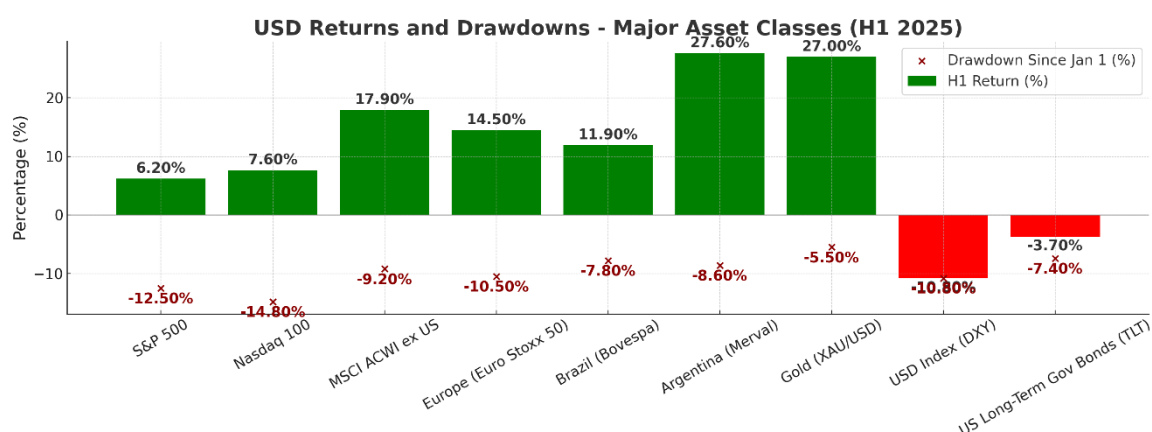


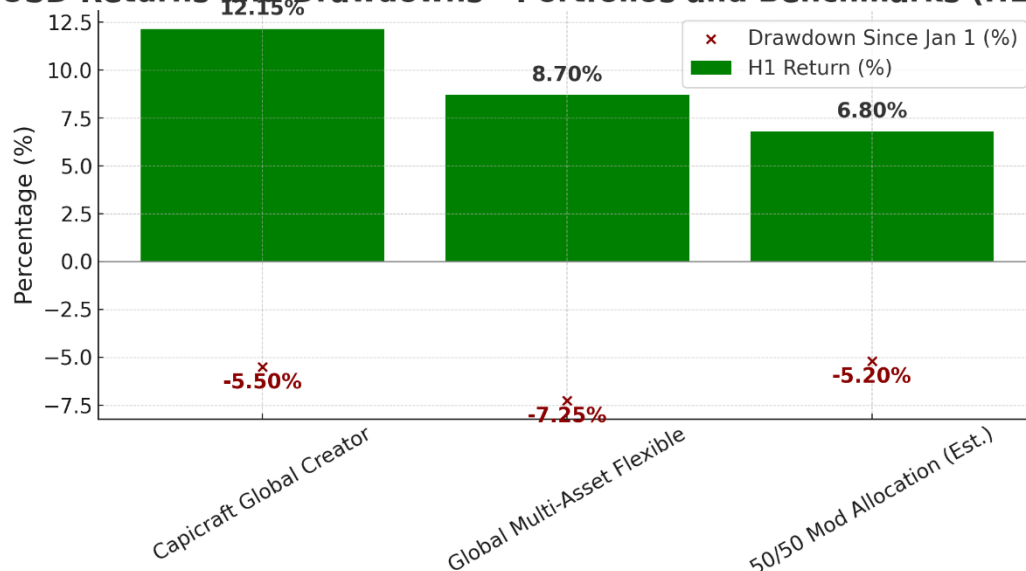
Capicraft Newsletter: Second Quarter 2025

At the beginning of the year, we wrote that the opportunities for investment returns lay outside the USA, especially outside the big technology giants. This indeed proved to be the case, with the dollar having lost about 10% of its value against major currencies since the start of the year. Against gold, the dollar lost 25% of its value. "Safe" US government bonds also experienced a sharp sell-off at one point. The Nasdaq and S&P500 both fell by 23% and 19% respectively. After the Trump administration delayed trade tariffs, both indices recovered strongly to post single-digit returns for the half-year. However, this compares poorly with other stock markets such as those in Europe. A world index excluding US stocks added 17.9% in dollar terms and did not experience nearly the volatility of US indices.



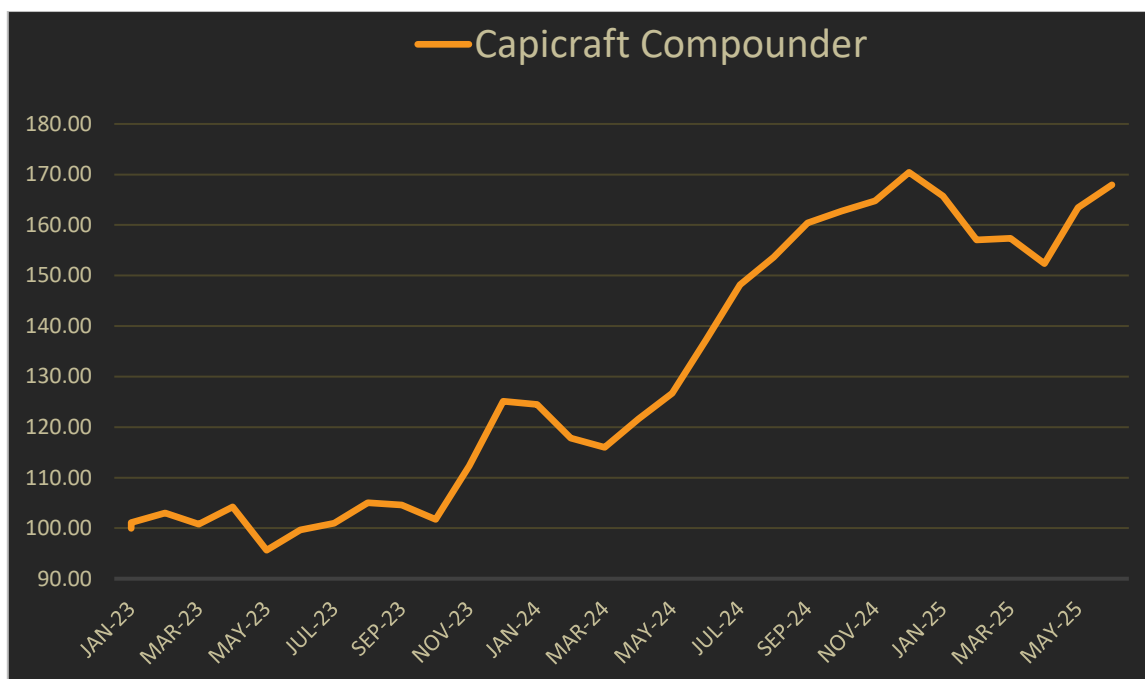
Given our cautious view on the US markets, the Capicraft Global Creator was well positioned in precious metals (including PGMs and silver). Exposure to South American markets such as Brazil, Argentina, and Mexico also supported our returns. Some of the fund's top performers were in the lesser-known uranium sector. As a result, the fund delivered 12.15% over the half-year and was only 5.5% lower (year-to-date) during the worst moments of the "tariff tantrum." This is a strong half-year performance relative to other multi-asset mandates similar to the Creator. We outperformed a portfolio of 50% global equities and 50% global bonds by 5.4%, and the average local fund manager under a global multi-asset mandate by 3.5%.

USD Returns and Drawdowns - Portfolios and Benchmarks (H1 2025)



Where our portfolios were supported last year by strong local returns on the JSE, this has unfortunately not been the case so far in 2025. The JSE has been supported by the gold index, more recently the PGM sector, and a handful of dual-listed stocks that have performed well alongside international markets. Banks, retailers, local industrial companies, and other domestically focused businesses are under pressure, especially since the signing of the Expropriation Act on January 23. We bought into these local "SA Inc." stocks aggressively last year before the election. When the Government of National Unity (GNU) was being negotiated, we accelerated these purchases. By October it was already clear that the GNU had a limited shelf life and would not bring about the desired reforms investors had hoped for. We gradually and patiently started taking profits. By February 2025, we began reducing our positions more urgently, but by that time, there was very little liquidity outside the Top 40 index.

The Capicraft Compounder, our local strategy, consequently lost 1.5% in rand terms over the past 6 months. However, this follows a 70% run in the 18 months leading up to 2025. The 6 months prior to that rally also saw the Compounder tread water. Good investment returns seldom move in straight lines and require patience through periods of uncertainty and frustration.



South Africa

Few things frustrate me as much as South African politics. Especially now. The ruling party clearly did not negotiate the GNU in good faith and is accelerating its policy of redistribution (theft and plunder). They are so blinded by their ideology that they cannot hear the wake-up call coming from the US. South Africa's diplomatic and trade relations will suffer major damage as a result. In contrast, there are several indicators pointing to an emerging economic upswing in the SA economy.

1. The electricity availability factor looks much healthier than in 2024.
2. Transnet's operational capacity is improving.
3. Vehicle sales are rising strongly.
4. Interest rates are slowly but steadily declining.
5. Inflation is around 3% and inflation expectations are not much higher.
6. The Reserve Bank wants to shift the inflation target lower accordingly.

SA long-term government bonds have already started pricing in a better interest rate and inflation outlook. The R209 bond has strengthened by nearly 150 basis points over the past 6 months to just above 10%. This means real long-term interest rates are still at 7% and have plenty of room to fall further. The most important price in the economy, the cost of capital, should move structurally lower. This is good for lending, capital investment, asset prices in general, and the rand. What could particularly boost this thesis is a shift in international capital flows back toward emerging markets.

Global Capital Flows

Global markets fell sharply and simultaneously after the shock tariff announcement on April 4, but several observations during that period are important:

1. The US dollar and US markets had already started falling in February.
2. Neither the US dollar nor US government bonds were safe havens during the subsequent selloff.
3. Gold, after a brief selloff, went to new all time highs.

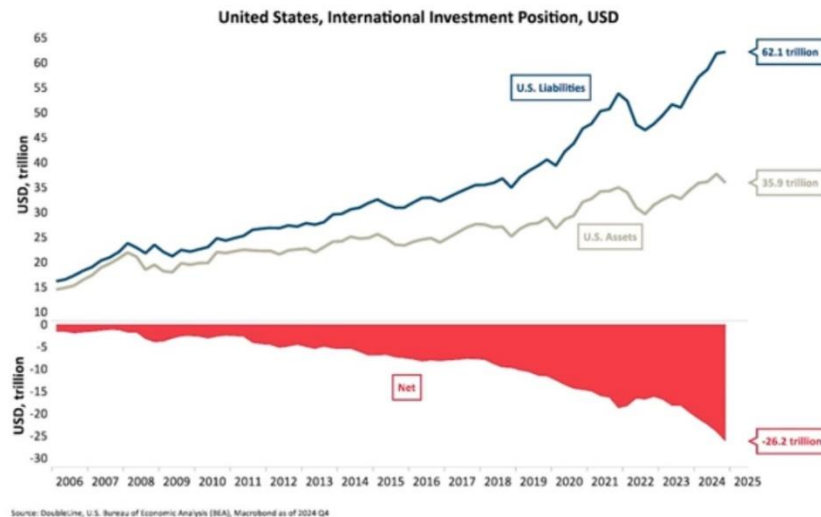
This behavior supports our thesis that global markets are in a new market regime. These are similar market movements to what we saw in 2022 – also a year of geopolitical upheaval. For a long time, investors could look to the US for both capital growth and capital protection. Surplus-export countries, especially in the East, but also countries like Germany, earned dollars and reinvested them in dollar-based assets. This drove the dollar higher and undermined the US's competitiveness.

The Triffin dilemma, proposed by economist Robert Triffin in the 1960s, arises when a national currency (like the US dollar) is used as the world's reserve currency. To supply sufficient global liquidity, the issuing country must run persistent trade deficits, but this eventually undermines confidence in the currency's long-term value and stability.

The dilemma has its origins in the system created at Bretton Woods in 1944. That system positioned the US as the world's financial hegemon. The US could assume this role confidently because it held massive gold reserves. By 1971, Richard Nixon had to end the convertibility of dollars into gold as the US had started to run out of reserves. From then on, reserve currency status had to be maintained through monetary and fiscal conservatism.

The US has, of course, been anything but conservative over the past two decades. As Triffin predicted, they abused this privilege. By 2025, the global and internal imbalances of the post-Bretton Woods system are evident in more than just statistics. They manifest in asset bubbles, most notably the US housing bubble of the early 2000s. You see it when you visit the US rust belt. You see it in the increase in Chinese cars on our roads. This is essentially a misallocation of capital that has financialized the US economy (and large parts of the West) while turning the East into industrial giants. The imbalances have become too big to ignore, and a backlash is underway. It finds expression in political movements like MAGA. It manifests in the erection of borders to keep both people and goods out. The current geopolitical and economic regime is bigger than Donald J. Trump.

For capital markets, this is reflected in the US's net investment position with the rest of the world. It has moved from a surplus two decades ago to a negative \$26.2 trillion position.



In this regime, investors will need to pursue true diversification. Geographical diversification, but also across asset classes and strategies. Capital has already started favoring other assets like gold. Asset managers and retail investors in Europe and the East will increasingly consider reallocating funds to their own stock markets. Other precious metals like silver and PGMs have already started moving. The next destinations are broad commodities and emerging markets. Even the JSE stands to benefit.

These shifts won't happen in a straight line. The dollar may have been punished too harshly in the short term and could stage a strong rally. There are of course attractive opportunities in the US amidst all of this. Policy uncertainty is extremely high everywhere. Concessions and ceasefires can be negotiated. Time can be bought. But larger multi-year and even multi-decade shifts are underway. The capital reallocation we've started to witness in the past few months has only just begun.

Your investment partner,

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