OLDMUTUAL

# OLD MUTUAL MULTI-MANAGERS
# MARKET MATTERS

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## COVID, CARS, COSTS AND CRISES


IZAK ODENDAAL

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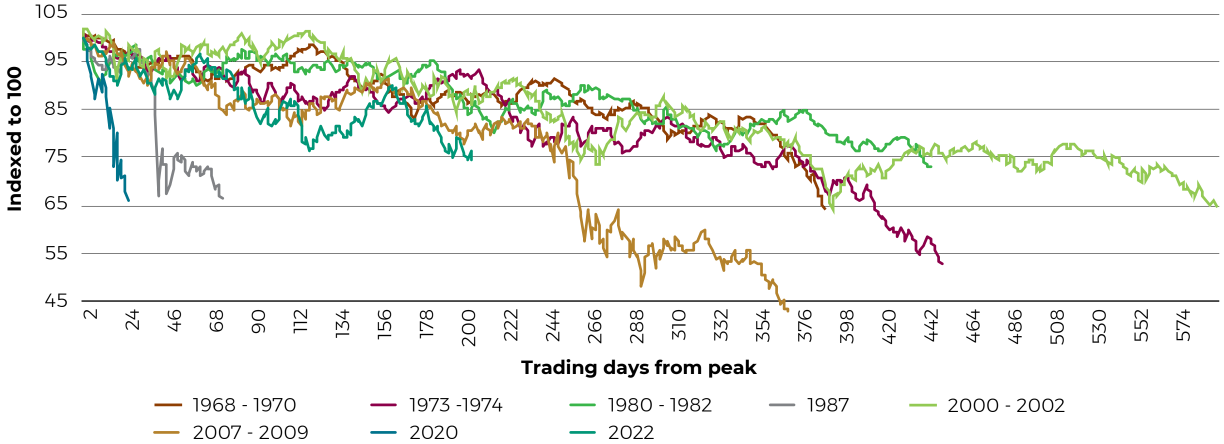
**Perhaps we don't want to remember, but amid today's heightened uncertainty, it is easy to forget that five years ago, March 2020, global markets collapsed in a heap. As country after country started locking down economies to slow the spread of Covid-19, investors sold out in a panic. The dash for cash was so intense that even the largest and most liquid market, the market for US Treasuries, temporarily seized up. Nobody knew what was happening next.**

The intervention from monetary and fiscal policymakers was unprecedented, however, in keeping with the once-a-century (we hope) nature of the crisis. It meant that, even though the coronavirus would rage unchecked for months until vaccines and a measure of natural herd immunity started dampening its impact – and even then there were more waves and new variants – markets never retested the March 2020 low. It was the sharpest but shortest bear market ever.

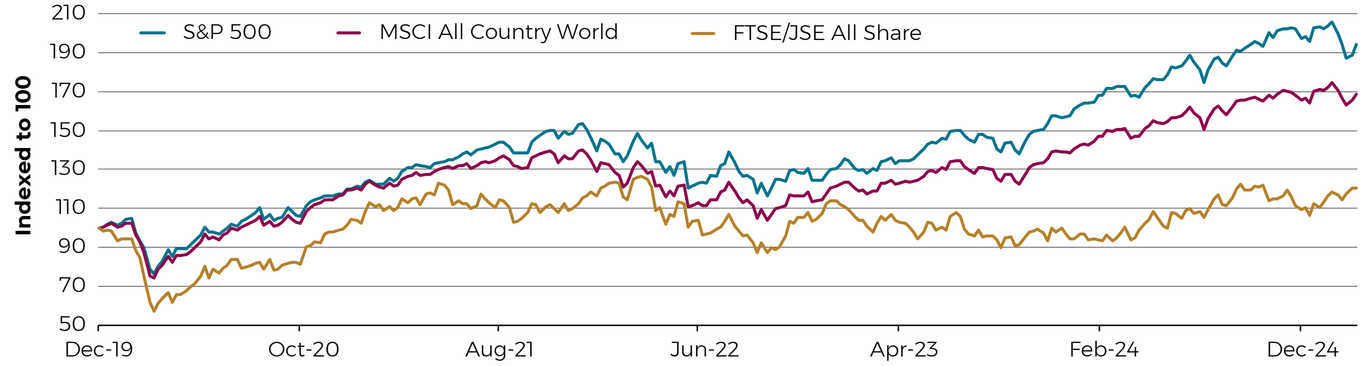
**CHART 1: S&P 500 BEAR MARKETS, PEAK TO TROUGH DECLINES**




Source: LSEG Datastream

It also turned out to be a great buying opportunity, though it would have felt brave to do so at the time. Covid was still in the early stages of the devastation it would cause to lives and livelihoods. However, bear markets always bottom out well before the economy does.

**CHART 2: EQUITIES SINCE 2020 IN US$**




Source: LSEG Datastream

## ADAPTABLE

Another lesson is how adaptable people are. Big decisions were made under conditions of extreme uncertainty, though not all of them turned out to be correct. Workers quickly got used to dialling in remotely, many companies changed their business models, new forms of entertainment sprung up. Life goes on, despite the circumstances, since people must eat, sleep and keep themselves busy every single day regardless.

Not all these lessons were easy. Fragilities in supply chains were exposed, as was the reality that low-wage frontline workers in healthcare, delivery and retail were vulnerable to infection every day, while highly-paid skilled workers could work from the safety of their homes.

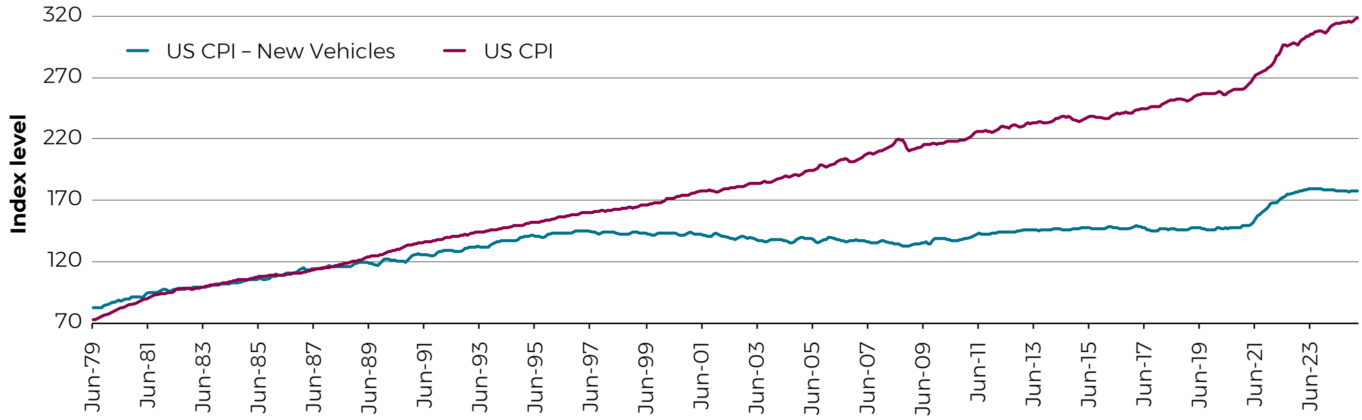
Perhaps the biggest fragility is how politicised everything was. Healthcare choices around mask-wearing and vaccination became political statements. Amateurs believed they knew more than trained scientists. Covid became yet another battle line in the never ending culture wars that ravage the US in particular, leaving it more divided than probably at any point since the Civil War of the 1860s.

## AFTERSHOCKS AND MORE SHOCKS

If Covid was the earthquake, the aftershocks were inflation, war, more political division, and a surge in global interest rates. The global cost of living crisis saw record election losses for incumbent parties in the past year or so, and ultimately sank the Democrats' hopes of retaining the White House.

One of the sectors that experienced a massive price jump in the wake of the pandemic was the car industry. Supply chain problems, particularly the shortage of microchips, saw a massive jump in the prices of new cars, and as a result, used cars too. With a lag, car insurance rates also increased sharply. Owning a car has become expensive, particularly in the US, and will become even more so. This is in contrast to the experience of the past 30 years. Starting in the early 1990s, US car prices diverged from the overall consumer price index and basically stopped rising. Technological improvements also play a role here, since every dollar spent on a car gets more bang for buck.

**CHART 3: US NEW CAR PRICES**

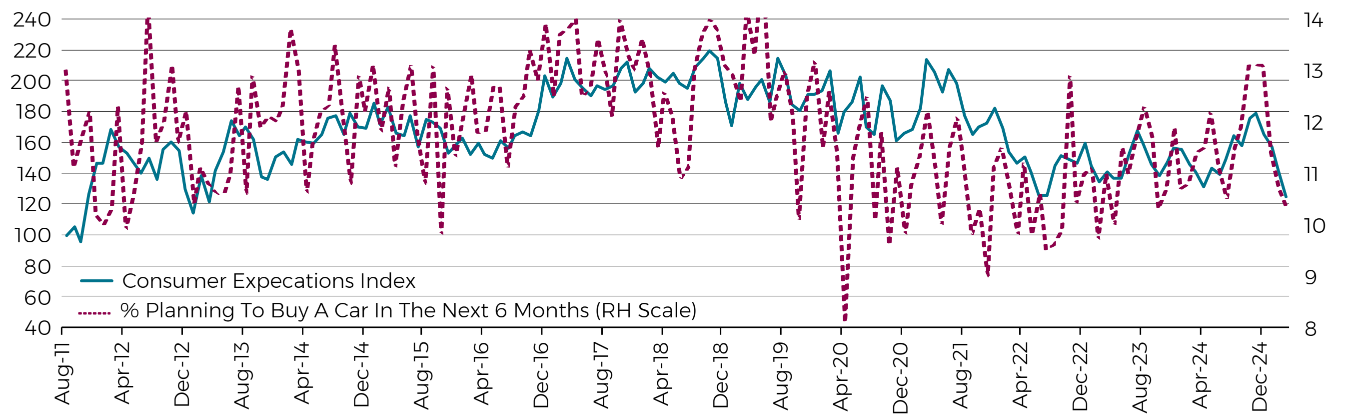



Source: US Bureau of Labor Statistics

Which brings us back to the present, and yet another shock. US President Trump has confirmed that 25% tariffs will be levied on any vehicle or vehicle components imported into the US. This is part of his April 2 "Liberation Day" tariff announcements. Contrary to expectations that Trump would be using tariff threats as a negotiation tactic, he is seemingly steaming ahead with little regard for any counteroffers.

About half the cars sold in the US are built elsewhere, and of those made in the US, about half the components are imported. Car prices are going to rise, the question is just by how much. Apart from the luxury brands, automakers and dealers typically don't have very high margins, and therefore they will want to pass on a substantial portion of tariffs to customers. On the other hand, it is not as if it is a seller's market. The number of US vehicle loans that are "seriously" delinquent is at the highest level since 2010. Consumer confidence has taken a dive, and a shrinking number of respondents to these surveys say they are planning to buy a car.

**CHART 4: US CONSUMER CONFIDENCE**




Source: The Conference Board

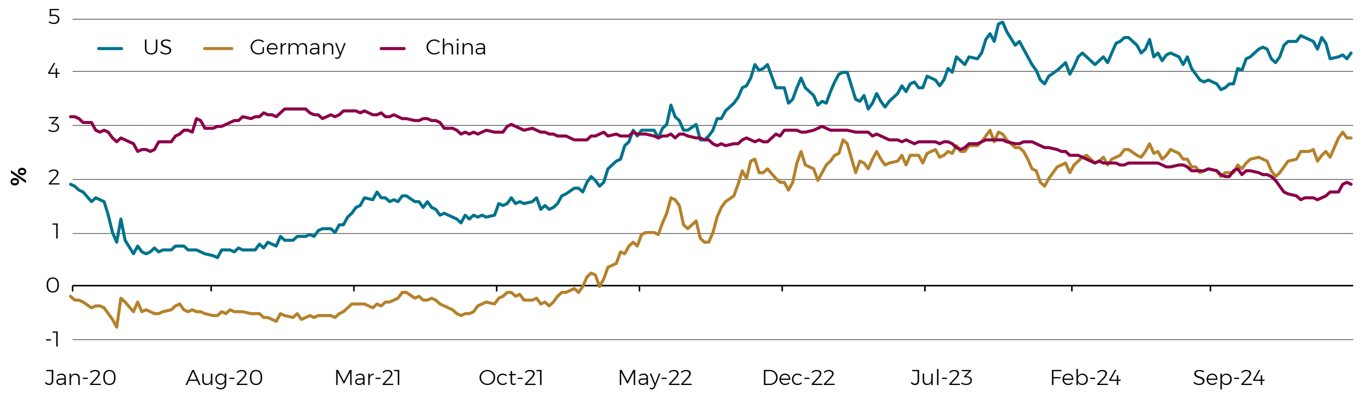
Between the producers, distributors, dealers and end consumer, someone will have to absorb these cost increases, though it is too soon to say who exactly. This is bound to be a headwind to economic growth in the US and in the countries that export cars and components to it, particularly Mexico, Canada, Germany, Korea and Japan. As for South Africa, it exports about R30 billion a year in vehicles and parts to the US, according to industry body Naamsa. Naamsa says it is unclear if Trump's tariff announcements override AGOA, which is an act of Congress, and gives duty-free access to South African auto exports, though probably not for long.

Every crisis creates an opportunity, however. While the share prices of car producers like Ford and General Motors – the companies these tariffs are meant to protect – predictably fell last week, the shares of US car rental firms jumped higher. Their large fleets of cars suddenly became more valuable. Moreover, the tariff disruptions come at a time when traditional car manufacturers already face existential challenges from the rise of electric vehicles (EVs). Trump's tariffs and potential retaliation could give EV manufacturers, including Tesla, an edge. EVs have fewer components and are therefore less reliant on complex global supply chains. All Tesla's cars sold in the US are made there, for instance.

## THE DOG THAT DIDN'T BARK

The one Covid aftershock we didn't experience – the dog that didn't bark – was a debt crisis, apart from a handful of developing countries that defaulted. Global government debt levels jumped as tax revenues dried up and spending on health and social security surged, but the world bond markets paid more attention to the inflation surge in 2021 and 2022 than to debt levels, contra to the "bond vigilantes" notion we often read about. Looking ahead, things might be a bit different.

**CHART 5: 10-YEAR GOVERNMENT BOND YIELDS, %**




Source: LSEG Datastream

Government debt levels are set to rise further in key economies, but for very different reasons. In the US, the nonpartisan Congressional Budget Office now projects that the US government debt-to-GDP ratio will reach 110% by the end of the decade, surpassing the World War II peak. It was already rising before Trump came to office, but massive unfunded tax cuts pose a risk to US fiscal sustainability that might not be offset by the country's formidable strengths as the world's economic superpower, issuer of its reserve currency and provider of its deepest and most liquid capital market, as ratings agency Moody's warned last week. The debt level by itself need not fundamentally erode trust in the value of the dollar, but combined with erratic policymaking, it just might.

China, the world's second largest economy and second largest sovereign bond market, is also ramping up borrowing and spending to stimulate its struggling economy. While the budget deficit will officially be 4% of GDP this year, adding together the other various stimulus measures it is closer to 10%, A budget deficit in double digits is a huge amount of money. Unlike other major economies, China can borrow at a lower interest rate than before Covid. This is helpful, but also a sign of economic weakness and deflationary pressures.

Crises force action. Germany finally got the wake-up call that it cannot rely on American security guarantees. Long averse to government debt, it will now borrow several hundreds of billions of euros to upgrade its infrastructure and defensive capabilities. This spending can offset the negative impact of tariffs on its key motor industry, but not immediately. More importantly, perhaps, is the impact on sentiment. After three years of stagnation, there is at last a feeling of forward momentum.

The same can probably be said of South Africa. The past five years have been tough, which is saying something given the country's difficult history. The economy was in bad shape going into 2020, and then government imposed one of the strictest lockdowns globally (no alcohol, no tobacco, and for a while, no rotisserie chickens for some reason).

Debt levels jumped substantially given the collapse in tax revenues and need for additional spending on health and welfare. There were also more bailouts for floundering state-owned enterprises, notably Eskom. But unlike in Europe, the US and China, South Africa is trying hard to stabilise government debt levels. Markets are still anxious about what the final 2025 Budget will look like since there is disagreement between the ANC and DA on key points with only days to go before the Parliamentary vote. However, there is agreement among all parties in the government of national unity (GNU) that South Africa's government interest burden is on an unsustainable trajectory. Parties disagree on the how, not the what. In two or three years, South Africa should start getting recognition that our debt ratio is moving in the opposite direction to other major countries.

Meanwhile, Eskom plunged the country into literal darkness, with 2021, 2022 and 2023 being the worst ever years of loadshedding. But this crisis was too large to ignore, and it finally forced a change in thinking in government circles. The private sector was allowed to generate its own electricity, and today loadshedding is mostly behind us while billions in rands in investments were unlocked. The same process is now underway in the rail and ports sector, and eventually, water. Accepting the need for private capital, operational know-how, and entrepreneurial spirit in key network industries that were previously monopolised by the state is perhaps the most important change in economic policy in 30 years. Importantly, it predates the formation of the GNU and can therefore outlive it.

## LOOKING BACK, AND LOOKING AHEAD

Looking back, what is remarkable about Covid is perhaps not the ways in which it changed the world, but the ways in which it didn't. On a day-to-day level, the biggest change has been that some of us now work remotely a few days a week. Much else remains unchanged, contrary to the pervasive feeling at the time that nothing would ever be the same. It is a reminder that, while the foundations of the global economic and geopolitical order are being shaken, the impact could surprise us in many ways, including that it might be surprisingly dull.

We don't know, however, and so the best course of action remains to spread our risks carefully and try to avoid knee-jerk reactions. The one thing we do know is that we remain as human as ever. One day perhaps, humans will merge with computers and be able to make purely rational decisions. But for now, we are still beholden to the same psychological makeup shaped by evolutionary forces on the African savanna hundreds of thousands of years ago. Despite our remarkable achievements as a species, we have not yet banished some of our baser instincts when it comes to craving power and status, nor our built-in tribalism. It is always worth remembering that the fight-or-flight response might have kept ancestors alive millennia ago, but it's not going to help grow or protect your wealth today.

**Please note there will be no market return data this week. We apologise for the inconvenience.**