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## Europe Monthly

- **UK elections: 'All change' on 4 July?** – The elections are unlikely to trigger a fundamental shift in the policy mix, with nothing substantive released so far in terms of electoral manifestos by the main parties. Based on recent polling data, the bar for the Conservatives to retain power after 14 years in government looks exceedingly high.
- **Germany's rebound** – The recovery story is gaining momentum across Europe and the ZEW survey of financial market participants confirmed that respondents are turning more optimistic about Europe. Clearer signs that the recovery is broadening in terms of sectors and countries means that Germany could soon contribute to faster GDP growth.
- **Central banks in rate cutting mode** – Inflation is moderating across the globe and evidence is growing that firms and households are more confident about inflation expectations re-anchoring. The final leg of inflation normalization remains ahead of us, softening wage growth and clear signs of inflation convergence towards the target mean that more central banks will likely join the rate cutting party. We expect the ECB to be next on 6 June.
- **Fundamentals recover in Swiss and Europe ex-UK equities** – Significant rebound in '24 and '25 earnings-per-share (EPS) growth, better global growth, elevated profit margins, strong return-on-equity and cheap relative valuations support Europe ex-UK and Swiss equities positioning.
- **Global Investment Committee conclusion** – At our latest Global Investment Committee (GIC) meeting (22 May 2024), we upgraded both Europe ex-UK and Swiss equities, from a neutral to an overweight position in our risk 3 model portfolio. Over the next 12-18 months, we are positive on these equity regions and believe it offers investors with the opportunity to broaden out their exposure from US equities.
- **South Africa at a crossroads** – Voters dealt a blow to the African National Congress (ANC), which lost its parliamentary majority for the first time in 30 years, partly in response to high unemployment, elevated inflation and low growth. Markets hope – and expect – that the ANC will ally with the pro-business Democratic Alliance (DA). However, populist parties (Economic Freedom Fighters (EFF) and uMkhonto weSizwe (MKP)) remain which, if chosen to form a government, may threaten President Ramaphosa's economic reforms.

# UK election, Germany's rebound and central banks

**UK: Legislative elections unlikely to trigger fundamental shift in policy mix.** On a very wet Wednesday 22 May, Prime Minister (PM) Rishi Sunak announced that the next General Election would be held on Thursday July 4, instead of November which had previously been the 'Westminster consensus'.

**In hindsight, it seems that PM Sunak was hoping to capitalise on better economic news,** both in terms of GDP (which rose in the first quarter of 2024 after a contraction of activity in the second half of 2023) and inflation (headline CPI had fallen to 2.3% YY earlier on that day, its lowest level since July 2021). However, the hope of a trifecta of better news might be dashed since market pricing was suggesting that the Bank of England (BoE) was unlikely to deliver a first 25 basis point (bp) cut in Bank Rate from its 5.25% level until 7 November.

**The bar for the Conservatives to retain power after 14 years in government looks exceedingly high.** In the last two weeks since the elections announcement, there has been virtually no change in voting intentions. Latest polling averages from Politico.eu suggest that the opposition Labour party is averaging around 45% of voting intentions, some 22 percentage points (pp) above the Conservatives. **FIGURE 1** shows that in the UK's "first-past-the-post" electoral system, seat projections for the lower house from YouGov point to a 194-seat majority for the current main opposition party (422 for Labour [+219 compared to 2019] versus 140 for Conservatives [-225]) if elections were held tomorrow.

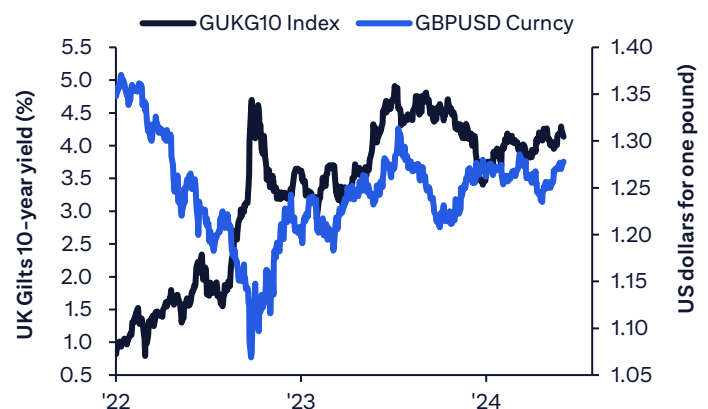
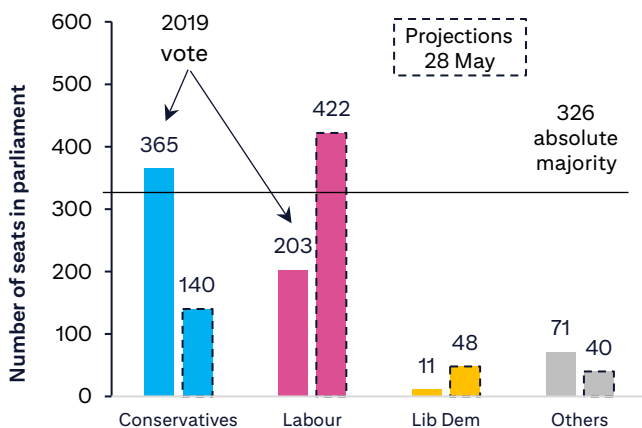
**In our note on the UK elections and asset price movements published in January** ([Europe Strategy | UK: What does the next General Elections man for investors](#)), we concluded that while equities have been largely politically agnostic, the UK gilts and sterling markets tend to be more reactive to fiscal (and monetary) policies. We continue to believe that the most important variable likely to influence the price of UK assets will be any meaningful changes by the new administration to the current restrictive trajectory of fiscal policy.

**Since the announcement of the election, the main parties have been working frantically to produce their policy manifestos, but nothing substantive has been released yet.** It is therefore very difficult to see what could change voting intentions in such a meaningful manner as to stop the opposition Labour party from gaining a substantial overall majority. Investors have taken the news of the election in their stride, with both 10-year gilt yields and cable (GBP/USD) essentially unchanged much since May 22 at 4.14% and 1.2780, respectively (**FIGURE 2**).

**We continue to expect a first 25bp rate cut at the 1 August meeting, with up to 75bp of cuts by the end of this year,** taking Bank Rate to 4.50%. Macro data has essentially continued to point to a small improvement in business confidence and house prices, but further evidence of some modest loosening in the labour market and muted consumer spending dynamics. Unsurprisingly, the [Bank of England held rates steady in May](#) but signaled its intention to move away from its highly restrictive monetary policy settings if data releases were to confirm that risks from inflation persistence are receding.

**FIGURE 1: High probability of regime change**

**FIGURE 2: Investors are not reacting to the news**



Sources: YouGov MRP poll for Sky News, and Citi Global Wealth Investments, as of May 28, 2024. **Past performance is no guarantee of future returns. Real results may vary.** Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment.

**The recovery story is gaining momentum across Europe.** The euro area and the UK are switching from recessionary conditions in the second half of 2023 to a modest recovery in the first half of 2024 as the manufacturing contraction eases. Investors are turning more constructive about the outlook for economic activity in Europe and China, and this is corroborated by multiple business climate measures suggesting that Germany's underperformance is ending.

**The ZEW survey of financial market participants confirmed that respondents are turning more optimistic about Europe and China,** while turning more pessimistic about the United States. For Germany, expectations improved for the tenth successive month to a 27-month high of 47.1 in May 2024, while current conditions rose for the third month in a row to a nine-month high of -72.3.

**The German Ifo survey showed that the business climate measure remained unchanged at 89.3 in May.** While expectations rose for the fourth successive month, up 0.7point (pt) to a 13-month high of 90.4, current conditions fell slightly for the first time in three months, down 0.6pt to 88.3. This modest fall in this backward-looking measure suggests that the economy might be struggling to regain much traction despite a 0.2% QQ gain in 1Q-24 GDP.

**However, there were broad-based gains across sectors** with the business climate rising in trade (+5.1pt to -16.9), in construction (+2.9pt to -26.0) and in manufacturing (+2.4pt to -6.2), while posting a small drop in services (-1.4pt to +1.8) after three months of gains. Yet, business expectations also rose in all four sectors, including services. Importantly, in the manufacturing sector, the level of expectations exceeds that of current conditions for the second month running, pointing to a likely rebound in industrial production as global demand recovers.

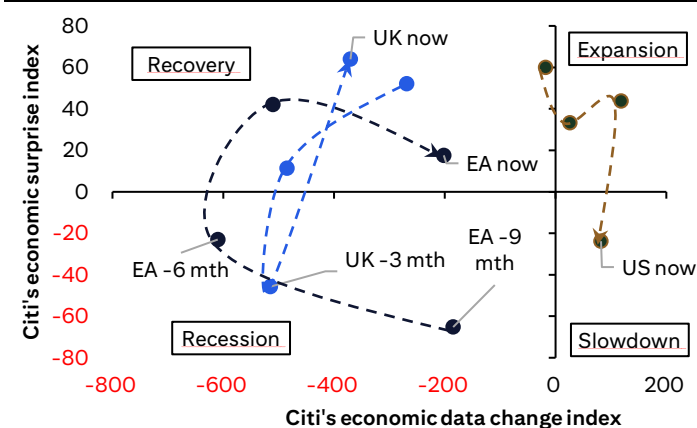
**S&P Global's Purchasing Manager Index survey** reported that Germany had seen a noticeable recovery in both services and manufacturing PMIs, up 0.7pt to 53.9 and 2.9pt to 45.4 in May, respectively, pushing the composite PMI reading to an 11-month high of 52.2 from 50.6 in April, after nine months in contractionary territory. In France, the composite PMI fell by 1.4pt to 49.1 in May, slipping back into contraction territory. The rest of eurozone continued to outperform, seeing the strongest expansion in May, when output increased at its fastest pace since April 2023.

**Citi's economic data momentum and surprise indices are pointing in the same direction.** Both the UK and the euro area are now firmly in the recovery quadrant, while the US is experiencing a meaningful slowdown (**FIGURE 3**).

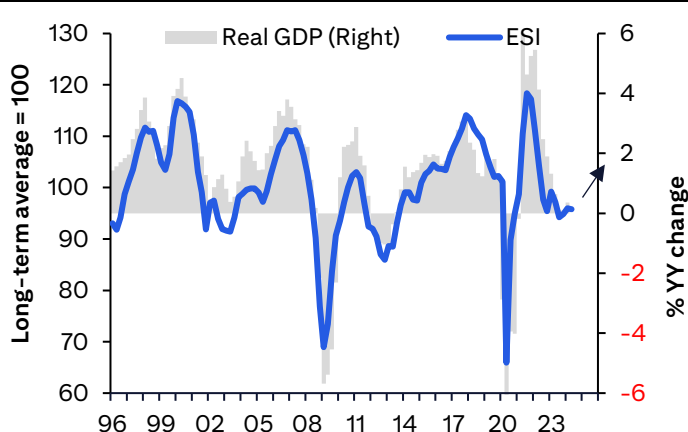
**The Economic Sentiment Indicator (ESI) for the EA rose by 0.4pt to 96.0 in May 2024** according to the European Commission, almost unwinding the 0.6pt fall recorded in April. As a proxy for real GDP, the average print of 95.8 for April and May is virtually unchanged from the 95.9 average in 1Q-24, pointing to a further modest rebound in economic activity of around 0.2%-0.3% QQ in Q-24, ahead of a possible modest acceleration in the second half (**FIGURE 4**).

**The euro area economy expanded in the first quarter of 2024.** Eurostat announced in the middle of May that GDP in the euro area had expanded by 0.3% quarter-on-quarter and 0.4% year-on-year in the first three months of the year. This followed from a 0.1% quarterly gain in the fourth quarter of 2023. In our [May Quadrant](#), we upgraded euro area real GDP growth in 2024 from 0.3% to 0.7% and maintained the 2025 1.4% GDP forecast. These averages mask a steady improvement in the quarterly trajectory of GDP from 0.0% YY in 4Q-23 to 1.1% YY in 4Q-24 and 1.6% YY in 4Q-25.

**FIGURE 3: Momentum favours UK, EU vs. the US**



**FIGURE 4: Faster growth is around the corner**



Sources: Bloomberg, Haver Analytics and Citi Global Wealth Investments, as of March 12, 2024. **Past performance is no guarantee of future returns. Real results may vary.** Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment.

**Inflation is moderating across the globe**, and the trend has been sustained in the last two years in European economies compared to the peak in double-digit territory in late 2022 (**FIGURE 5**). The good news is that composite measures of selling price expectations have been stable close to their long-term average, at 0.3 standard deviations (lowest since March 2021) in April and May. Demand forecasts remain muted, around 0.7SD below their long-term average, suggesting that price pressures should remain contained unless there were to be negative supply shocks.

**Household inflation expectations showed further improvement** in April, according to the ECB survey. Prices are expected to increase by 2.9% in the next 12 months, their lowest level since September 2021, after 3.0% in March (**FIGURE 2**). For the next three years, consumers expect prices to rise by 2.4% in April compared to 2.5% in March, well below the perceived past inflation rate of 5.0%, and in line with the Eurostat print of 2.4% in April.

**The flash euro area inflation estimate rose to 2.6% YY in May from 2.4% YY in April**, presenting a slight upside risk to the ECB's forecast that inflation will average 2.4% YY in 2Q-24 and will ease to 2.2% YY in both 3Q and 4Q-24. Core inflation, rebounded from a 26-month low of 2.7% YY in April to 2.9% YY in May.

**On a three-month average basis, annualised inflation rates look sufficiently well behaved** (2.0% headline CPI and 2.6% core CPI) for the ECB to consider cutting interest rates after 8 months at a peak of 4% in the deposit facility rate. The main issue for the ECB is the extent to which the rebound in negotiated wages growth to 4.7% YY in 1Q-24 is likely to prove transitory. All evidence points to some moderation in compensation in coming quarters.

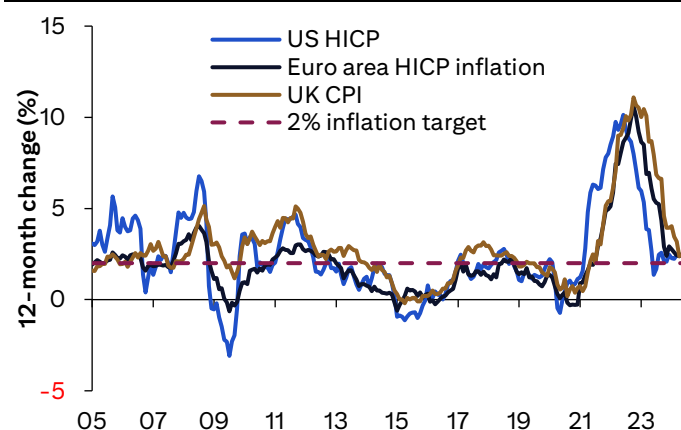
**We agree that rates need to come down meaningfully soon**, having a lot of sympathy for the views expressed by ECB Governing Council member Fabio Panetta who argued on Friday 31 May that "monetary policy would remain restrictive even after several rates cuts". We believe that the bar to a series of interest rate cuts is relatively low in coming quarters given the long lags between monetary policy decisions and their translation to the real economy.

**More central banks look set to join the rate cutting party.** In March, the Swiss National Bank (SNB) cut its policy rate by 25 basis points (bp) to 1.5%. This was a surprise to investors as the consensus had expected the SNB to be more patient and to lower rates at its next meeting on 20 June. The main story besides being the first of the G10 central banks to cut rates was the large downward revision to its inflation forecasts, in part due the Swiss franc's strength.

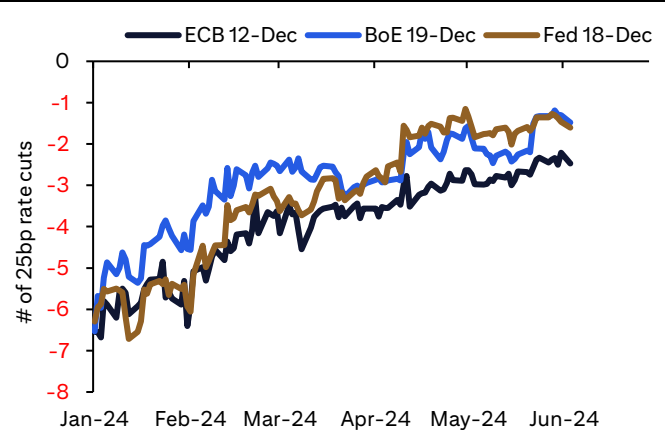
**In May, the Swedish Riksbank became the second G10 (as well as European) central bank to cut rates**, also lowering its policy rate by 25bp to 3.75%. The Riksbank justified this easing step by arguing that "inflation is approaching the target while economic activity is weak." In terms of interest rate guidance, it explains that "if the outlook for inflation still holds, the policy rate is expected to be cut two more times during the second half of the year."

**Depending on the trajectory from updated Eurosystem staff macroeconomic projections** to be unveiled at the 6 June meeting, including wages, ECB communication could be relatively cautious, most likely resulting in some reluctance to guide markets towards the speed of potential cuts in the second half of 2024. We continue to see up to three ECB rate cuts by year-end, worth 25bp each at the monetary policy meetings coinciding with forecast updates (6 June, 12 September and 12 December), implying up to 75bp of rate cuts in 2024, versus market pricing of 62bp (**FIGURE 6**).

**FIGURE 5: Inflation is normalising markedly**



**FIGURE 6: Yet fewer rate cuts are being priced in**



Sources: Bloomberg, Citi Global Wealth Investments, as of June 3, 2024. All forecasts are expressions of opinion and are subject to change without notice and are not intended to be a guarantee of future events. **Past performance is no guarantee of future returns. Real results may vary.** They are shown for illustrative purposes only and do not represent the performance of any specific investment.

# European Equity Strategy

European equities have continued to perform positively in May (**FIGURE 7**). The S&P 500 has outperformed in May, pushing ahead of Europe's main indices. It is not the best monthly performer however, with the Swiss market posting a remarkable 6.6% gain (**FIGURE 7**). Among European sectors, financials continue to be the best performer year-to-date (**FIGURE 8**), while energy performance is finally slowing down after being the best performer in April.

**FIGURE 7:** Dollar strength has sapped European equity strength YTD, though trend is reversing

	1M	3M	YTD	1M	3M	YTD
Equity Indices	Local (%)			USD (%)		
<b>Stoxx 50</b>	1.3	2.2	10.2	2.9	2.6	8.1
<b>FTSE 100</b>	1.6	8.5	7.0	3.4	9.4	6.7
<b>DAX</b>	3.2	4.6	10.4	4.8	5.1	8.3
<b>CAC 40</b>	0.1	0.8	6.0	1.7	1.3	3.9
<b>Swiss</b>	6.6	4.9	7.7	8.3	2.7	0.1
<b>S&amp;P 500</b>	5.0	3.9	11.3	5.0	3.9	11.3
<b>MSCI ACWI</b>	4.1	3.8	8.9	4.1	3.8	8.9

**FIGURE 8:** Financials have continued to perform strongly, while energy has lagged

Europe Sectors	1M	3M	YTD
<b>Financials</b>	5.9	12.7	16.4
<i>Banks</i>	5.5	21.3	24.9
<i>Insurance</i>	5.8	6.2	12.6
<i>Diversified Financials</i>	7.0	5.0	5.9
<b>Information Technology</b>	3.3	-1.3	14.9
<b>Industrials</b>	5.1	6.2	13.5
<b>Health Care</b>	2.8	7.8	12.2
<b>Energy</b>	-1.7	12.0	8.7
<b>Consumer Discretionary</b>	0.4	-2.5	7.2
<b>Materials</b>	2.1	9.9	6.6
<b>Communication Services</b>	5.1	6.1	6.0
<b>Real Estate</b>	5.0	13.5	3.6
<b>Consumer Staples</b>	2.2	3.3	1.1
<b>Utilities</b>	4.0	9.4	-1.0

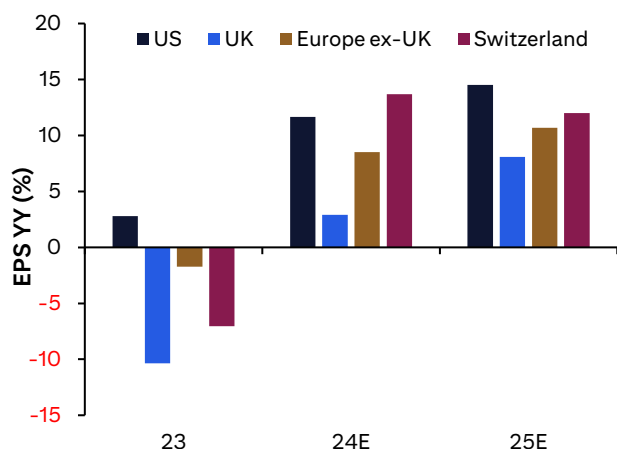
Source: MSCI, Bloomberg, as of May 31, 2024. Past performance is no guarantee of future returns. Real results may vary. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment.

## The revival in Swiss and Europe ex-UK equities earnings-per-share

Looking ahead, we believe current consensus earnings per-share (EPS) estimates are too optimistic, for both Europe ex-UK and Swiss equities. The consensus forecasts a significant rebound in Swiss and Europe ex-UK EPS for 2024 of about 13.7% YY and 8.5% YY, respectively, and 12.0% YY and 10.7% YY in 2025, after declines of 7.0% YY and 1.7% YY in 2023, respectively (**FIGURE 9**).

In our view, Swiss EPS will be in high single digit territory for 2024. Key positive fundamentals are driving the EPS re-rating; 1) improving global GDP growth, 2) a higher healthcare index allocation (**FIGURE 10**) providing a good defensive hedge, and 3) still elevated profit margins.

**FIGURE 9: Swiss consensus EPS bounces back for 2024**



**FIGURE 10: Swiss equity sector composition**

Sector Composition	MSCI Swiss (%)
Health Care	33.6
Consumer Staples	19.9
Financials	17.8
Industrials	10.6
Materials	9.5
Consumer Discretionary	5.8
Communication	1.0
Information Technology	1.1
Real Estate	0.5
Utilities	0.2
Energy	0.0

Sources: Citi Research, Worldscope, MSCI, FactSet, Citi Global Wealth Investment and Bloomberg, as of June 4 June 2024. Past performance is no guarantee of future returns. Real results may vary. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment.

## A poor 2023, followed by a much better start to 2024

Swiss equities de-rated significantly in 2023. Last year’s underperformance was mainly driven by two possible reasons: 1) the Swiss equity index composition, where the largest holdings account for around 56% of the MSCI Switzerland index. This group has generally lagged in terms of both performance and earnings-per-share versus their peers. 2) The defensive composition of the MSCI Swiss index, with higher allocations to consumer staples (~21% of the index) and health care (34%) (**FIGURE 10**). Therefore, given the cyclical rebound in late 2023, defensively positioned indices underperformed relative to growth indices.

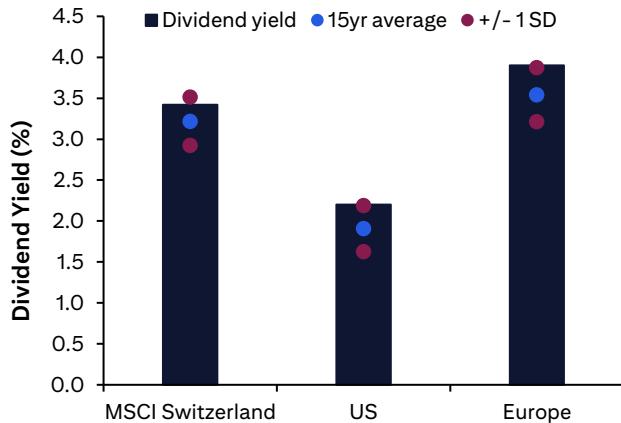
However, year-to-date Swiss performance has been impressive, and we believe that there is an opportunity for investors.

**FIGURE 11: Upgrade to 2024 growth forecasts**

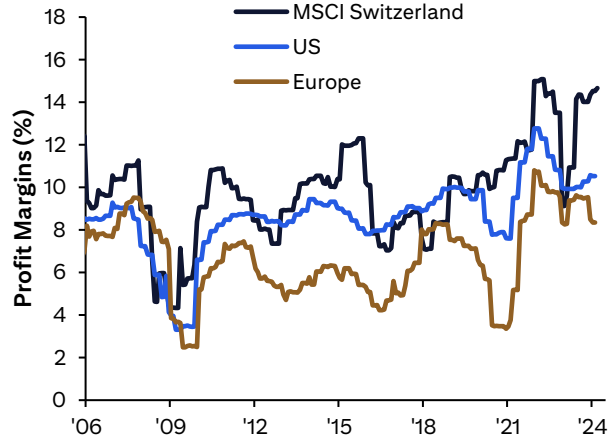
Regions	2020	2021	2022	2023E	2024E	2025E
US	-2.8	5.8	1.9	2.5	2.4	2.3
China	2.2	8.5	3.0	5.2	5.2	4.8
EU	-6.3	5.6	3.4	0.5	0.7	1.4
UK	-11.0	7.6	4.3	0.1	0.7	1.3
Global	-3.2	5.9	3.3	2.6	2.6	2.9

Sources: Citi Global Wealth as of November 12, 2023. RHS Source: Bloomberg & FactSet as of October 30, 2023. All forecasts are expressions of opinion and are subject to change without notice and are not intended to be a guarantee of future events. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Past performance is no guarantee of future results. Real results may vary.

**FIGURE 12:** Swiss dividend yield one of the highest amongst developed market peers



**FIGURE 13:** Swiss profit margins the highest amongst developed market peers



Sources: MSCI, Citi Global Wealth Investment and Bloomberg, as of 4 June 2024. **Past performance is no guarantee of future returns. Real results may vary.** They are shown for illustrative purposes only and do not represent the performance of any specific investment.

Year-to-date (YTD), another story emerged, fuelled by increased geopolitical tensions and the likelihood of global central banks easing monetary policy which played into the Swiss equities defensive nature. This provided some cushion and a slight revival of Swiss equities.

We believe recovery is likely to continue second half of 2024 given 1) the busy global election calendar and 2) rising trade tensions between the US & Europe on one side and China on the other. This would allow investors to hedge against these ongoing risks, whilst earning both income and capital appreciation. For example, Swiss dividend yield is one of the highest amongst developed market peers, yielding 3.3% comparably higher than US dividend yield at 1.5% (FIGURE 12).

Let us look into Swiss equities in more detail and why we see positive momentum building;

- 1. Recent revision to Mid-year outlook 2024 global growth** – Citi Global Wealth Investments upgraded the 2024 US and global GDP estimates from 1.6% to 2.4% and 2.2% to 2.6%, respectively, with 2025 global GDP revised up by 0.2 percentage points to 2.9% (FIGURE 11) ( [Global Strategy Quadrant | World Economy Recuperating, US Labor Market Slowing: Forecast Update](#) ). An improving picture of global demand should benefit the Swiss index for which 60% of revenues are generated globally.
- 2. Defense to the rescue** – As highlighted above, geopolitical tensions are likely to persist over the course of this year, Swiss equities allocation to healthcare should provide a good hedge to volatility. The Swiss index offers both quality, growth, and a defensive mix, which is likely to thrive.
- 3. Margins likely to soften; relative to developed market peers remain much higher** – Historically elevated Swiss profit margins offer great comfort to investors compared to its developed market peers. As FIGURE 13 shows, aside from the period between Sep-16 to Apr-19, historically Swiss margins have been significantly higher than the US. Therefore, we now see strong potential returns to be earned of the next 12-18months in Swiss equities. In addition, acknowledging the risk from the 4Q-23 earnings season, where major Swiss firms recognised some troubles ahead in terms of revenue generation and profit margins, we believe even with these slight pressures, Swiss margins will remain higher than US peers, benefitting investors.

## Euro area fundamentals offer pockets of opportunities

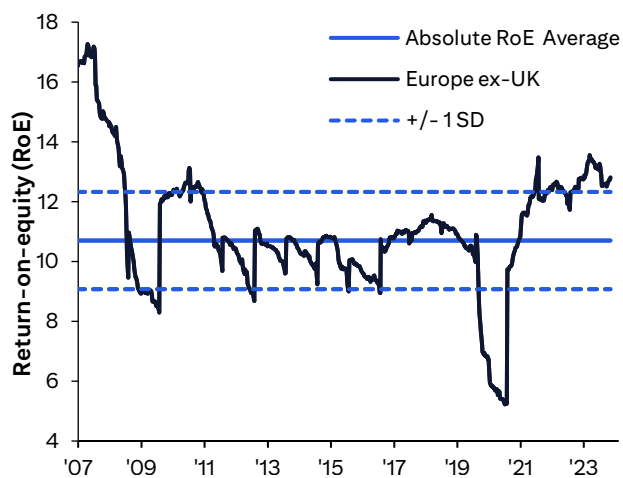
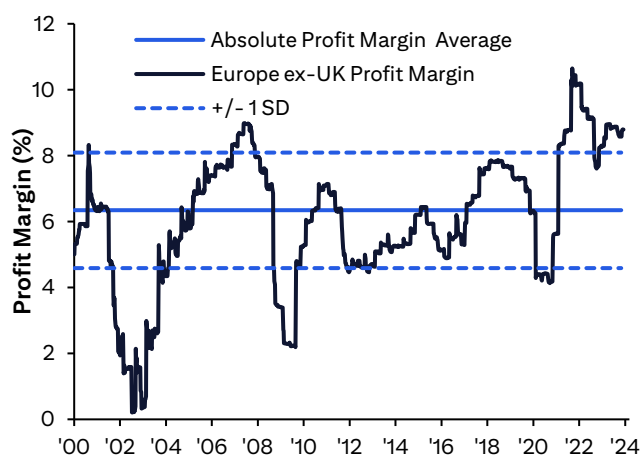
Since the start of 2024, European ex-UK '24 and '25 EPS has been upgraded repeatedly. The very likely loosening in monetary policy settings against a backdrop of moderating inflation, together with some improvement in household and corporate credit conditions, ought to support further gains in European ex-UK equities. Therefore, we remain in-line with the 8.5% YY consensus EPS forecast.

In addition, after peaking in April 2022, European ex-UK equities profit margins have proved resilient, remaining more than 1 SD above their 15-year average (**FIGURE 14**), largely helped by some moderation in input inflation costs and slower wage growth, despite elevated debt servicing costs. Over the next 12-18 months, we would expect some further softening in the euro area labour market and improving supply dynamics to contain input costs, eventually feeding into lower operating costs, and therefore keeping profit margins above their 15yr average.

It is essential for investors that European firms at least maintain or preferably increase shareholder value. **FIGURE 15** shows that this has been a clear case over the past two years, with the return-on-equity (RoE) to shareholders standing 1 SD above its 15-year average at around 11x (it looks lower than 11x on the chart). This has been mainly attributed to firms' renewed focus on share buy backs and increasing dividend yields in some sectors. Given the continued high level of cash on corporate balance sheets, we would expect European firms to continue with this strategy.

**FIGURE 14:** European ex-UK earnings is strong for 2024 & 2025

**FIGURE 15:** Elevated RoE supported by moderating euro area inflation

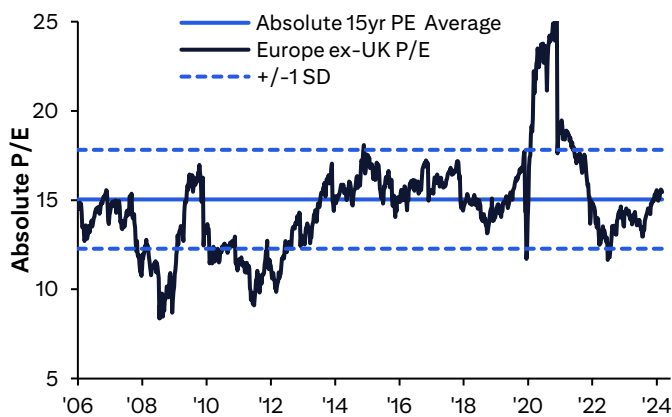


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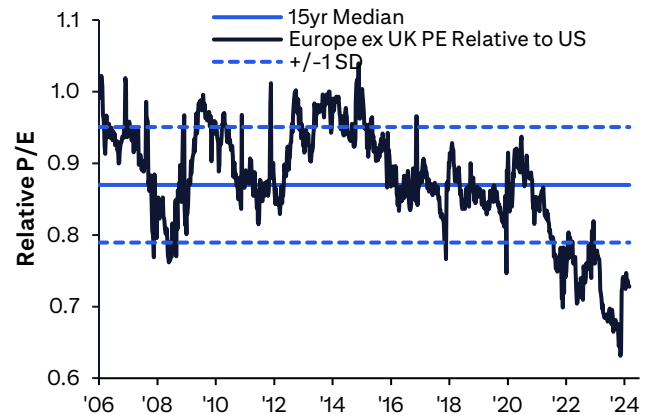
## Attractive European equity valuations

European ex-UK absolute price-to-earnings (P/E) ratio has risen since November 2022, and are in line with their 15yr average of 15x (**FIGURE 16**). It is only now that European ex-UK relative valuations have started to show some positive momentum, rebounding from their lows in February 2024 (**FIGURE 17**). We would argue that this positive trend should continue, with the relative valuation gap converging nearer to fair value, supported by a better global growth outlook, moderating euro area inflationary pressures and a less hawkish ECB.

**FIGURE 16: Absolute P/E valuation is expensive**



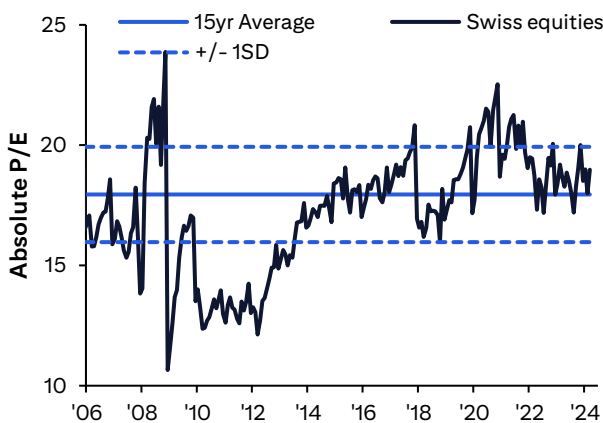
**FIGURE 17: Relative P/E valuations are cheap**



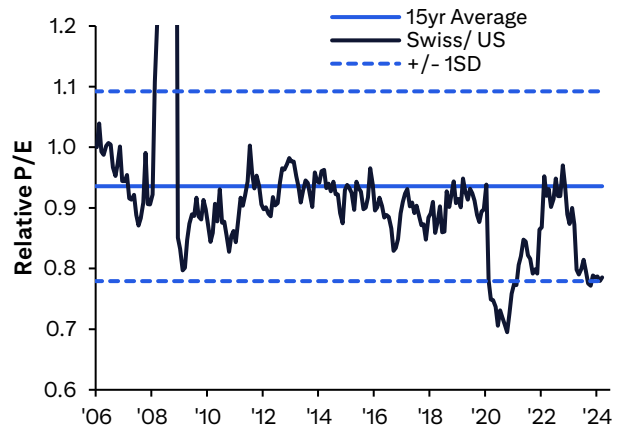
Sources: MSCI, Citi Global Wealth Investment and Bloomberg, as of 4 June 2024. Past performance is no guarantee of future returns. Real results may vary. Indices are unmanaged. They are shown for illustrative purposes only and do not represent the performance of any specific investment.

Swiss equities are one of the European equity markets which has maintained its valuations, in terms of earnings and price relative to US equities. Since Dec 2023, on an absolute basis, Swiss P/E ratio derated towards fair value but has become slightly more expensive since April, trading at 18.5x, above its 15-year long-term average of 17.5x (FIGURE 18). However, on a relative, basis, Swiss equity P/E now trades very cheaply against US equities (FIGURE 19). This is only the third time in history that the Swiss equities P/E fell to one standard deviation below its 15-year average. This could mark a potential entry point for investors willing to take exposure in the Swiss equity market.

**FIGURE 18: Absolute P/E valuation is expensive**



**FIGURE 19: Relative P/E valuations are cheap**



Sources: MSCI, Citi Global Wealth Investment and Bloomberg, as of 4 June 2024. Past performance is no guarantee of future returns. Real results may vary. Indices are unmanaged. They are shown for illustrative purposes only and do not represent the performance of any specific investment.

## Conclusion

At our latest Global Investment Committee (GIC) meeting (22 May 2024), we upgraded both Europe ex-UK and Swiss equities, from a neutral to an overweight position in our risk 3 model portfolio. Over the next 12-18 months, we are positive on these equity regions as both exhibit strong fundamentals for the rest of 2025 and next year. In addition, relative valuations against US equities remain cheap, providing investors the opportunity to add these regions into their portfolios.

# Emerging Middle Eastern and African Markets

Looking at the MSCI Emerging Markets EMEA index, 2024 performance has been negative almost across the board, with Gulf Cooperation Council (GCC) countries performing particularly poorly (**FIGURE 20**). Geopolitical issues and a decline in crude oil prices have weighed heavily on GCC equity markets. Moreover, with GCC currencies being pegged to the US dollar, the higher-for-longer interest rate narrative also contributed to driving down equity prices.

Among the top five constituent countries in the index, Poland is the only positive performer, having returned 6.6% year-to-date, only softening slightly to 6.4% when accounting for its currency weakening against the dollar.

**FIGURE 20:** GCC equity performance has been negative in 2024

MSCI Indices	1M	3M	YTD	1M	3M	YTD
	Local (%)			USD (%)		
Saudi Arabia	-4.5	-9.1	-4.2	-4.5	-9.1	-4.2
South Africa	1.2	5.6	-1.2	1.0	8.8	-2.5
UAE	-4	-10.1	-11.2	-4.1	-10.1	-11.2
Poland	0.8	2.3	6.6	2.9	3.4	6.4
Qatar	-2.5	-11.2	-13.4	-2.5	-11.2	-13.4
EM EMEA	-1.4	-2.4	-0.2	-1.1	-2.0	-1.3

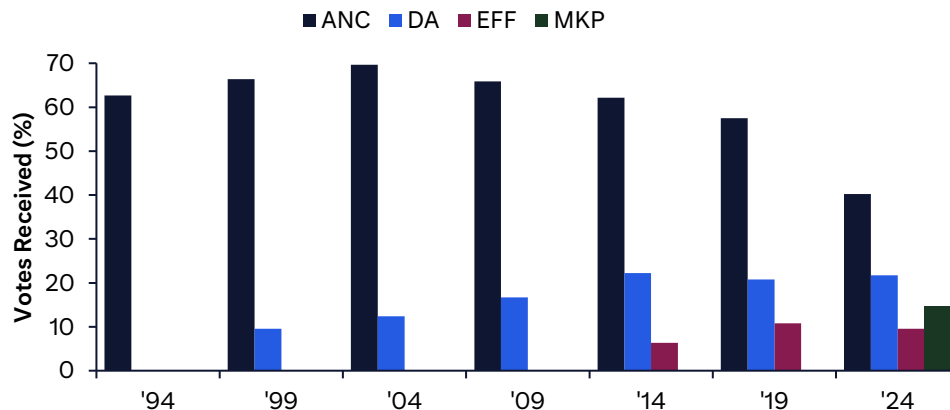
Source: FactSet, as of 4 June, 2024. Past performance is no guarantee of future returns. Real results may vary. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment.

The MSCI South Africa index continued its recovery in May after posting losses earlier in the year, though it has given back most of its gains due to the historic results from last week's elections. It is possible that South African equities will see enhanced volatility until the political situation is stabilized, particularly given market participants' polarised view of the outcome – see below.

## South Africa: A Monumental Defeat for the ANC Raises Questions for the Future of South Africa

Results from South Africa's elections on May 29 show that for the first time in the country's 30-year electoral history, the African National Congress (ANC) has failed to secure a parliamentary majority (**FIGURE 21**). The party of Nelson Mandela must now look to form a coalition with their political rivals to continue governing, with ANC Secretary-General Fikile Mbalula stating "there is no party we are not going to talk to." Markets are monitoring developments closely to determine the makeup of any potential coalition, especially as choices range from the pro-business Democratic Alliance (DA) to the populist Economic Freedom Fighters (EFF) and uMkhonto weSizwe (MKP) parties.

**FIGURE 21:** The ANC has lost its majority, with much of its voter base going to the MKP



Source: South Africa Electoral Commission, as of 4 June, 2024.

**Choice 1: ally with the DA.** The official opposition party since 1999, the moderate DA has long had an adversarial relationship with the ANC, clashing over a wide range of issues. In terms of economic policy however, the parties are not far off. Markets view a coalition with the DA as the business-friendly option, likely to lead to a continuation of the economic reforms embarked upon by President Cyril Ramaphosa. There does, however, remain a significant obstacle: foreign policy. The ANC has led South Africa on a distinct course on the global stage. The DA, on the other hand, is more western in its views and. These divides are not seen as insurmountable however, with Bloomberg reporting that President Ramaphosa's closest allies have urged him to form his government with the DA.

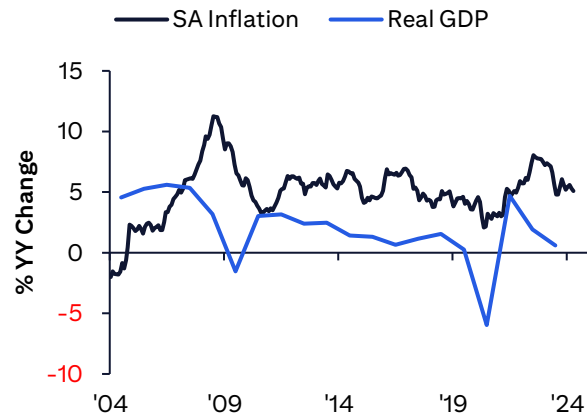
**Choice 2: partner with the EFF or MKP (or both).** The alternative to a coalition with the DA, a sharp turn to the left would lead the country to dangerous waters for investors, many of whom would stand to lose from the populist reforms espoused by the red beret-wearing EFF and MKP. Adding salt to the wound, the MKP is a party that was formed only five months ago by Jacob Zuma, the former president who led South Africa for nearly nine years before being replaced by Ramaphosa. Jacob Zuma has been very vocal in criticizing his successor, stating that any negotiations with the ANC must include President Ramaphosa stepping down from power. EFF leader Julius Malema, widely seen as a controversial figure and convicted of hate speech, also has a rocky relationship with the ANC leader, having been suspended from the ANC in 2011 for causing division within the party. As such, any move from the ANC to ally with either party may include the removal of the current South African leader from power.

**Populism in the face of inequality.** Regardless of which path the ANC chooses, election results have certainly served as a serious wake-up call to the ANC, whose failure to fix the economic issues plaguing the country have alienated many voters. Foremost among these is unemployment, which has risen starkly in the past decade, amplified by the jobs lost due to the pandemic (**FIGURE 22**). Adding to the issue, inflation, while down from 2022 levels, remains above 5%. In contrast, real GDP for 2023 grew at just 0.6% (**FIGURE 23**). Perhaps it is no surprise that the messaging of the EFF and MKP parties, both of whom advocate for the nationalisation of key industries (mines, banks) and the expropriation of land without compensation, has resonated with voters, even if such extreme measures may alienate investors. As a reminder, precious metals (particularly gold) remain South Africa's largest export. The country's mines serve an important source of revenue for some of its largest companies.

**FIGURE 22:** Unemployment has remained at elevated levels since the pandemic



**FIGURE 23:** Inflation remains high, while real GDP falls below 1%



Sources: South Africa Department of Statistics, Haver Analytics, and Citi Global Wealth Investments, as of 31 May 2024. All forecasts are expressions of opinion and are subject to change without notice and are not intended to be a guarantee of future events.

Looking at the markets' reaction to latest developments, the rand (-2%) and the JSE all share index (-1.1%) have dropped since elections began on Wednesday. Sovereign yields have increased marginally across the curve, with the 10-year yield initially increasing 18bp to 12.22% before declining to 12.09%. Selloffs have been restrained by reassurances from the ANC, which has stated its intent to seek stability and continuation of economic policy, which investors have taken as a signal that a coalition will likely be formed with the DA. Under South African law, a government must be formed within 14 days of the announcement of election results, marking June 16th as the deadline for negotiations.

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Bond credit quality ratings	Rating agencies		
	Moody's <sup>1</sup>	Standard and Poor's <sup>2</sup>	Fitch Rating <sup>2</sup>
<b>Credit risk</b>			
<b>Investment Grade</b>			
Highest quality	Aaa	AAA	AAA
High quality (very strong)	Aa	AA	AA
Upper medium grade (Strong)	A	A	A
Medium grade	Baa	BBB	BBB
<b>Not Investment Grade</b>			
Lower medium grade (somewhat speculative)	Ba	BB	BB
Low grade (speculative)	B	B	B
Poor quality (may default)	Caa	CCC	CCC
Most speculative	Ca	CC	CC
No interest being paid or bankruptcy petition filed	C	D	C
In default	C	D	D

1 The ratings from Aa to Ca by Moody's may be modified by the addition of a 1, 2, or 3, to show relative standing within the category.

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- volatility of returns;
- restrictions on transferring interests in the Fund;
- potential lack of diversification and resulting higher risk due to concentration of trading authority when a single advisor is utilized;
- absence of information regarding valuations and pricing;
- complex tax structures and delays in tax reporting;
- less regulation and higher fees than mutual funds; and
- manager risk.

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