FOREWORD

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The second quarter brought investors some relief. Oil prices fell after the US-Iran ceasefire, global equities recovered and investors again found confidence in the promise of artificial intelligence. Yet the same forces that supported markets — optimism, liquidity and technology spending — also left important questions about valuation, inflation and the durability of the cycle.

In this issue of Foreword, our *Did You Know?* profiles 'animal spirits' — John Maynard Keynes's phrase for the confidence, fear and instinct that often drive investment decisions. Rashaad Tayob applies that idea to Foord's M.I.C.E. framework and the AI boom, asking whether confidence has moved ahead of earnings.

JC Xue looks at AI from another angle, arguing that the race to build domestic data centres, chip capacity and cloud infrastructure is becoming part of the broader shift from efficiency to resilience. Brian Arcese examines the oil market following the on-again-off-again ceasefire, where prices are moving faster than physical supply chains can adjust.

Closer to home, Dhersan Chetty writes on the stretched but still-spending South African consumer, while Julie Macleod-Henderson begins a new series on the Great Wealth Transfer. We also return to one of Foord's enduring concerns: inflation, which Dave Foord has described as 'the biggest destroyer of capital'.

We close, as always, with Markets in a Nutshell, our regular snapshot of global and South African market performance.

Regards

Paul Cluer
Managing Director

WHEN CONFIDENCE DOES ALL THE WORK

Foord's M.I.C.E. framework looks at four forces that support markets or hold them back: Money, Interest rates, Confidence and Earnings. All four matter, but they do not always matter equally. In today's artificial-intelligence boom, Portfolio Manager RASHAAD TAYOB writes that the most dominant factor may be the C, even if the E is the most important.

Confidence is not a soft factor. Economist John Maynard Keynes (see Did You Know?) used the term 'animal spirits' to describe the instinctive optimism that pushes people to invest when the future cannot be known. Markets need optimism. Without it, companies would not build factories, hire people or fund new technology. But confidence can also become circular: rising stock prices validate the story, the story attracts more capital, and the new capital pushes prices higher still.

The AI boom is now in its fourth year, and this confidence cycle has been the main driver of global equity returns. The clearest winners have been the suppliers of AI infrastructure. Nvidia and other chipmakers have seen sales multiply as customers race to secure graphics processors, memory and related equipment. Profit margins have expanded to levels more commonly associated with software than hardware. Even suppliers in cyclical and historically commoditised areas — such as memory — are earning record profits, because demand has overwhelmed supply.

The harder question is whether the users of that infrastructure can earn the returns implied by today's spending. AI providers are committing enormous sums to data centres, chips, power and talent. While revenues are rising quickly, capital expenditure is rising faster. In many cases, the result is deeply negative cash flow. That is not unusual in the early phase of a technology cycle. It does mean, however, that the boom still depends on investors believing that future revenues will justify present spending.

There are already signs of strain beneath the excitement. Leadership in the AI models race is proving less stable than markets once assumed. Some companies — like Facebook parent Meta — that spent tens of billions of dollars have fallen behind. Others — such as first-mover OpenAI — have seen growth slowing down. Open-source Chinese models are available at a fraction of the cost of leading Western models, raising an uncomfortable question about pricing power. If the best models become cheaper and less scarce, the economics of the AI providers may prove less attractive than the story suggests.

The speculative mania is most evident with the recent listing of Elon Musk's rockets-to-robots business, SpaceX. Its listing combined three powerful market themes: Elon Musk, artificial intelligence, and the moonshot idea of space. The combination was irresistible to many retail investors. SpaceX raised a record amount of capital and briefly traded at a valuation that placed it alongside the world's largest technology companies, despite still being loss-making and generating far less revenue than they do. Much of the value investors assigned to the company reflected not rockets or satellites, but the promise of its AI business. Yet its AI model, Grok, still trails the leading models in performance and user adoption. The share price has already surrendered much of its first surge. At the time of writing, SpaceX's market valuation was back at an eye-popping $2 trillion.

This is how animal spirits in markets work — they lift prices but also change the terms on which investors provide capital. When confidence is high, companies can raise money, spend aggressively and point to that spending as proof of future dominance. A virtuous cycle forms. The danger is that it can also run in reverse. If revenues disappoint, margins normalise or a market darling stock falls sharply, investors may become less willing to fund the next round of AI investment.

History offers a useful warning: railways, electrification and the internet all produced infrastructure that changed the world; they also produced many poor investment returns. Too much capital chased the same opportunity. Capacity was overbuilt, prices fell and early industry leaders disappeared.

AI may prove as important as its strongest advocates believe. But investors still face two familiar traps: paying trillion-dollar prices for companies with uncertain future cash flows, and assuming that today's extraordinary hardware margins are permanent. Confidence has built the AI boom and may yet build something lasting. But confidence is not earnings, and animal spirits are not cash flow.

THE AGE OF AI — BUILDING THE SAME FUTURE TWICE

One of the more surprising features of the global economy has been its resilience. Tariffs have risen, trade tensions have deepened and geopolitical uncertainty has become a more permanent feature of business planning. Yet growth has held up better than expected. Foord Singapore Portfolio Manager JC XUE writes that part of the explanation lies in the extraordinary wave of investment now being directed towards artificial intelligence.

At first glance, AI and deglobalisation seem to belong to different stories. AI speaks to technological progress, innovation and the next phase of productivity. Deglobalisation suggests fragmentation, higher costs and the unwinding of decades of economic integration. That said, the two forces are fast becoming closely connected.

For much of the past three decades, the global economy was organised around efficiency. Companies produced goods wherever labour was cheapest and supply chains stretched across continents. Digital infrastructure could be located wherever costs, tax rates and regulation were most attractive. The aim was to minimise costs. Consumers benefited from lower prices, inflation was contained and many emerging markets prospered as they became part of global production networks.

That model is now changing. Governments are more focused on the control of key technologies than on the price of goods and services. Data, computing power, semiconductor production and cloud infrastructure are increasingly treated as strategic national assets. Europe talks about digital sovereignty. China emphasises technological self-sufficiency. The US frames the issue in terms of national security. The language differs, but the objective is similar: countries want more control over the technologies on which their economies depend.

The result is a race to build domestic technological infrastructure. Countries want local semiconductor capacity, domestic data centres, secure cloud networks and national AI capabilities. This has created a powerful investment boom, especially in the US. Spending on data centres, chips, power infrastructure and computing capacity has helped offset some of the drag from tariffs and trade uncertainty. Without this AI-related capital spending, recent US growth would probably have looked much weaker.

The irony is that the AI revolution is not reinforcing the highly efficient global system that emerged after the Cold War. Rather, in many ways it is encouraging countries to duplicate capacity. Semiconductor plants are being built in more places. Data centres are being located closer to end-users and regulators. Supply chains are being redesigned not only for cost, but also for security and political acceptability.

This provides resilience, but it is not free. Building parallel systems is less efficient than relying on a single integrated global network. Domestic production often costs more than offshore production. Duplicate supply chains require more capital. Power grids must be expanded. Skilled labour must be found. Over time, this points to structurally higher costs and more persistent inflationary pressure than the world became used to during the era of hyper-globalisation.

History also suggests that transformative technologies can be both economically important and financially dangerous. Railways, electrification, telecommunications and the internet all changed the world. They also produced periods of overinvestment, excess capacity and poor returns for many investors. While the infrastructure was useful, the investment outcomes were mixed.

AI may follow the same pattern. It could raise productivity, reshape industries and create large new companies. Yet the rush to control the technology may also lead to duplicated investment and lower returns on capital. The political logic is clear, but the investment case is more complicated.

The age of hyper-globalisation was built on efficiency. The age of artificial intelligence may be built on resilience. That may make the global economy safer in some respects. It is unlikely to make it cheaper.

OIL PRICES MOVE FASTER THAN FACTS

For some weeks, the oil market hastily chose to believe in the US-Iran ceasefire deal. After the adversaries announced a 60-day pause and a path to reopening the Strait of Hormuz, Brent crude quickly fell towards $70 a barrel, from more than $110 in May. Renewed fighting in July has sent prices sharply higher. As Foord Singapore portfolio manager BRIAN ARCESE writes, prices are moving faster than facts.

Traders are quick to price in relief, but the physical market is always slower to adjust. Even during a ceasefire, tankers must be persuaded to pass through the recently mined strait. Insurers must cut war-risk premiums. Ships that diverted to safer and more profitable Atlantic routes must return. Gulf producers must restart output, while refineries damaged by Iranian strikes must raise throughput. None of this happens overnight.

Events of early July proved the point. Attacks on commercial vessels in the strait, renewed US strikes and the revocation of the waiver permitting Iranian crude sales sent Brent back above $80 within days. The market's optimism, it turns out, had run well ahead of the physical and political reality.

During the worst of the disruption, the world avoided catastrophe through three buffers. Firstly, China cut crude imports, partly by drawing on reserves and partly by cutting demand. Then, America exported more crude and refined products, helped by releases from its Strategic Petroleum Reserve. Finally, other producers — including Brazil, Canada, Norway and Venezuela — added barrels at the margin.

These buffers bought the market time and capped a more extreme oil-price increase. Looking forward, China may soon want to rebuild stocks rather than drain them. America's Strategic Petroleum Reserve is already at a four-decade low. The pace of releases is expected to slow dramatically, or stop completely. Europe has done less than it might appear, because much of its emergency oil is held in commercial tanks rather than dedicated state depots. Global reserves are thin and, in some cases, close to minimum operating levels.

These factors limit how far crude prices can fall, even if Gulf production returns smoothly after a more durable ceasefire. But a sustainable move much below the mid-$70s per barrel would require more than diplomatic optimism — it would require ships, refineries, reserves and end-users all to behave as if the shock was truly over. They are unlikely to do so quickly. The market will retain some risk premium for Iran, some scarcity premium for low inventories and some restocking premium for the barrels governments and consumers must replace.

The inflation story is also not straightforward. Lower crude prices will help headline inflation, especially in economies where fuel prices adjust quickly at the pump. They also ease pressure on central banks facing renewed energy-driven price rises. But crude oil is only the first price in the chain. Petrol, diesel, jet fuel, LPG and naphtha matter more to households and companies, and these refined products remain exposed to refinery bottlenecks, shipping delays and regional shortages. Africa is short of petrol. Europe relies on Gulf diesel and jet fuel. Asia needs naphtha and LPG. American refiners may swing back towards petrol for the home market, but low domestic stocks mean pump prices may remain sticky.

The immediate disinflation from cheaper crude prices may therefore prove real but shallow. The larger risk is that the oil price remains too high for central banks to declare inflationary victory. If inventories must be rebuilt just as summer travel lifts fuel demand, oil may become less of a shock but more of a floor under already elevated inflation.

THE THRIFTY SHOPPER IS RESHAPING SOUTH AFRICAN RETAIL

Consumer confidence has been negative for seven years and has fallen further as fuel costs have risen and interest rates have ticked higher. Equity Analyst DHERSAN CHETTY writes that South African grocery shoppers are under pressure, but they have not stopped spending.

This resilience should not be mistaken for comfort. Consumers are increasingly highly price sensitive. Shoppers are buying more on promotion, switching brands and moving towards retailers that offer the clearest value.

This trend has helped Shoprite and Boxer gain share from Pick ‘n Pay and Spar, which have faced both market pressure and internal challenges. Being price competitive is no longer enough. Retailers also need the right format, stock availability, data and customer loyalty to turn value into repeat business.

Shoprite’s Checkers brand has done this particularly well. Its scale gives it buying power, while its data allows promotions to be more targeted. The group’s Sixty60 platform has also changed customers’ perceptions of Checkers. It is no longer just a middle-income supermarket chain. For some consumers it has become the most convenient grocery option; for others, it has replaced a weekly shop at Pick ‘n Pay or a convenience stop at Spar. The shift is not only an online phenomenon: once customers change their view of the brand, it can also affect where they shop in store.

Pick ‘n Pay subsidiary Boxer is winning in a different way. Its discount grocery model is built on a narrower product range, high volumes and low prices. That appeals to shoppers managing tight household budgets, and to suppliers that need scale. Boxer is expanding from a low market-share base, both in attractive nodes and in rural or semi-urban areas where formal retail remains underpenetrated.

Woolworths is an altogether different case. Its food business has been resilient because of product quality, brand trust and a loyal middle- to upper-income customer base. However, its online offer is weaker than Sixty60, particularly in delivery availability. The brand remains strong, but the convenience gap has begun to matter as shopping habits change.

Private label supermarket sales should, in theory, benefit from price-conscious consumers. In practice, growth has been less exciting. Penetration is already reasonably high in South Africa, while local production capacity is limited. Branded food producers are also fighting back by cutting costs, simplifying packaging and launching cheaper variants. This narrows the gap between branded products and private label. Companies such as Tiger Brands — in which we are invested — are adapting to this shift.

Lower oil prices may offer some immediate relief to households and retailers’ transport costs. Yet the benefit is unlikely to reverse the full petrol price increases that followed the on-again-off-again US-Iran war. Packaging and input costs may even rise with a lag, while a possible El Niño later in the year could put renewed pressure on food inflation if it brings drier conditions to Southern Africa. Retailers may therefore become more selective with promotions as they protect profit margins.

The weakest area for the retailers is clothing, which is more discretionary and more exposed to brutal Chinese competition. Food retail remains the safer part of the consumer market, but even there the winners are separating from the pack. In our view, the best opportunities are in businesses with scale, strong systems, good formats and clear value propositions. The South African consumer is stretched, but still spending carefully. Retailers that understand that difference are gaining ground.

THE GREAT WEALTH TRANSFER — STEWARDSHIP IS LEARNED

Over the next two decades, one of the largest transfers of wealth in history will quietly reshape families, investing and financial advice. Often called the Great Wealth Transfer, it will see substantial assets pass from older generations to their children and grandchildren. Head of Distribution JULIE MACLEOD-HENDERSON writes that the real significance lies not only in the value of the assets, but in the responsibility that comes with them.

For many families, wealth has taken decades to build. It reflects disciplined saving, patient investing and careful decision-making through many different market cycles. The next generation will therefore inherit more than money. They will inherit the responsibility to preserve it, grow it and use it wisely. Wealth can pass from one generation to the next in a moment. The judgement needed to manage it takes much longer to develop.

Women are expected to play a defining role in this transition. Many women outlive their spouses and increasingly inherit or control family wealth. Younger generations will also control a greater share of household wealth than before, often earlier in life. This creates opportunity, but also raises a practical question: are future investors being prepared for the decisions they will need to make?

For parents and grandparents, the task is not only to decide what they will leave behind. It is to share the values and habits that helped build the wealth in the first place. For future beneficiaries, the responsibility is to learn, ask questions and develop the confidence to make thoughtful financial decisions. Good stewardship is not instinctive, it is learned.

This matters because many beneficiaries change advisers or move inherited investments soon after receiving them. Sometimes there are good reasons: their needs may be different, or their tax position, income requirements or investment horizon may have changed. But too often, heirs inherit the assets without understanding the thinking behind them. They know what they own, but not why they own it.

That is why families should talk about wealth before it changes hands. Families that discuss financial values, long-term goals and investment philosophy help the next generation become stewards rather than merely recipients. These conversations need not begin with detailed portfolio construction or tax planning. They can start with simpler questions: what is this money for, what risks should it avoid and what principles should guide decisions when markets are difficult?

For younger investors, an inheritance can be both empowering and unsettling. Managing a meaningful portfolio may be unfamiliar. The temptation to make quick changes can be strong, especially where markets are volatile or recent performance has disappointed. Taking time to understand the purpose of existing investments before making major decisions can prevent mistakes driven by emotion, impatience or incomplete information.

The Great Wealth Transfer is therefore about more than passing on financial assets. It is about passing on knowledge, values, confidence and responsibility. Families that begin these conversations early give the next generation a better chance of protecting what has taken a lifetime to build.

This is the first in a series of articles on how families can prepare for this generational transition: from starting meaningful conversations and involving younger family members, to helping future investors understand the value of long-term investing. Wealth can be inherited, but stewardship must be learned.

INFLATION — THE QUIET DESTROYER OF CAPITAL

Investors often measure success against market indices, peer groups or recent winners. These comparisons have their place. But for most people, the real benchmark is simpler: do their investments grow faster than the cost of living? LINDA EEDES writes that for long-term investors, protecting purchasing power is not a side issue; it is the point.

Dave Foord has described inflation as 'the biggest destroyer of capital'. It is the gradual erosion of what money can buy. It usually works quietly and rarely feels dramatic. A grocery bill rises, medical aid costs more, electricity tariffs increase and insurance premiums edge higher. Over time, the damage compounds. At 5% inflation, the purchasing power of money roughly halves every 15 years. For a person retiring at 65, this matters enormously. A retirement that lasts 25 or 30 years is not unusual. Over that period, a nest egg that looks safe at the start can become dangerously inadequate.

This is why headline returns can be misleading. If a portfolio earns 6% in a year when inflation is 7%, the statement may show a gain, but the investor has gone backwards in real terms. There are more rands, but those rands buy less. Inflation is therefore not just an economic statistic. It is one of the most important risks in long-term investing.

That risk is quietly rising. Oil prices have eased from their recent spike, but investors should be careful about assuming that the inflation problem is over. Several forces that helped keep inflation low for decades are now weakening. Global supply chains are being redesigned for resilience rather than pure efficiency. Tariffs are raising costs in parts of the trading system. Geopolitical tension can quickly disrupt energy, food and transport markets. These pressures may not push inflation up in a straight line, but they make a return to the low-inflation world of the 2010s less certain.

This matters especially when markets are enthusiastic about narrow investment themes and the risk of permanent capital loss is high. Artificial intelligence may be one of the defining technologies of the next decade — but even powerful themes can become dangerous when investors are willing to pay almost any price to participate, as we note elsewhere in this newsletter. If expectations disappoint, capital losses can be severe.

Foord's approach starts with a simple question: will this asset preserve or grow purchasing power after inflation? Different assets answer that question in different ways.

The first line of defence is equities with pricing power. A share is ownership in a real business. The best businesses can pass rising costs on to customers without destroying demand. They often have strong brands, essential products, high barriers to entry or dominant market positions. Over time, their revenues, earnings and dividends can rise with inflation. However, valuation still matters. A high-quality business is not a good investment at any price.

The second tool is inflation-linked bonds. Unlike conventional bonds, their capital value adjusts with inflation. They are not bought for explosive returns, but for purchasing-power protection. If inflation stays low, investors may not need that protection. If inflation surprises to the upside, it can be very valuable.

The third area is real assets. Gold, infrastructure and selected utilities can play useful roles. Gold produces no income, so it must be sized carefully. But it can help when investors worry about inflation, currency debasement or geopolitical stress. Infrastructure and utilities can also help where revenues are regulated or contractually linked to inflation.

There are four practical lessons. Do not chase a fashionable theme without asking what is already priced in. Do not hold too much cash at low or negative real returns. Do not assume all bonds are safe when inflation is the source of the stress. And, most importantly, focus on real returns. A portfolio succeeds only if it improves what money can buy.

DID YOU KNOW? ANIMAL SPIRITS

Investment markets trade on mood as much as on mathematics. Economists use the term 'animal spirits' to describe the waves of confidence, fear and excitement that move people to take risks. When animal spirits are strong, investors see opportunity everywhere. They buy shares, fund new ventures and assume that tomorrow will be better than today.

British economist John Maynard Keynes coined the term in 1936, arguing that many economic decisions could not be reduced to cold calculation. Because the future is unknowable, people act on instinct, confidence and stories. A new technology, a falling interest-rate cycle or a run of strong profits can persuade investors that old limits no longer apply.

Without optimism, businesses would not invest and households would not spend. However, optimism can overshoot. The same mood that supports growth can also inflate bubbles, leading to boom-bust cycles. In reverse, Keynes argued that free markets could not self-correct during a recession because human fear paralyses spending. That insight helped to shape Keynesian economics: when private confidence fails, governments must step in.

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MARKETS IN A NUTSHELL

	WORLD	SOUTH AFRICA
Equities	Global equities rebounded from the March oil shock, led by US technology and the AI supply chain — emerging markets surged as Korean and Taiwanese semiconductor shares outperformed, while China lagged	The JSE slipped in rand terms as resource shares fell sharply, with gold down by double digits and oil heavily off the March highs — financials and industrials advanced, cushioning the broader market
Bonds	Global bonds were broadly flat as investors weighed easing oil prices against sticky inflation — credit spreads tightened on resilient earnings and improved risk appetite	SA bonds rallied strongly despite the SARB's May rate hike — high real yields, rand strength and renewed foreign demand supported local fixed income
Currencies	The US dollar weakened modestly as risk appetite improved — the euro firmed and emerging-market currencies benefited from better global sentiment	The rand recovered ground against the US dollar over the quarter — broad dollar weakness and stronger demand for SA bonds helped, though June was softer
Commodities	Gold retreated as speculative and safe-haven demand faded on the prospects of higher rates, and Brent crude fell sharply as the Iran shock de-escalated — copper rose on demand linked to AI, power grids and infrastructure	
Economy	The global economy proved more resilient than was feared — AI capital spending and corporate earnings momentum offset some of the drag from energy disruption and softer consumers	SA growth stayed positive but weak — finance, agriculture, trade and transport supported activity, while business confidence and fixed investment remained subdued
Monetary and fiscal policy	Central banks remained divided as energy prices unsettled inflation forecasts — the US Fed and Bank of England held rates, while the ECB tightened for the first time since 2023	The SARB raised the repo rate to 7.0% in May as fuel-driven inflation risks narrowed the room for policy support — rate cuts are off the table for now

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