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Disconnect between economies and markets warrants caution

2025 was a great year to own South African financial assets despite mostly negative news headlines and lacklustre economic growth – a theme common among several markets. Returns both locally and abroad were very narrow, coming from a handful of shares. In our first investment update of 2026, chief investment officer Duncan Artus fields questions from Tamryn Lamb, head of Retail, as he sets the scene for the year ahead. He reminds investors not to expect a repeat of the unusually high returns delivered last year in an environment where risks remain heightened. Watch the 20-minute video and read the commentary below.

2025 will go down as the year artificial intelligence (AI) emerged as a dominant theme for markets and broader society. While this is most likely the correct view, its effect on markets, entire sectors and individual businesses (including asset management) is harder to predict with confidence. There will be sectors that are disrupted, while some may not even exist in five years. If historical periods of great disruption are anything to go by, new industries, businesses and jobs will be created. Who would have predicted, five years ago, that Nvidia would surpass technology giants such as Apple and Microsoft to become the first company to reach a market capitalisation exceeding five *trillion* US dollars? To put this into perspective, the difference between the market cap of Nvidia and Microsoft is greater than the total market value of Walmart, the world's largest retailer. One thing I can promise you is that I did not use ChatGPT to write this commentary.

Much of what I focused on in last year's commentary has played out. Geopolitical tensions continue to escalate, with the world becoming more divided, and the rally in SA Inc. shares post the 2024 national elections has mostly petered out. Furthermore, rest-of-the-world equities outperformed the S&P 500 and the US dollar weakened. We have written about these themes on several occasions and continue to assess the potential risks and opportunities that they may bring. We are bottom-up investors, but we strive to be on the right side of long-term trends. This is easier said than done.

Turning to markets

The South African equity market, as represented by the FTSE/JSE All Share Index (ALSI), returned a strong 42% in 2025, outperforming both cash at 7.3% and inflation at 3.6%. This translated into a significant US dollar return of 62%. The aggressive "Liberation Day" sell-off in April 2025 is nothing but a distant memory that has long faded from investors' minds. The FTSE/JSE All Bond Index returned 24% from an attractive starting valuation and benefited from large foreign purchases. Yields on the South African 10-year bond fell from a high of 11.1% to finish the year at 8.4%. The rand strengthened by almost 14% against the US dollar, although this must be seen in the context of a weak dollar. 2025 was clearly a great year to own South African financial assets despite mostly negative news headlines. Many local consumer companies found it much tougher going in our low-growth economy. It is important to note that the ALSI is not representative of South Africa's current economic performance.

Internationally, the MSCI World Index (World Index) and the FTSE World Government Bond Index returned 21% and 8% respectively, in US dollars. The World Index is trading at all-time highs. Another major headline story for the year was the performance of precious metals. In US dollars, the price of silver rallied by almost 150%. The gold price continued its bull market run to set new all-time highs. The rally dragged up the price of platinum group metals (PGM), with platinum up 127% and the PGM basket up 94%, both in US dollars. While the moves in the precious metals complex feel extended in my view, it is tricky to forecast with any great degree of accuracy.

Globally, markets were focused on the "dollar debasement", positioning for a weaker US dollar and relatively stronger demand for non-US and real assets. I am somewhat sceptical of this, but it is correct that the trade and investment imbalances that have built up over many years need to be corrected. Despite this, the S&P 500 is within a whisker of 7 000. Tariffs and trade protection were a big focus of markets. Please refer to my colleague Sandy McGregor's article, which is available on our website, for a detailed look at tariffs and their implications for markets.

We are focused on what the large imbalance between Chinese production and consumption means for industries globally. This is alongside an increased focus on resilience for nation-states. The final large theme is the AI capital expenditure of hyperscalers, such as Amazon, Meta, Microsoft and Alphabet. The amounts that have been and are projected to be spent on chips and data centres are staggering. The big seven tech companies are collectively forecast to spend between US$350bn and US$500bn in 2026. This spending has contributed a not-insignificant amount to US economic growth.

Locally, the market bifurcated between the performance of the precious metal shares (gold and platinum miners), Prosus and the rest of the market, especially SA Inc. shares. For a detailed discussion of our views on precious metals, the miners and drivers of the gold price rally, please listen to episode 28 and episode 30 of *The Allan Gray Podcast*. As discussed earlier, many SA Inc. shares have given up a significant portion of their post-election rally as reality has set in on their growth prospects. We are finding some intriguing opportunities in this area, such as in the depressed retail sector. It is also interesting because of the divergence in their performance when compared with the bond market, which has continued to rally strongly, while SA Inc. shares have lost momentum. We continue to find value in high-quality multinationals, such as Anheuser-Busch InBev and British American Tobacco, which have underperformed the precious metal miners.

Performance

For the 2025 calendar year, absolute performance was strong and well above our expectations through the cycle. Relative performance improved across most of our funds, with particularly pleasing performance from the offshore portfolio. I thank our colleagues at our offshore partner, Orbis, for an outstanding job. As discussed earlier, while local equities performed remarkably, our selection of local shares lagged the ALSI, given our underweight position in precious metals and Prosus/Naspers. This is despite having a 20% position across the two.

The Allan Gray Balanced Fund returned 24%, outperforming its benchmark by 4%. The Allan Gray Stable Fund returned 15%, ahead of its absolute benchmark, which returned 8.6%. The Allan Gray Equity Fund returned 27%, narrowly underperforming its benchmark.

The Orbis Global Equity Fund returned 21% in rands for the year, outperforming the World Index by 13%. The Orbis SICAV Global Balanced Fund returned 22%, outperforming its 60/40 benchmark by a remarkable 20%. Orbis' strong relative returns were achieved despite having minimal exposure to US mega-cap tech shares.

Conclusions

Risk remains heightened across the board. I remain concerned about the elevated level of global sovereign debt and geopolitical tension. The Investment team continues to apply the same philosophy and process we have adhered to for the last 52 years in managing our clients' hard-earned savings.

Commentary contributed by Duncan Artus, chief investment officer, Allan Gray

Over the decades, we have learnt the importance of sharing transparent, engaging information with our clients. This is particularly important during the cycles of underperformance that are inevitable when investing over the long term. To outperform the index and peers, by definition, our portfolio needs to look different. This carries both career and business risk.

As always, I encourage you to focus on your long-term financial plans and goals rather than worrying about the daily news cycle – as challenging as it may be these days. Long-term investing proves most fruitful for those who manage to stay the course. It is worth highlighting, again, that last year's returns are well above what we could consider normal. The market has done a lot of heavy lifting for the portfolios. That won't always be the case.

On behalf of the Investment team, thank you for the ongoing trust you place in us.

Adapted from the chief investment officer's comments, which will appear in the Allan Gray Unit Trust Annual Report, 2025.

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