2025 INVESTMENT LETTER

JANUARY 2026

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EXECUTIVE SUMMARY

South African assets delivered remarkable returns in 2025, driven by a favourable combination of global and local factors.

A **weaker US dollar and surging gold prices** improved South Africa's terms of trade, supported the rand, and strengthened fiscal outcomes.

The Medium-Term Budget Policy Statement **(MTBPS) outcome was positive** and key trends in fiscal prudence were supportive of the rand and South African Government Bond (SAGB) valuations

South Africa formally shifted to a **3% inflation target** in November, following the MTBPS and SARB MPC adoption.

While equity market gains were highly **concentrated in a handful of resource and tech-linked stocks**, return drivers did broaden out over the final quarter – with financials broadly benefiting. It remained a tough year for active management.

Foreign investor flows returned to the bond market last year, while equity flows remained negative overall, with selective buying in certain sectors.

The **Local Government Elections** this year are set to test the GNU as its member contest against each other in key metros – most notably Johannesburg.

Our approach remains deliberately diversified, **prioritising capital preservation and risk management** as we navigate an environment of both opportunity and uncertainty.

INTRODUCTION

A confluence of events this year has led to a continued weakening of the US dollar and marked rally in the price of gold[1]. Expectations for interest rate cuts by the Fed, elevated geopolitical risks, and concerns about the US fiscal situation all coupled with central bank (notably China and other Emerging Markets) diversification away from US dollar into gold colours the backdrop.

The weaker US dollar and the gold rally have been a major boost for South Africa's economy this year, providing improvement in our terms of trade (ratio of export prices to import prices), a strengthened fair value of the rand, and helped government revenues outperform expectations. The result is a healthier fiscal position and a more resilient current account.

The MTBPS outcome was positive as it credibly kept debt on a peaking path and reaffirmed fiscal consolidation while advancing infrastructure and reform programmes, lifted revenue forecasts without new taxes and created scope to trim domestic bond issuance – supportive for the rand and SAGB valuations.

Chart 1a: Gold price higher; US dollar lower

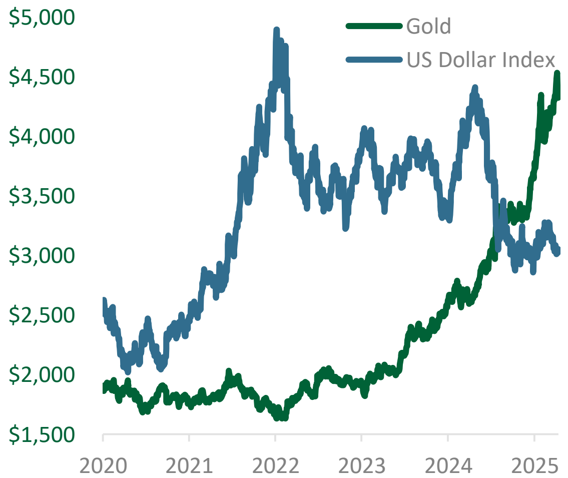


Chart 1b: Improved Terms of Trade

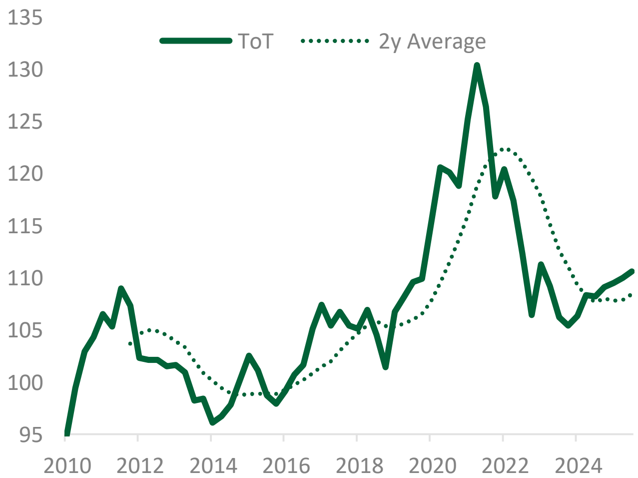
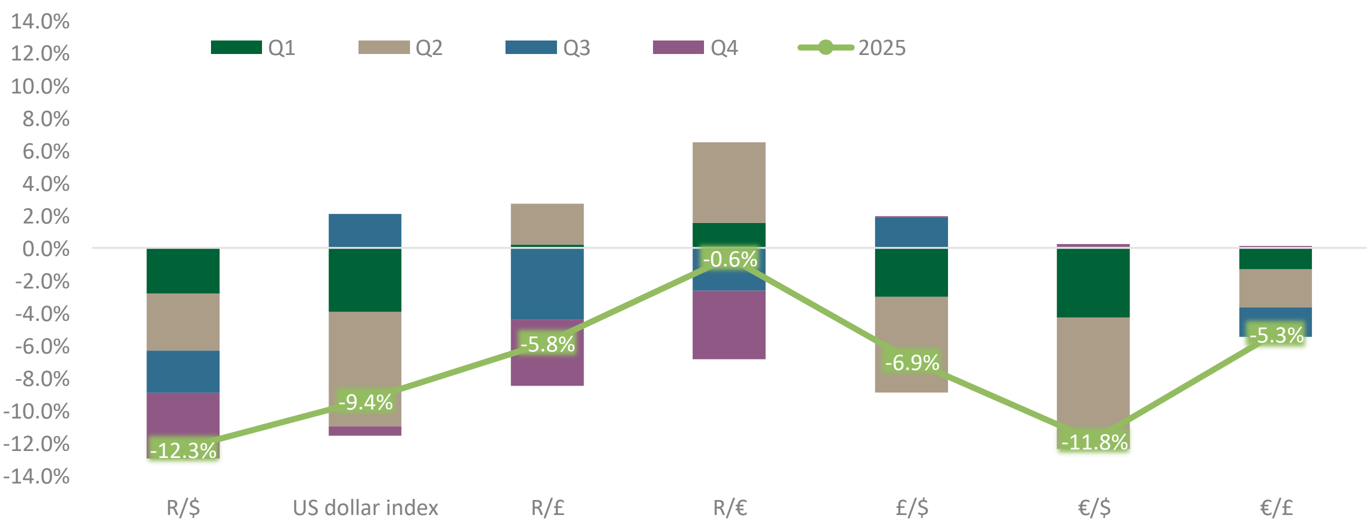


Chart 2: While the US dollar weakened last year, the rand is broadly stronger too



[1] *Source: For all data on this page. Bloomberg. As of 31 December 2025.*

INFLATION AND INTEREST RATES

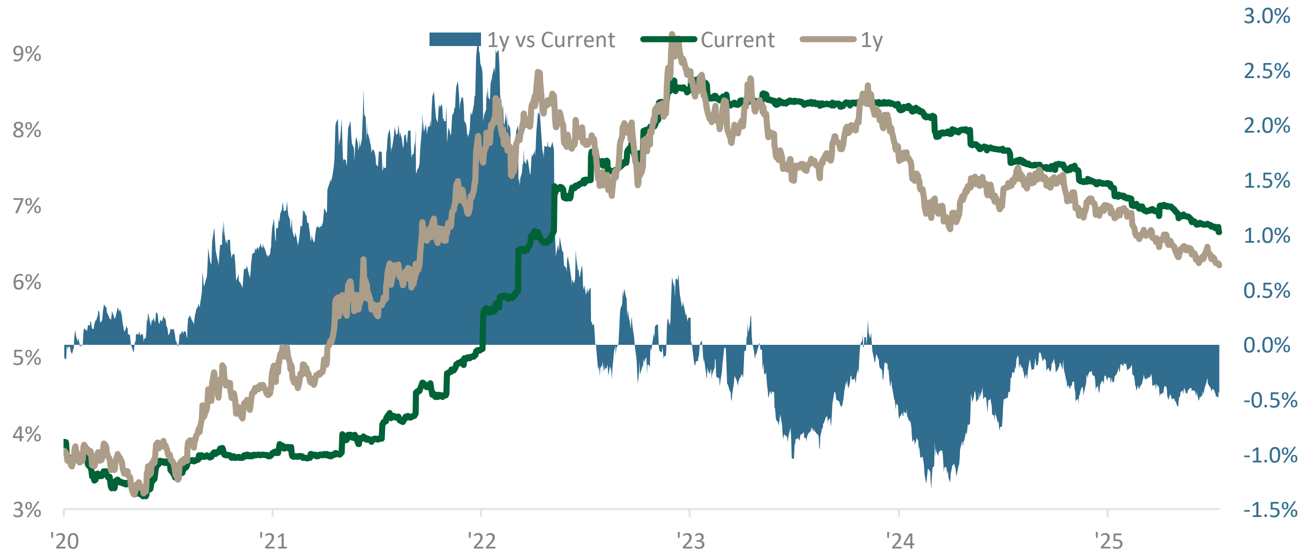
Last year saw significant developments in inflation targeting. At its July meeting, the Monetary Policy Committee of the South African Reserve Bank (SARB MPC) signalled its intention to aim for a 3% annual inflation target (still within its existing mandate at the time). However, it was at the November MTBPS that the Finance Minister formally amended South Africa's inflation target, and the SARB MPC subsequently adopted this new mandate at its November meeting.

The target is now set at 3% per annum, with a tolerance band of ±1%. This represents a significant shift in monetary policy, aligning South Africa with other emerging market central banks that have moved from a range-based framework to a single-point target over the past decade.

As noted in our October letter, modelling by the SARB indicates that this shift should lower inflation expectations and, ultimately, inflation and interest rates – all supportive of real returns and a steadier rand. A steadier rand should also translate into reduced imported inflation.

Regarding the impacts on realised inflation, we continue to expect a gradual adjustment lower, with sticky categories (electricity, medical aid, municipal tariffs) keeping inflation above 3.5–4% in the medium term. For context, average annual headline inflation last year was 3.2%[2]. This allowed the MPC to cut the repo rate by a full percent over the year (from 7.75% to 6.75%). Its modelling currently indicates the repo rate could be up to 0.5% lower by the end of this year[3]. For its part, the market (as seen in chart 4 below[4]) is currently pricing around 0.4% worth of cuts over the next 12 months.

Chart 4: Money market pricing for further interest rate cuts



These developments have been supportive of SA fixed income assets in general and longer duration government bonds in particular. Reflective of the reduction in this risk premium (and reflected in charts 5a and 5b below[5]), the yield on the 10-year SA government bond shifted 1.9% lower (from 10.3%) over 2025. It has also led to the SA government bond market continuing to attract the interest of foreigner investors. Accumulating a net R161bn over the first three quarters, there was some profit taking over the final quarter, seeing foreigners sell R67bn. While still well below the 42.8% peak seen in 2018, foreign ownership is now 25.0% of total outstanding government bonds.

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[2] *Source: StatsSA – as of November 2025.*
[3] *Source: SARB MPC – as of November 2025.*
[4] *Source: Bloomberg. 31 December 2025. Chart shows current 3-month interest rate and 3-month interest rate in 1-year*
[5] *Source: Bloomberg – as of 31 December 2025*

Chart 5a: SA government yield curve

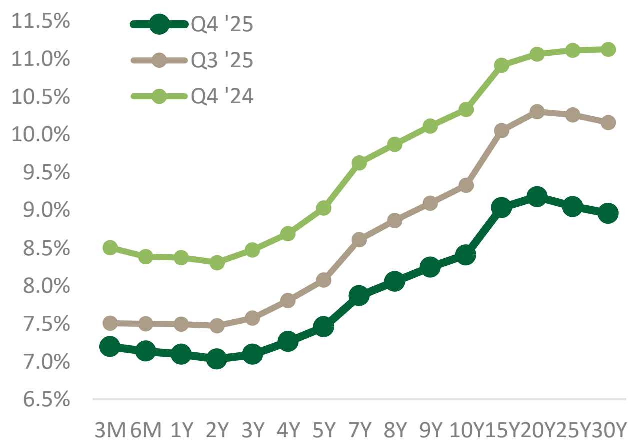
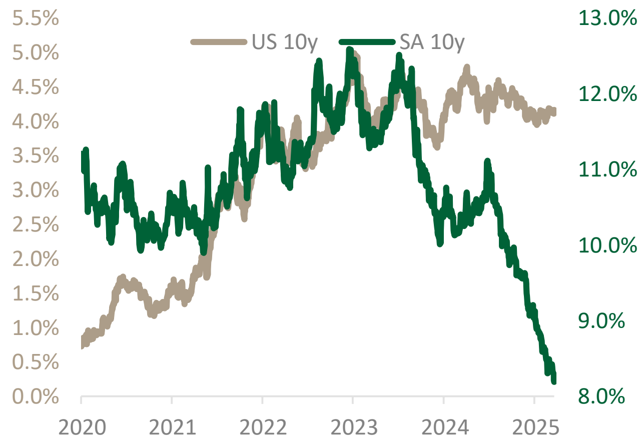


Chart 5b: US 10y & SA 10y government bond yields

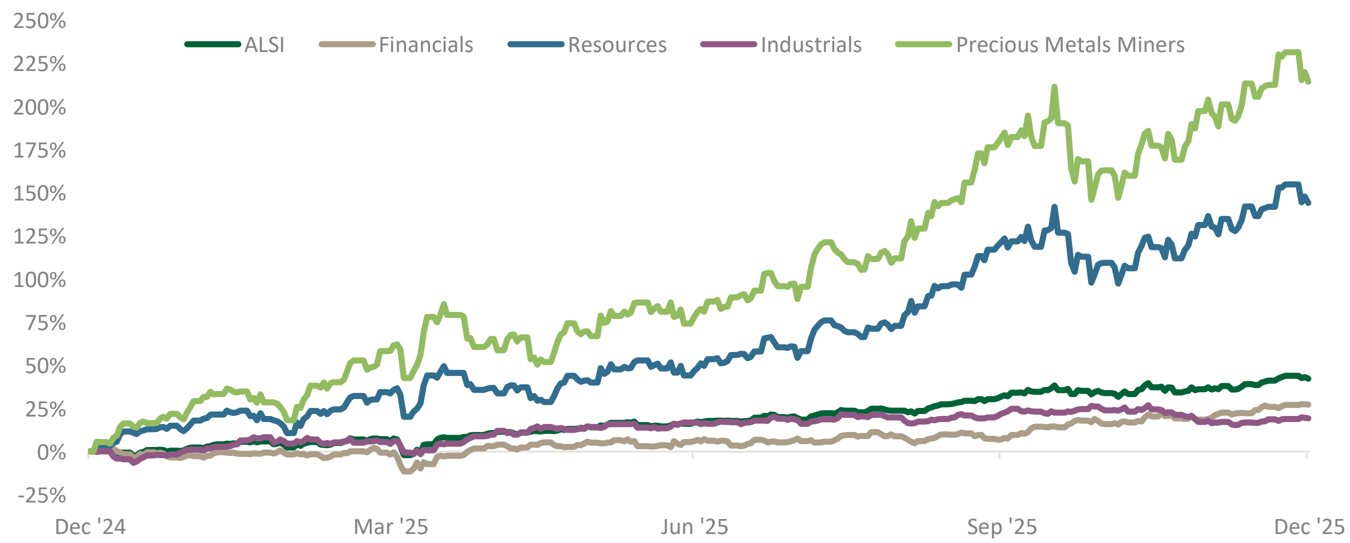


With cash rates and the yield on government bonds having contracted, we are cognisant that future returns from the asset class could be lower than in the recent past. We note, however, that the real yield on these assets remains attractive – especially so when one considers the change in the inflation target coupled with the SARB MPC's hard earned credibility

EQUITY MARKET

The South African equity market had a remarkable year in 2025. The main All Share index (ALSI) ended the year up 42.4% in rand. The more concentrated Top 40 index returned 47.7% in rand, and 68.2% when measured in US dollar.

Chart 6a: Selected industry performances this year



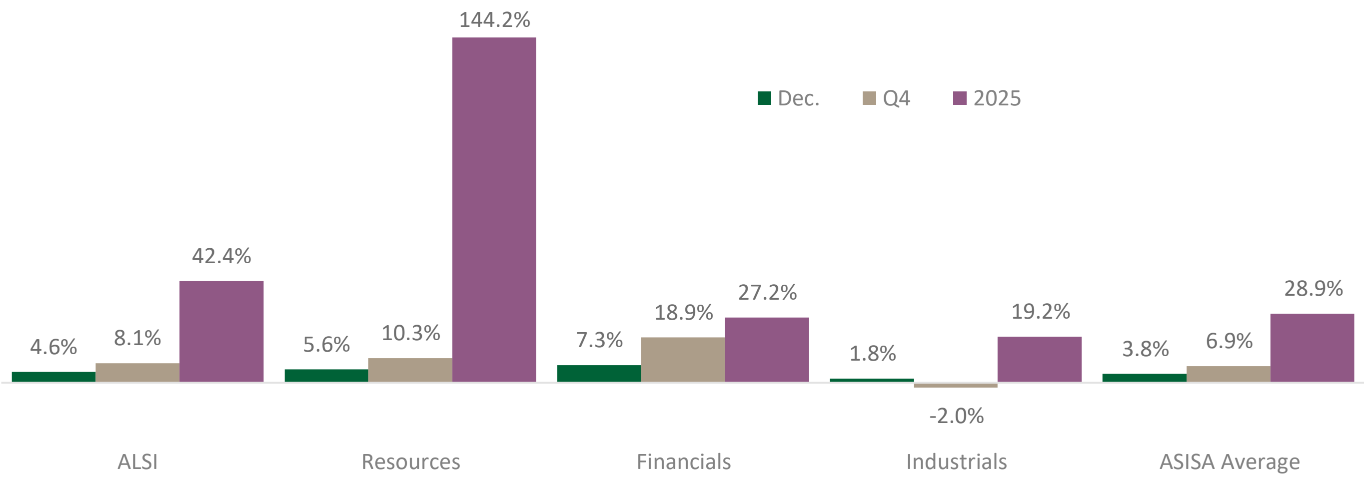
As covered in our letter in October last year, a large part of this can be ascribed to the US dollar price of an ounce of gold rallying almost 65% over the year. This saw the Resources subindex of the ALSI up 144.2% last year, with the Precious Metals Miners rallying an eye watering 214.6% in rand[6]. We also commented on the immense concentration of return drivers contributing to the index's strong return up to the end of September last year, when the combined returns of the Precious Metals Miners, Naspers/Prosus, and MTN comprised just over two thirds of the index's headline 42.2% rally.

[6] *Source (for all data in this section): Morningstar. As of 31 Dec. 2025. All figures in ZAR.*

It was in the final quarter, however, when returns did broaden out marginally, with SA financials and banks in particular, delivering strong returns. While gold took a relative breather (up around 9.5% in rand), the banking sector was up 21.4% (29.3% for the year). This was largely due to the formally adopted lower inflation target, which allows for a more benign future interest rate path. The prognosis leans on the potential for increased loan volumes, and a less financially stressed consumer leading to increased revenue growth and lower defaults faced by the banks.

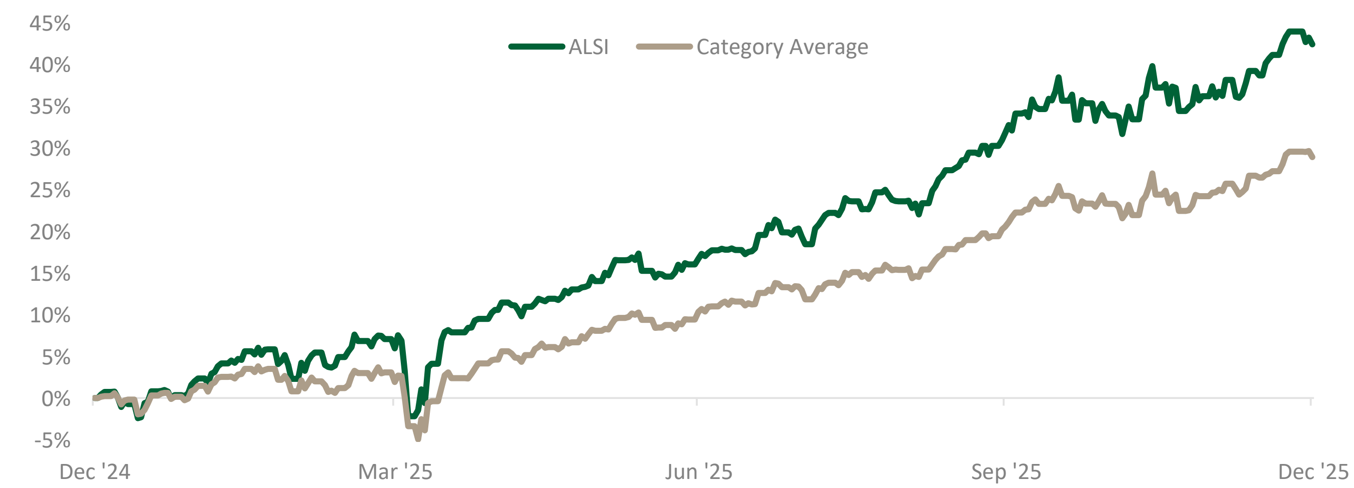
This is interesting given the relatively poor performance of the consumer discretionary sector last year, with the subindex being down 6.4%. We are cautiously optimistic about the next stage of this interest rate cycle and what it could mean for the prospects of SA consumers.

Chart 6b: Resources lead the year, while Financials rally in the final quarter



We reiterate that last year was a tough environment for active managers. Unless portfolios were heavily overweight the handful of top-performing resource stocks and rotated sharply into banks in October, it was extremely difficult to keep pace with the index. Many active managers, especially those with risk conscious diversified approaches, underperformed the ALSI. The same phenomenon has played out in the US, where S&P 500 returns have been driven by a small group of mega-cap tech stocks ("Magnificent 7"). Most active US equity managers have also struggled to outperform the index, as gains were concentrated in a few names.

Chart 7: All Share Index (ALSI) versus ASISA General Equity Category Average[7]



[7] *Source: Morningstar. As of 31 Dec. 2025. Unless specifically stated otherwise, all figures in ZAR.*

For us, this concentration raises important questions about the sustainability of returns and the associated risks – specifically, how these indices would perform if the current market leaders experienced a significant reversal. Our approach remains deliberately diversified, with a strong emphasis on capital preservation and risk management over chasing short-term performance, ensuring that portfolios are resilient across different market environments.

While economic and market dynamics have been favourable, the evolving political landscape remains a critical factor for investors to monitor.

POLITICS

2025 was a busy year on the domestic and global political front. The maturation of the GNU, through a reduction in the noise emanating from it as the year progressed, was welcome. Similarly, at least after conclusion of the G20 summit in Johannesburg, geopolitical pressures abated as flare ups between Pretoria and Washington seemed to subside.

Considering the year ahead, the key item on the agenda will be the Local Government Elections, which could reassert pressure on the GNU as its members contest against each other in key metros – most notably Johannesburg. We will monitor these developments keenly as it could affect the outlook and direction of travel for key elements like reform and service delivery.

While it will be a key topic of discussion throughout this year, the battle for ANC succession will take place next year. With Cyril Ramaphosa’s term as ANC President ending in December 2027, we will watch closely to gauge who might replace him. This could have material consequences. We will update you on our views as the year progresses.

CONCLUSION

South African assets have delivered exceptional returns this year, supported by a favourable alignment of global and local factors. While there are clear risks in the form of political uncertainty and stalling reform momentum, there are macroeconomic tailwinds keeping us optimistic heading into this year.

As stewards of client capital, our approach remains anchored in diversification and disciplined risk management, ensuring portfolios are resilient across a range of scenarios and focused on long-term value creation.

We will continue to monitor key economic, political, and market signposts as this year unfolds, maintaining our focus on capital preservation and long-term value creation for our clients.

We thank you for your continued support.

Stonehage Fleming Investment Management (South Africa) Investment Committee
January 2026

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