And So It Starts – Market Commentary

February saw a sharp US market decline discussed in more detail in the main body of this commentary.

The decline drove the MSCI World Index down due to the large weight of the US in the index.

Value was slightly up over this period at +1.6%, no doubt due to non-US markets and the European rally in particular. Growth, while driven, as expected, by Tech in the US, was down -2.8%. The S&P 500 ended the month -1.3% in USD, while the Tech-heavy Nasdaq was down -2.8%.

EMs were +0.5% up in USD, and South Africa was in line, though at 0.0% in ZAR terms.

The various market returns for the month and year-to-date are summarised in Table 1 below.

Table 1. South African and global equity returns (USD) for February 2025*

	Feb-25	YTD 2025
FTSE/JSE ALSI (ZAR)	0.0%	2.3%
FTSE/JSE ALSI (USD)	0.5%	3.9%
MSCI World	-0.7%	2.8%
MSCI EM	0.5%	2.3%
MSCI Value	1.6%	6.1%
MSCI Growth	-2.8%	-0.3%
S&P 500	-1.3%	1.4%
Nasdaq 100	-2.7%	-0.5%

*Total return indices, Source: Factset

The S&P 500 began declining on 19 February through to 13 March, registering a -10.1% move in USD terms. As usual at the time of writing we are unsure if the low will be tested, or the market will reverse course and recover. We have the following comments to make however

1. Markets seldom suddenly change course from bull to bear. When driven by the onset of recession, we would describe the motion as a slower rollover, much like in 2008 before the real declines begin. We think 2022 was, in contrast, a correction of pandemic-induced overvaluation, or rather stimulus-induced overvaluation, itself pandemic-induced.

2. Per point 1 above, we would not be surprised to see the market recover to its pre-correction level until a new piece of deteriorating economic data leads to a new decline. We do not know this for sure, however. It could equally decline further from current levels.

3. The above presupposes a US recession materialises in the first place. This is not assured, but, we think, likely. We have been of the view for some time that if a slowdown in the US is to occur, now would be an excellent time, historically speaking, in the current post-yield curve inversion period. We set out the historical chart of US inversions and recessions in Chart 1 below.

Chart 1. US Treasury (post-) yield curve inversions and recessions

Per Chart 1 above, we do not consider the 6 occurrences of inversion and recession over the previous 50 years statistically reliable but, it has to be said, the record is almost 6 out of 6, notwithstanding a brief dip in 1998 which could well have been a precursor since markets can take their time. Note of course that correlation also does not imply causality.

As a side note we continue to be impressed by the slight inversion in September 2019 and the subsequent Covid-related recession in March 2020. If yield curve inversion is indeed a predictor then we suggest the US bond market performs better than AI.

What to expect

An economic slowdown implies earnings growth slows. Perhaps to zero, perhaps negative. Current consensus expects +11.7% growth in 2025. We can expect this to be quickly revised down if problems materialise.

The other element is PE. Chart 2 below presents a history of the S&P 500 Price to Earnings ratio. Reference is often made to long term averages. We do not consider this to be a reliable gauge. Instead investors should perform own calculations taking into account interest rate and earnings growth assumptions.

For the purposes of this commentary we note from Chart 2 that during the “taper tantrum” towards the end of 2018, for those who remember, the PE fell to 16.7. The Covid decline in March 2020 stopped at 17.1, and the 2022 declines on rising Treasury yields also stopped at 17.0. 2009, in contrast, saw the PE below 10.

For perspective, a straight derating to 17x from the current 24.8x (already down from 27.8x achieved in January 2025) comes out at -31%. Of course this is before any earnings revision.

To give what might be a somewhat more specific useful range, if earnings growth remains as currently expected at +11.7% and only sentiment deteriorates (an unlikely development), the decline would be -19.8%. If earnings growth is flat, the decline would be -28.2% and if earnings decline -10%, the market decline might be -35.4%.

Chart 2. S&P 500 PE history

Source: Factset

We summarise the ranges above in the Table below.

Table. Earnings growth and de-rating scenarios

Earnings Growth	Possible decline
+11.7%	-19.8%
0.0%	-28.2%
-10.0%	-35.4%

What about interest rates?

The US Fed will most likely respond, and Treasury yields are likely to decline, providing support to prices.

Fiscal policy?

We think there may be a question mark over this. In the ordinary course of events one might expect a supportive response. The current administration is making a concerted effort to cut spending and the fiscal deficit. We wonder how they might behave in a downturn. Should there be no fiscal or little fiscal response it is possible a downturn might be sharper and last longer.

Which stocks benefit?

We offer some general commentary on the Value/Growth spectrum as opposed to sector-specific details. Companies with average to below average earnings quality in normal times might be under pressure in a downturn i.e. Value. Companies with strong growth might also be under pressure as growth slows, though less so than Value. Lower yields will likely provide relatively more support to these Growth shares as well. This leaves more resilient operators which we expect should be least affected.

What about Europe and other markets including Emerging Markets?

Much is made in media commentary of the US "ceding leadership" to Europe in recent weeks. We regard the Euro rally to be sentiment-driven and correcting underperformance over the last 12 months (European stocks actually outperformed over 2022 and 2023). We suspect the rest of the world will not be insulated. Capital and trade flows still matter, tariffs and all, in which case correlation across markets is likely to manifest, to varying degrees.

Will Gold provide any protection?

Finally we offer a short note on Gold. We suspect the strong Gold price is due to central bank buying. And central banks are buying because of geopolitical developments. After all €300 billion of Russian central bank money is frozen and threatened to be transferred to Russia's declared enemy. The interest on the capital is already being transferred. Regardless of one's views on the conflict it is not a stretch to imagine every government and central bank around the world thinking about finding themselves in a similar situation and taking steps to mitigate the risks. So these structural price increases stop when the institutional buyers are satisfied that their exposure is sufficiently reduced. In general we think the freezing of capital does not engender confidence in the financial system and is perhaps a step too far where one hurts oneself in attempting to hurt an adversary.

In a downturn Gold and Gold shares seemingly provide no protection. Gold fell -31% in 2008. We think this is because in a US downturn capital around the world is pulled back to the US causing the USD to strengthen. Inflation expectations are usually tempered as well, a not independent development. Structural buying may provide some support this time round however.

As a final note we ask about Gold, why it is that this all-knowing and all-seeing new technology which will revolutionise the world, including asset management, was not able to predict the Gold price rise. This is, of course, because if the above argument about central bank buying is correct, there is a new driver of demand which has not manifested historically and is not available in past data to be fed into an inductive algorithm. In this sense this is similar to the Covid recession and AI point above – Covid developments were not available to be fed into AI and so AI ended up being not very intelligent.

In general we think if AI had had any material success in dealing both with Covid and the current gold market, and any other market for that matter, driven by forces which have not manifested historically, we would not have stopped hearing about it to this day via the Financial Times / Bloomberg / The Wall Street Journal / Business Day / take your pick.

Summary

In summary we think it is time to be cautious.