SIB Standard Investment Bank

Regulated by the Capital Markets Authority

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GLOBAL MARKETS COMMENTARY

Q1 2025 MANSA^{X} MARKETS REVIEW & Q2 2025 OUTLOOK

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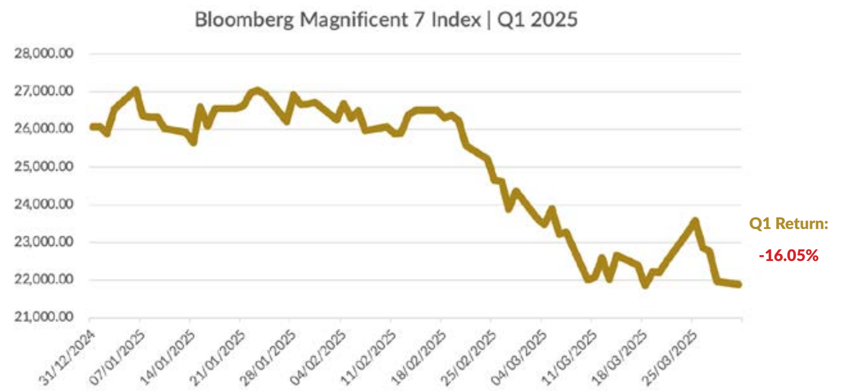
Turbulence, tariffs and the tech unwind.

Stocks went into the start of 2025 with the bull market solidly intact, albeit with valuations beginning to look stretched. The Fed appeared to have achieved a soft landing for the economy, and investors were still looking forward to rate cuts. That backdrop began to change as news that China's DeepSeek had developed an artificial intelligence (AI) model comparable to market leaders, but at a fraction of the cost, caused investors to reassess expectations around AI, US leadership in the field, and returns on investment. Specialists said DeepSeek's technology still trails that of OpenAI and Google. But it is a close rival despite using fewer and less-advanced chips, and in some cases skipping steps that U.S. developers considered essential. The AI theme has powered stock markets in recent years, contributing to the outperformance of the "Magnificent Seven" group of stocks, and so the news put pressure on some of the largest stocks in the index with this contingent collectively losing over 16% during this quarter.

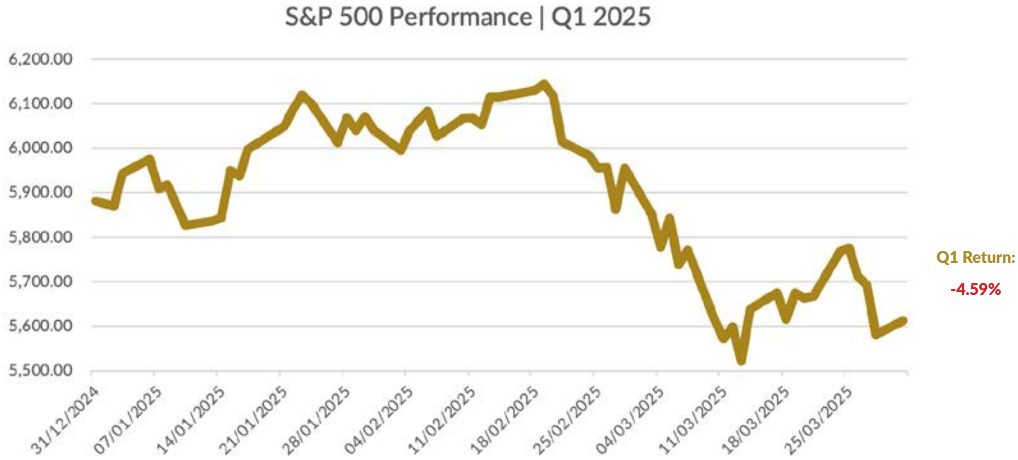


China's advances in AI caused investors to reassess expectations around US leadership in the field and returns on investment, putting pressure on some of the largest stocks in the "the "Magnificent Seven" Index, which lost 16.05% in Q1

Following a 57.8% total return over the prior two years, marking its best two-year performance since 1998 (26 years), the flagship S&P 500 reversed course and came close to correction territory in the new year. Fear of consequences from potential policy changes drove the S&P 500's dramatic decline of over 10% between February 19 and March 13, one of the fastest market corrections in the past century, leading to its worst quarterly performance (-4.6%) since the peak of the hiking cycle in Q3 2022. Typically, a rapid correction more closely follows fundamental triggers like surprising economic reports, a banking crisis, or government defaults.

Actions by Musk-led Department of Government Efficiency triggered investor anxiety; reflected by the S&P 500's worst quarterly performance since Q3 2022

This time, however, the sharp sell-off stemmed primarily from mounting investor anxiety around the aggressive and haphazard nature of the undertakings by the newly formed Department of Government Efficiency (DOGE), led by Elon Musk as a "special government employee," and potential trade policies proposed by the Trump administration. As policy uncertainty spiked to levels not seen since the pandemic, business and consumer confidence deteriorated and weighed on investor sentiment.



Following a 57.8% total return over the prior two years, the flagship S&P 500 reversed course and came close to correction territory in 2025, closing Q1 at -4.59%

Aside from the Nasdaq-100, which benefitted in December with greater weightings towards large-cap growth, the major equity indices (S&P 500, Dow Jones Industrial, S&P Mid-Cap 400 & Russell 2000) registered monthly declines in three of the prior four months starting in December. Large-cap growth held up near its cycle highs into mid-February before succumbing to the rotation of selling pressure. From a glass half full perspective, most large-cap sectors experienced their greatest declines in December and downside momentum has since been waning with eight of the 11 sectors having a positive Q1.

Trade tariffs increasingly became a key theme towards the end of the quarter as President Trump announced tariffs on certain countries (notably Mexico and Canada) and on some goods (cars, steel, aluminium). Meanwhile, U.S. economic data throughout the quarter showed signs of an economy that is cooling. Housing inventories have risen to pre-covid levels raising concerns there could be a slowdown in residential construction later this year. The 30-year fixed-rate mortgage fell to 6.65% in late March, but it likely needs to move lower to improve existing home sales which for two years have been hovering at levels last seen during covid and the GFC eras. While employment appears solid, there are signs amidst quit rates, real wages, new hires, and average weekly hours which may suggest future upward pressure in the unemployment rate. Consensus at the start of the year projected 2025 Real GDP of 2% for the US, however the widely referenced Atlanta Fed GDPNow economic model now projects a substantial contraction (-2.8%). The uncertainty brought about by the DOGE efforts and Trump's trade policy has resulted in the CEO confidence index plummeting to levels last seen back in 2010. The CEO confidence index is a barometer of the health of the US economy from the perspective of US chief executives. The measure is based on CEOs' perceptions of current and expected business and industry conditions gauging expectations about future actions their companies plan on taking in four key areas: capital spending, employment, recruiting, and wages over the next 1 year.

The CEO Confidence Index is an assessment of how confident CEOs are in the US economy and prospects for business over the coming year

Amidst this, The Federal Reserve paused its rate cutting cycle with Chair Powell affirming the Fed is in "no hurry" to cut rates at the most recent March FOMC. The Fed's quarterly Summary of Economic Projections revised growth lower (from 2.1% to 1.7% GDP) and higher inflation (core-PCE from 2.5% to 2.8%) for 2025 but held constant its Interest Rate guidance at 3.9%, implying just two 25bp rate cuts. The Fed noted the economy is in good shape but also placed strong emphasis on the increasing uncertainty surrounding the economy and its future projections. Some argue the Fed's monetary policy is too tight, creating a passive tightening effect by waiting for bad news to act which puts excess strain on cyclical areas of the market. The old market mantra "don't fight the Fed" has been replaced by "don't fight the Treasury" highlighting the Trump administration's focus on the bond market as they are seemingly willing to tolerate pain in the equity markets if it results in Yields on the 10-Year Treasuries keep coming down.

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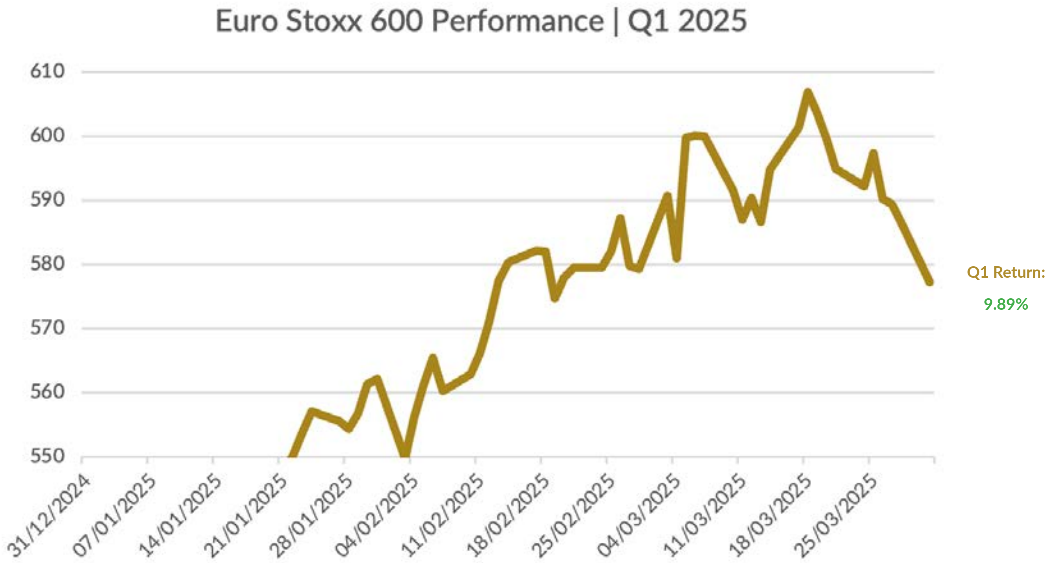
Eurozone

European equities outperformed global peers thanks to a huge fiscal regime shift towards higher defence spending. The first quarter marked the biggest quarterly performance gap between the Stoxx 600 and the S&P 500 in a decade.



European stocks outperformed global peers in Q1

Against a backdrop of more stagnant economic data, the European Central Bank cut rates in January and March by 25 basis points, with a further 60bps of cuts priced by markets through the end of the year. Banks were particularly strong, amid some robust earnings updates. Banks are also relatively insulated from trade tariff concerns. Industrial stocks performed just as well, given the anticipated uptick in domestic production. On the political front, the German election took place in the latter part of the month. The result was broadly in line with opinion polls beforehand, and the conservative CDU/CSU bloc opened talks with the centre-left SPD to form a new government which would pursue a pro-growth agenda led by Friedrich Merz as the new chancellor.

UK equities also rose over the quarter, with large cap banks and defence names prominent. Sentiment towards UK small and mid-sized companies was weaker, with this largely down to ongoing concerns around the domestic economic outlook, hampering consumer-facing sectors. In response to the growing European security threat, Prime Minister Starmer announced an increase in defence spending to 2.5% of GDP by 2027, raising concerns about the UK's fiscal outlook. UK Chancellor Rachel Reeves sought to alleviate this by announcing new spending cuts to comply with the government's fiscal rules. On the monetary front, the Bank of England cut rates by 25bps in February.

The WisdomTree Europe Defence Index is designed to track the performance of European companies involved in the defence industry. The index was established with a base value of 200 on October 31, 2024

Asia

Asian equities achieved modest gains in the first quarter. China, Singapore, and South Korea were the best-performing markets in the region while the Japan, Taiwan & Indian markets were laggards.

Investors have had plenty of reasons to give up on Chinese stocks in recent years. China's economy is muddling through a rout in the property market that has dented consumer balance sheets and left households skittish to spend as property prices have fallen by as much as 60% in four years. Debt and an aging population have dampened longer-term growth prospects. Subsequently, foreign direct investment into Chinese equities plummeted over 90% post-Covid as companies reassessed their Chinese exposure and leader Xi Jinping's multiyear corruption and private sector crackdown damaged business confidence.

Since the second half of 2024, Beijing started to course-correct its approach to healing the economy, unveiling monetary and fiscal measures to put a floor under the economy and domestic market. The latest pivot in 2025 came as Xi met with the country's top technology leaders, including heads of artificial-intelligence and electric-vehicle companies and leaders of internet giants that had been in the regulatory doghouse for years. The reappearance of Jack Ma, Alibaba Group Holding's once outspoken co-founder who became persona non grata after taking regulators to task in 2020, signalled that the technology sector may be back in favor and that Beijing is now more willing to support entrepreneurs. However, the surprise release of China's low-cost AI model, DeepSeek, added a spring to the step of Chinese markets as it showed a narrowing gap in the AI race sparking a tech-driven rally. This momentum continued throughout the quarter, with the MSCI All China Index surging 16%.

The surprise release of China's low-cost AI model, DeepSeek, added a spring to the step of Chinese markets. This momentum continued throughout the quarter, with the MSCI All China Index surging 16.09%

On the flip side of the coin, the Japanese equity market declined in Q1, ending the quarter with a negative return of -3.4% for the TOPIX Total Return index. The Japanese equity market faced selling pressure, driven by uncertainty surrounding tariff policies under the Trump administration, as well as rising concerns about the risk of a US recession. These fears were exacerbated by an announcement towards the end of March that the Trump administration would impose 25% tariffs on imported cars. As a result, exporters and technology-related stocks were among the most heavily affected. Moreover, several Japan-specific positives supported share prices in certain sectors such as financials. These included: rising Japanese government bond yields, driven by positive inflation and wage growth data; an announcement by Berkshire Hathaway that it is increasing its stakes in Japanese trading houses; and increased defense spending by the Japanese government. The Bank of Japan raised its policy rate in late January, a widely expected move that supported financial stocks, particularly banks.

Elsewhere, Shares in Taiwan experienced sharp declines in the first quarter amid investor fears over tariffs imposed by Donald Trump on semiconductor exports to the US and concerns over a potential slowdown in AI investments by some of the large US technology companies. In India, equities were also weaker in the quarter amid investor fears over a potential trade war with the US and signs of a slowdown in the Indian economy.

Fixed Income

There was a notable shift in the global macroeconomic landscape during the first quarter of 2025. US exceptionalism was challenged as heightened policy uncertainty led to a sharp fall in sentiment and raised recession concerns. In comparison, Germany's fiscal regime change prompted a significantly improved outlook across Europe, catalysing a marked divergence in fixed income markets.

The creation of a 12-yr €500Bn infrastructure fund to initiated a sell-off of German Bunds, which reversed partially towards the end of Q1

In March, Germany's parliament approved plans by incoming Chancellor Friedrich Merz to loosen borrowing limits, exempting spending on defence and security from the country's strict debt rules. This also facilitated the creation of a €500 billion infrastructure fund to run over the next 12 years. Consequently, German Bunds bore the brunt of the ensuing sell-off across the eurozone, with 10-year yields recording their largest daily jump since reunification in 1990 following the announcement (yields move inversely to price). There was a partial reversal of the market weakness towards the end of the quarter as focus turned to the impact from tariffs ahead of the ironically-dubbed "Liberation Day".

US Treasuries outperformed this quarter, ending a volatile quarter with yields falling (and prices rising) to 4.2% in response to a weakening of global investor sentiment and a more uncertain outlook for the US economy. Canada also faced tariff uncertainties, leading to falling yields, although its performance lagged behind the US.

Despite attempts by the Fed tried to tame optimism about economic growth, the sell-off in US bonds did not slow down

In the UK, the Bank of England (BoE) cut its policy rate to 4.5% in February and held rates steady in March, citing a 'gradual and careful' policy approach amidst a stagflationary outlook and a vulnerable fiscal position. Inflation remained a concern, with headline CPI peaking at 3% in January before easing to 2.8% in February, though services inflation stayed elevated. As at the end of March, the market is pricing in around 50bps of cuts by the end of 2025, down from the 60bps expected at the start of the year. Lower than expected gilt issuance for the upcoming fiscal year helped to alleviate concerns around the fiscal outlook somewhat. Overall, the risk-off tone in markets and dovish messaging from the BoE supported short-dated gilts, but longer-dated bond yields rose.

Over in Asia, Japanese government bonds underperformed all major markets. The Bank of Japan (BoJ) hiked rates in January to 0.5%, while persistent above-target inflation, encouraging initial results from this year's wage negotiations, and somewhat hawkish BoJ comments fuelled expectations of another rate hike later in the year. Yields peaked mid-quarter but stabilised in March along with other bond markets as US policy-induced growth concerns intensified. Conversely, in China, a largely deflationary outlook stemmed a rise in yields.

Commodities

The S&P GSCI Index gained in the first quarter. Precious metals was the best-performing component, with strong price gains achieved by gold and silver. Worries over tariffs and their potential impact on economic growth saw investors turn to assets perceived as safe havens, such as gold as strong central-bank buying pushed it to a new record of more than US$3,000 per Troy ounce.

Worries over tariffs and their potential impact on economic growth saw investors turn to perceived safe havens, such as gold

Agriculture was the worst-performing component of the index, driven lower by a sharp fall in the price of cocoa. Declines in the price of wheat, cotton and corn were more modest, while coffee and sugar prices gained in the quarter. Within energy, natural gas achieved the biggest price rise while Crude Oil was little changed albeit with swings on either side.

Precious metals was the best performing component in Q1, with strong gains achieved by gold & silver. Inversely, agriculture was the worst performing component in Q1, driven by a sharp decline in the price of cocoa, as well as modest drops in the price of wheat, cotton & corn

In industrial metals, the price of copper was sharply higher as the market began to anticipate that proposed tariffs on the commodity could be implemented sooner than expected, prompting buyers to accelerate their purchase plans. However, iron ore, aluminium and Zinc each declined, while lead and nickel achieved more modest gains. Zinc prices fell in the quarter.

Nairobi Securities Exchange

NSE Q1 Performance

- NSE 25: +3.8%q/q
- N10: +3.1%q/q
- NASI: +5.9%q/q
- NSE 20: +10.8%q/q

The bourse closed the quarter in the green with the NASI, N10, NSE 20, and NSE 25 gaining 5.9%q/q, 3.1%q/q, 10.8%q/q, and 3.8%q/q, respectively. Notably, March was the only month in the quarter to register a price decline on the broad market, with the NASI retreating by 1.0%, partly diluting the gains of 3.9% and 3.0% in January and February, respectively. Looking at the Sub-Sahara market performance, all markets shy of Namibia and Rwanda posted bullish performance in the first quarter of 2025.

From a corporate action vantage point, the anticipation of record earnings with the announcements of banking sector FY24 results drove bullish sentiments in the market – which we believe will remain sustained until the book closure of declared dividends. That said, price attrition may kick in with likely muted growth of 1Q25 earnings on the back of a high base in 2024 and the softening yield curve and lending rates.

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Despite the market disruptions from the Trump 2.0 policies and its ripple effects, we maintain our view that 2025 will likely see the market close with broad gains given the price discounts. Shy of the banking sector, mean reversion suggests that the deep discounts – largely misaligned to fundamentals – registered in 2022 and 2023 are set to continue seeing an upward reversal in 2025. In our view, small caps may rise the highest, benefiting the most from this tide, on the back of increased local investor participation as attention shifts from fixed-income assets to equities. For large caps, the case remains strong for an upswing, however, we worry about the building uncertainty on Trump's 2.0 policies ripples – which may upend foreign flows if investor attention in the US market remains high, for longer than expected.

Looking Ahead

Here's the interesting thing about capital markets: they cannot be indicted, arrested or deported; they cannot be intimidated, threatened or bullied; they have no gender, ethnicity or religion; it cannot be fired, furloughed or defunded; they cannot be primaried before the next midterm elections and they cannot be seized, nationalized or invaded. It's the ultimate voting machine, reflecting prospects for earnings growth, stability, liquidity, inflation, taxation and predictable rule of law.

Holding diversified portfolios is the tried-and-true strategy to withstand turbulent markets

For all the turmoil in the news lately, investors who stuck with the tried-and-true strategy of holding diversified portfolios came out of the first quarter of 2025 with barely a scratch. There's no question that the quarter did not turn out the way most pundits thought it would. US President Donald Trump's trade wars and significant breaks with the longstanding geopolitical order turned recent stock and bond market trends upside-down. US stocks went from record highs to suffering the losses of a 10% "correction" in less than a month. A previously solid outlook for the US economy has been hit by a high degree of uncertainty, thanks to swings in trade policy and federal government layoffs.

Now that the first quarter is in the books, everyone wants to know what the rest of the year will look like. Trade and fiscal policy developments will remain critical factors shaping investor sentiment and the outlook looks somewhat muddy right now. Concerns about more tariffs, inflation, faltering economic growth, and what (if anything) the Fed can do will continue to weigh on markets until we have clarity on the path ahead. The new quarter has started with more news on tariffs as the administration's April 2nd "Liberation Day" was meant to announce a range of tariffs designed to be broad-based and reciprocal, matching the duties that other countries charge on U.S. products. However, the announcement was widely criticized with many pundits describing it as worse than the worst-case scenario causing more questions about the outlook for investment spending over the next couple of quarters as the weighted effective tariff rate has gone from 2.3% last year to 27%.

We shall also soon start to hear from corporate America as companies start reporting first-quarter earnings. During fourth-quarter earnings calls from mid-December through early March, data found it was the lowest number of companies mentioning the term "recession" since Q1 2018. It is worth paying attention to what these companies will say about the economy just a couple of months later and to their outlook for earnings growth relative to expectations coming into the year along with if they still intend on following through with previously announced capital expenditure plans in the near term. Corporate earnings and revenue expectations have come down amidst this rise in probability of a recession. Projected S&P 500 earnings growth for 2025 has declined from 14.8% at the start of the year to 11.5%. This comes as many financial institutions now have raised the probability of a recession in the US to above 55%. Of the 11 recessions in the US since World War 2, 10 have begun under Republican presidents, so the signs are ominous. The mood is currently confused as many don't know which policies are going to stick and which ones aren't, leaving markets in a state of flux and vulnerable to huge swings on minor news for either side. It isn't necessarily outright bearish at the moment; it is just not bullish.

Many financial institutions now have raised the probability of a recession in the US to above 55%

Finally, the Fed has scheduled meetings in the first week of May and the third week of June. We expect the Fed will remain data-dependent, but any deterioration in economic fundamentals could see the central bank adjust interest rates in June and possibly fuel a rebound in the markets.

Despite market volatility, history reminds us that corrections are a natural and expected part of long-term investing. The recent pullback in the S&P 500, while significant, aligns with historical trends, reinforcing the importance of diversification and disciplined investment strategies. Certainly, declines can continue, which we've seen a few times over the past five years. In general, corrections have been a good time to look for opportunities to enhance portfolios for long-term views and as we have witnessed as recently as mid-February, perceptions can quickly change.

Understandably, there is heightened concern about the path forward for the U.S. economy and how it will affect markets. There is no clear answer to how that will unfold—but there never is. President Trump is erratic, and who knows how long he'll keep some of the head scratching policy proposals in place. Interest rates, valuations, and earnings growth are key to understanding how the market will move. We will be watching all closely as we get updates in the short to intermediate term. However, equity markets beyond the US, buoyed by fiscal stimulus measures, have become compelling, while fixed income, commodity and currency markets have continued to provide us with exciting opportunities. There is also no one-size-fits-all portfolio construction solution to navigate volatility. At times like this, what we continue to do is to maintain a strategic and diversified approach while ensuring that the portfolio aligns with the long-term objectives that our investors are trying to achieve and look to quickly rebalance when portfolios are out of line with those objectives and risk parameters. We believe that diversification is working, and we expect it will continue to do so.

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