turmoil, the JSE All Share index advanced 8% in US dollars for the quarter, compared to the MSCI World's 2% decline and MSCI Emerging Markets' 2% gain. Most will be wondering if we've made an error on the performance figure, however, when we look at the composition of the JSE, nearly half of the market capitalisation has very little to do with the South African economy.



In rand terms, the JSE All Share rose nearly 6% in the first quarter, with seven of the top ten best performances coming from gold (3 of the top 5) and platinum group metals (PGM) miners. Combining gold and PGM miners, the Precious Metals and Mining index rose 59% for the quarter, followed by telecoms (MTN and Vodacom) +28% and then the rand hedge heavy sectors of beverages (AB InBev), personal goods (Richemont), and tobacco (BATS). The SA Inc sectors of banks and retailers were down 2% and 20%, respectively.



Using a simple average forward PE multiple across the basket of mid and large cap "SA Inc" companies shows that the aggregate multiple across the group has fallen from 16x at the peak of the GNU/Two Pot withdrawals optimism to 12x currently. SA Inc equities have effectively given up all the gains made post the formation of the GNU, despite a general SA economic outlook that is drastically better than a year ago.

We continue to argue that outside of the noise of GNU disagreements and the general antipathy being shown by Trump's administration towards the country, South Africa retains growth tailwinds over the next two years.

- Inflation remains subdued, with core food and fuel categories putting little upward pressure on the headline index.
- The remaining units at Medupi and Kusile have been recommissioned, providing a much greater cushion against loadshedding risk.
- Contrary to expectations, around half of two pot withdrawals were used to reduce debt rather than supplementing consumption.
- The rand Platinum Group Metals basket is 10% higher year-to-date while rand gold prices are 23% higher, providing higher tax receipts and export revenue.
- Transnet Freight Rail's annualised run rate so far this year have greatly exceeded the tonnage moved in 2024.
- A potential exit from the Grey List towards the end of the year.

As we are all too accustomed to, South African asset class performance remains at the mercy of global conditions. The first hurdle to overcome is a renewed and strengthened GNU, which helps settle the anxiety of a GNU involving the EFF. Next, we require a coherent approach towards US relations, limiting diplomatic own goals. While general risk sentiment is determined globally, South Africa can ensure it doesn't let a good crisis go to waste and depart from the default of adding to rather than diffusing it.