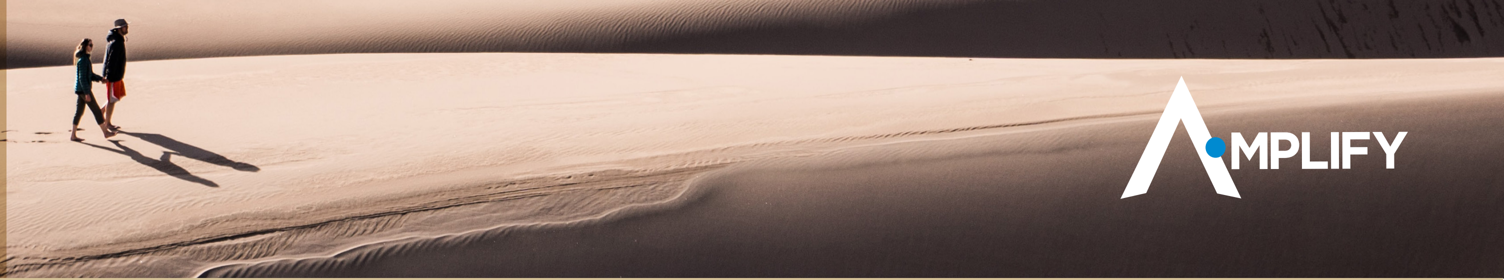
Amplify SCI* Strategic Income Fund

Fund Commentary | March 2025



Erik Nel
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"Progress is mixed: efforts to exit the FATF grey list and improve credit ratings offer tailwinds, but foreign relations strains and GNU tensions pose headwinds."

Global overview

From optimism to caution: the economic outlook shifts

Just three months ago, a higher-for-longer interest rate narrative dominated markets, bolstered by political shifts promising front-loaded global growth, sticky inflation, and delayed policy rate normalisation. Prospective US trade and developed market immigration policies were flagged as potential negative supply shocks, likely to dampen global growth. Yet, this drag was expected to be offset by a widespread shift towards easier fiscal policies. Analysts anticipated 2025 growth to surge early, driven by global industrial activity ramping up ahead of looming US tariff hikes. The optimism was palpable – policy changes seemed poised to sustain economic momentum despite challenges.

Fast forward to less than 100 days into President Trump's second term, and the landscape has shifted dramatically. While backward-looking data has shown relative resilient expansion, characterised by what some would describe as strong mid-cycle fundamentals that have weathered the drags from high, late-cycle interest rates – the latter of which were beginning to normalise, forward-looking data points to slowing growth.

Markets spent March navigating a storm of policy shocks, liquidity stress, and global fiscal shifts. Trump's kitchen sink strategy to slow the US economy by front-loading tariffs, restricting immigration, and DOGE budget cuts has now impacted over US$1.3 trillion in trade, while the DOGE-driven fiscal retrenchment threatens to flip a 100-bps GDP tailwind into a similarly sized headwind. Treasury Secretary Scott Bessent reaffirmed that short-term weakness is a deliberate cost of reorienting the economy towards supply-side strength.

Trade war fears and policy uncertainty

The threat of an escalating trade war now looms large, poised to erode business confidence and drag down the global growth outlook. Unlike past cycles, where the first 100 days of a US presidency offered a clear policy roadmap, this time the usual playbook feels irrelevant. The administration's signals are muddled yet ambitious – committing to sweeping changes that leave markets grasping for clarity. Beneath this uncertainty lies a macroeconomic tug-of-war. Tax cuts and deregulation aim to ignite growth, explicitly targeting business vitality. However, plans to curb global engagement – through immigration restrictions and tariff increases – threaten to counteract these gains, weighing heavily on economic prospects.

This policy dissonance isn't the only challenge testing entrenched assumptions. The past two years have already defied consensus: the US dodged a 2023 recession, and 2024's expected rapid normalisation of inflation and developed market policy rates fizzled out. Markets reflect this unease – equity indices have suffered significant losses, and short-term interest rates have undergone sharp repricing. We remain cautious, seeing upside potential tempered by mounting downside risks. Globally, Trump's policy rhetoric has reignited uncertainty, souring sentiment towards risk assets.

Tariffs, inflation, and growth at a tipping point

Fears of resurgent inflation, coupled with expectations of a cautious US Federal Reserve (Fed), have somewhat limited the decline in bond yields to date, defying typical late-cycle patterns.

In the absence of negotiated settlements to ease tariff tensions, tariff wars are likely to slow economic growth more than they drive inflation. The US Treasury's efforts to reduce the deficit will probably limit increases in bond yields, suggesting the Fed will eventually resume cutting interest rates to bolster the economy. However, significant tariff retaliation from other countries could heighten the risk of a US or global recession,

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potentially triggering aggressive monetary easing and fiscal stimulus to counteract the downturn.

Beyond the US, reduced reliance on American demand has spurred Europe and China to tackle their own cyclical and structural growth hurdles. This could mark an inflection point for non-US growth, potentially broadening risk appetite once current uncertainties subside. A weaker US dollar would follow, lifting emerging markets and South Africa – provided the political landscape improves.

Local overview

Key drivers and barriers to South Africa's economic rerating

Locally, South Africa's next rerating hinges on stronger growth and corporate earnings delivery, both tied to rising confidence and accelerated reforms. Progress is mixed: efforts to exit the FATF grey list and improve credit ratings offer tailwinds, but foreign relations strains and GNU tensions pose headwinds.

The budget standoff among the GNU partners extends beyond the initial disagreement regarding the proposed 2% increase in VAT, later revised to 0.5%, aimed at financing increased expenditure. The core issue lies in the urgent need for a more robust economic policy capable of addressing an economy trapped in low growth and struggling to generate jobs.

Market optimism from coalition reforms and resolved loadshedding has faded. South African asset prices will most likely continue to tread water until both global uncertainty and a frustratingly poor local political landscape improves. Previous stellar returns suggest the easy gains from the reflation trade are behind us, yet cyclical disappointments could unlock opportunities for a longer-term structural rerating.

South Africa's recovery is hampered by structural weaknesses, including fragile logistics and energy infrastructure, reliance on EU and Chinese demand, and sluggish labour-intensive sectors like construction. High consumer debt, particularly among lower-income households, threatens the sustainability of consumption-led growth, while import-heavy private capex limits domestic spillovers. Globally, geopolitical tensions, trade wars, and the potential loss of AGOA benefits heighten export risks.

Monetary easing may be required to support growth

Targeted reforms in logistics and energy, alongside fiscal support for labour-absorbing sectors, could bolster competitiveness and job creation. The South African Reserve Bank (SARB)'s cautious monetary policy reflects inflation concerns, but rate cuts may be needed to spur growth. Growth was projected at 1.6% in 2025 and 1.7% in 2026, though external headwinds, tempered by Germany's fiscal measures, pose risks to this trajectory. The 30% tariff announcement exceeds expectations with a potential 0.4-0.5ppt GDP hit.

Contained inflation, under normal circumstances, would enable potential further SARB easing. However, global tariff-driven inflation fears and the SARB's inclination towards a lower inflation target may cap cuts until confirmation of a severe US/global slowdown and a stronger reaction by the Fed than is currently priced.

Capital flows and leadership signals are key for Q2

Heading into the second quarter, investors must remain disciplined. Globally, without a timely QE pivot, headline-driven rallies are likely to fade until downside economic risks stop perpetuating capital outflows from US assets, while local political battles are unlikely to make SA a recipient of such US outflows, highlighting the importance of improved leadership outcomes, as often highlighted in these commentaries in past editions.

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