

Straight jacket or strait sailing: our midyear update

We have been on the road for the past two weeks, delivering our midyear market update. The war in Iran is now more than three months old, the last six weeks characterised by a stalemate as both sides grow more stubborn. The outlook for markets clearly hinges on the path forward from here – we discuss and assign probabilities to various scenarios. Equally frustrating is that the nascent recovery evident in SA earlier in the year has now been delayed – thanks to soaring fuel prices and a change in the trajectory of interest rates. But we still believe that the longer-term outlook is improving, thanks to steady progress on structural reforms, especially rail. We concluded by marrying our views to portfolio construction and explaining what we mean by a shift to “quality.”

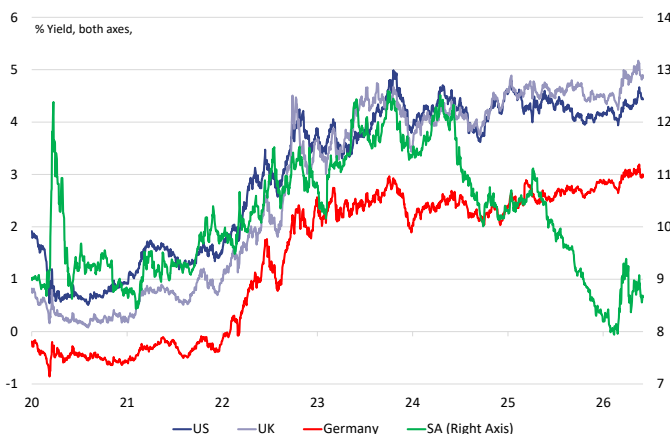


**Michael
Porter**

We are now three and a half months into the Iran War. In any scenario analysis, a prolonged Middle East conflict that closed the Strait of Hormuz would have been seen as a worst-case outcome. This vital waterway has never been closed before. Yet oil prices continue to hover around \$100 per barrel and global markets are mostly positive. It does not make sense. Oil prices would be far higher, were it not that

we entered the year with record global stockpiles of crude – both national and strategic reserves. These are now being drawn down rapidly, so the longer the war continues, the greater the upside risk to oil prices as reserves get more

GLOBAL & SA BOND YIELDS



Global bond yields are at their highest levels in twenty years, raising political and refinancing risk as existing debt matures. Yet SA finds itself in a different, and far more positive, cycle. This should shield us from the worst of consequences as the war drags on.

SPEED READ

- Three months into the war, energy prices have spiked, causing many downstream prices to also rise sharply. Yet markets remain buoyant, largely due to AI and its associated growth.
- Even if the war ends tomorrow and the Strait of Hormuz reopens, oil prices should average \$100 per barrel for the rest of the year. But they should fall sharply in 2027.
- We assign a 40% probability to an end to the war soon and a 50% probability to an ongoing “stalemate.” There is a growing consensus that oil prices will need to reach crisis levels before both sides are willing to compromise.
- The nascent economic recovery in SA has been delayed – we face higher fuel prices, higher interest rates, and rising food inflation. That is before we factor in the impact of a “Godzilla” El Nino.
- Our portfolio construction reflects an ongoing shift to Quality. We delve into this theme using examples to demonstrate our process.

depleted. Nonetheless, downstream prices have risen more than crude prices – a reflection of demand and supply for different commodities. Ultimately, consumers don’t buy crude oil – they buy petrol, diesel and jet fuel, amongst other things. Already there is a reduction in demand, and this is likely to accelerate. We further believe that this crisis will be a major turning point for alternative technologies. Consumers are re-evaluating electric vehicles and other options. We expect this trend to accelerate exponentially.

Unfortunately, the past six weeks can best be characterised as a stalemate situation. The Strait remains closed, through a combination of the US blockade and Iranian skirmishes.

Both sides appear to have become more intransigent, believing they hold the upper hand. This has spooked markets. Inflation is starting to rise. Taken together with political developments, this is now manifesting in higher bond yields. Ten-year yields across the US, Europe and the UK are now at, or near, their highest levels since the Great Financial Crisis of 2007/8. The longer the war drags on, the greater the risk that central banks raise short term rates. Interest rates have already risen in various countries, including our own, but there will be more to come if this stalemate persists. Together with higher bond yields, this will impact consumer spending and economic growth. But higher bond yields also raise refinancing risk for major developed economies. Up to 25% of US national debt matures over the next 18 months – debt that was issued when interest rates were 2%. That must now be refinanced at rates closer to 4.5%. The impact on debt ratios and the interest bill will be profound. Consequently, we expect the Dollar to revert to a weakening bias once hostilities subside.

I want to pause here for a moment and highlight an important point – the difference in cycles between global bond yields and our own. We have been on the rough end of higher bond yields for years and suffered the consequences of perilous government finances. But progressive reforms, the influence of the GNU, and improving growth have resulted in a significant decline in our bond yields. In turn, government has benefitted from lower borrowing costs, which has reinforced the turnaround. It is worth pausing and acknowledging the progress that our country has made. Without it, we would be facing far bleaker times.

Where to from here? We outline three possible scenarios for the war from here:

1. A comprehensive peace deal or ceasefire. In that scenario, we envisage oil prices being rangebound between \$70 and \$95 as oil markets rebuild stockpiles and shipping normalises. In such a scenario, we would expect markets to remain firm, central banks to keep rates steady, and for gold prices to rally. We assign a 40% probability to this outcome.
2. An extended “blockade”. Oil prices are likely to trade between \$95 and \$115 per barrel, which will force central banks to raise interest rates. It is highly unlikely that rates would fall by the end of this year. Even the SARB would probably raise our own rates further. Unsurprisingly, markets will remain volatile with a downward bias and precious metals would remain under pressure. We assign a 50% probability to this

scenario, as there is a growing belief that it will take oil prices to reach crisis point before either side is prepared to compromise.

3. A renewal of hostilities. This implies a return to war. Oil prices could reach \$150 or more as the end to fighting becomes increasingly uncertain. Such a scenario would see aggressive increases in interest rates, with all the negative consequences thereof. Equities would enter a bear market, driven by higher rates, weaker growth and a contraction in risk tolerance. Investors are likely to flock to the safety of the Dollar, thereby putting further pressure on precious metals. We assign a 10% probability to this scenario.

Let me now turn my attention to SA. So much can change in just a few short months. In February, after a very positive annual budget, we wrote that the outlook for SA had not looked this positive for ten years! That now feels like a distant memory. In the near term, we will feel the pain like

everyone else. Fuel prices are at record highs and may still move higher as Treasury reinstates the remainder of the fuel tax in July. Interest rates have already risen by 0.25% and will move higher if there is no respite on fuel. Finally, the agricultural sector is facing severe input price pressures – from diesel to fertiliser. That is before we discuss the potential impact from the weather. Scientists

are calling the current El Nino that is forming one of the worst on record – akin to the conditions that caused such devastating droughts in 1982/3 and 2015/7. Food inflation is inevitable.

Fortunately, the longer-term picture is far more promising. Electricity reforms are now five years old and bearing fruit. Eskom celebrated 365 days without loadshedding last month. That was inconceivable just two years ago. In 2027, we will see private sector locomotives on our railways. Reform in the rail sector is now moving quickly. This will open the sector to large scale investment which should improve capacity and reduce costs, both of which will enable higher rates of growth. Finally, a silver lining of the current crisis is higher commodity prices, which implies a substantially higher tax take for government from mining royalties. That should ensure that our fiscal improvement should remain on track.

What does all this mean for portfolio construction? Over the past eighteen months we have repeated our strategy of moving to “Quality”, but what do we mean by this? Briefly, this applies to companies and investments that

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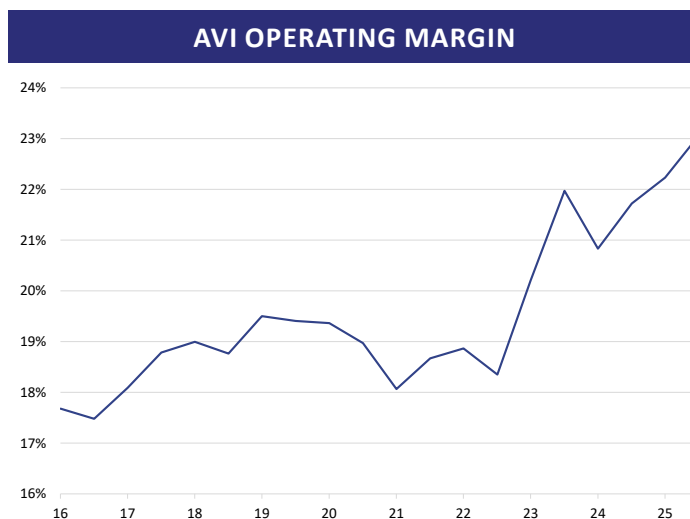
have attractive market positions and a strong competitive advantage; strong balance sheets and cash flows; and they exhibit consistent growth in both earnings and dividends over time. Finally, and most importantly, we also assess the quality and track record of management.

The presentation highlighted three examples of this strategy in action.

Clients will be familiar with our “Supported Consumer” theme – something that we have highlighted consistently for the past three years. Earnings are more resilient at the bottom end of the market where spending is supported by the township economy and social grants. Our first example compared four clothing retailers to Shoprite and Clicks. All operate in the same economy and face the same economic pressures. Yet each company has chosen its own strategic path. Our clothing sector composite underperformed both Clicks and Shoprite on every metric – earnings growth, balance sheet gearing (debt levels) and dividend growth. We do not expect these trends to reverse and hence have used market volatility over the past two years to increase exposure to Clicks, Boxer and Shoprite where the investment case is far more robust.

Our second example focussed on the mining sector. Seven years ago, we recognised the need to increase exposure to precious metals, so we chose Sibanye Stillwater given that it was both a gold and PGM miner. We thought we were killing two birds with one stone. Yet hindsight has proved that to be a poor decision. Sibanye has faced declining production and rising costs. On top of a weaker balance sheet, that makes an already cyclical investment even more volatile and risky. We have used the rally in precious metals prices to switch away from Sibanye Stillwater into AngloGold Ashanti and Valterra (formerly Anglo Platinum). Whilst all mining companies are cyclical, the latter exhibit far more defensive characteristics, and their shareholder returns are consequently far more consistent and predictable.

Finally, we illustrated the advantage of investing in companies with a proven management team. AVI is a household name in SA – or more accurately, their brands (which include Five Roses, Freshpak, House of Coffees, Bakers, I&J, and many more) are household names. AVI has faced the same economic pressures as every other SA company – a weak economy, the rise of private label products, currency volatility, surging commodity prices – the list goes on. Yet despite those challenges, AVI has increased its operating margin steadily – from 18% in 2016 to 23% currently. That has delivered superior returns and cash flows, which in turn has underpinned consistent earnings and dividend growth.



Despite facing challenging economic conditions, AVI has managed to improve its margins over time, a testament to good management. Shareholders have been rewarded through consistent and growing dividends, supplemented with special dividends every three years.

In conclusion, headlines remain volatile and often misleading. Those who focus on headlines do so at their own risk. Despite what is happening in the Middle East, the world goes on. Growth is being fuelled by AI and the productivity gains therefrom. The war is just one cog in the global engine. We encourage clients to take a step back and take the headlines at face value. Our strategy remains to stay invested in growth assets to ensure long-term inflation-beating returns, but equally, to ensure that companies included in portfolios can withstand the bad times and yet flourish when conditions inevitably improve.



5 Roses tea is a brand of AVI - a company that has been weathering South Africa's tough economy with skill.



Our next seminar will be held in September. We will announce a topic in due course.



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HARVARD HOUSE GROUP



3 Harvard Street, Howick, 3290, South Africa



P.O. Box 235, Howick, 3290, South Africa



+27 (0) 33 330 2164

Topic:

To be confirmed

Natal Midlands

Date: 10th of September, 2026

Venue: Christ Church Howick, 23 Mare Street, Howick

Morning Time: 10am for 10.30am

Evening Time: 5.30pm for 6pm

Johannesburg

Date: 8th of September, 2026

Venue: Rosebank Union Church, Cnr Winne Mandela Drive and St Andrews Road, Hurlingham

Time: 7am for 7.30am

Cape Town

Date: N/A

Venue: Kelvin Grove Club, 144 Camp-ground Rd, Newlands, 7700

Time: 7.30am

Venue: Helderberg Village Lifestyle Estate, 63 Bakkerskloof Rd, Helderberg Village, Cape Town

Time: 5.30pm for 6pm



+27 (0) 33 330 2617



admin@hhgroup.co.za



www.hhgroup.co.za

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Performance figures quoted for the portfolio is from Morningstar, as at the date of this document for a lump sum investment, using NAV-NAV with income reinvested and do not take any upfront manager's charge into account. Income distributions are declared on the ex-dividend date. Actual investment performance will differ based on the initial fees charge applicable, the actual investment date, the date of reinvestment and dividend withholding tax. Performance fees do not apply to any funds managed by Harvard House. The manager does not provide any guarantee either with respect to the capital or return of the portfolio. A schedule of fees, charges, and maximum commissions are available on request from the manager.



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