What could lie ahead for the economy and financial markets further into 2023?

Yolanda Naudé
Investment Strategist & Portfolio Manager

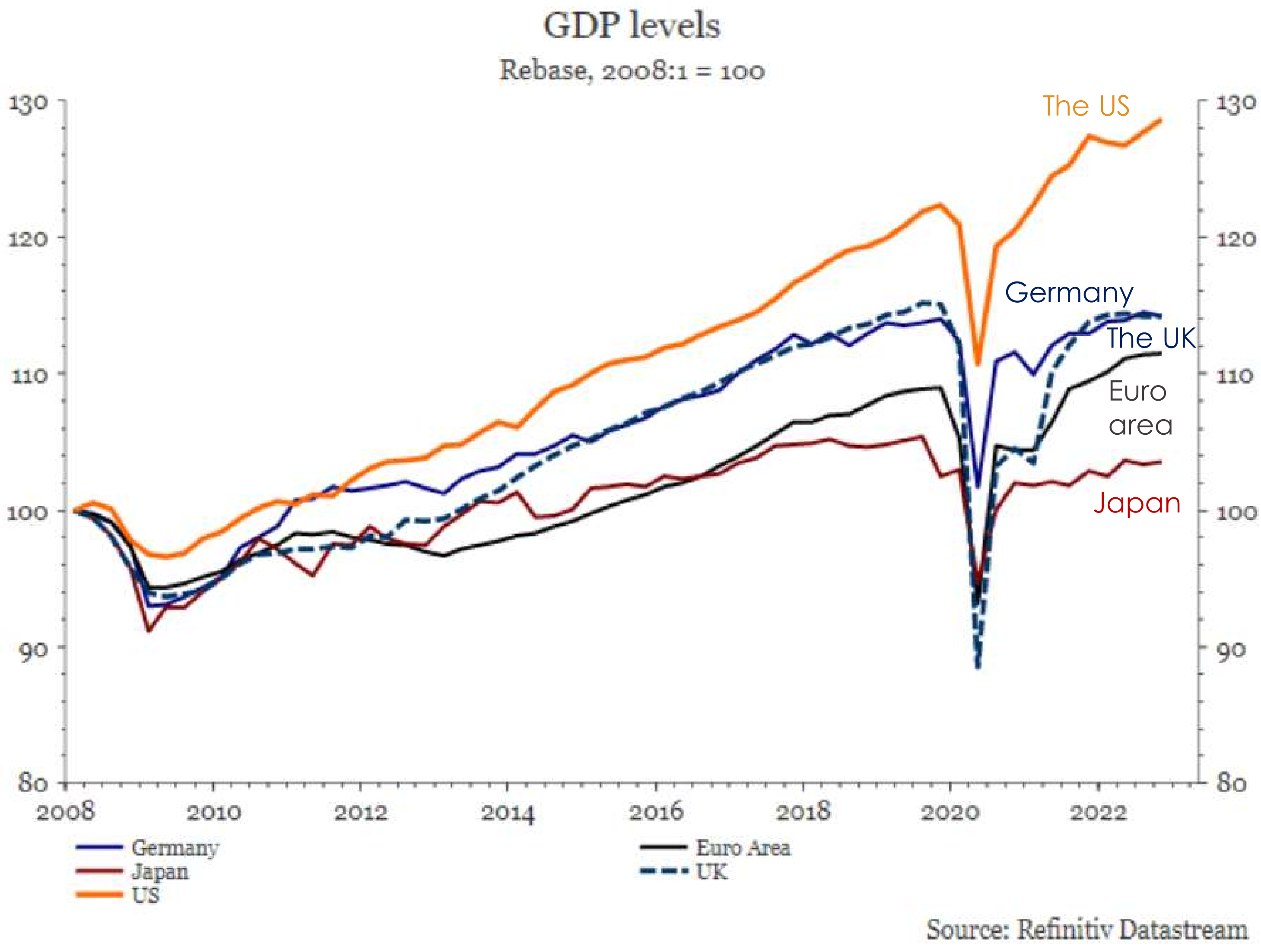
24 February 2023

Themes / risks / opportunities into 2023

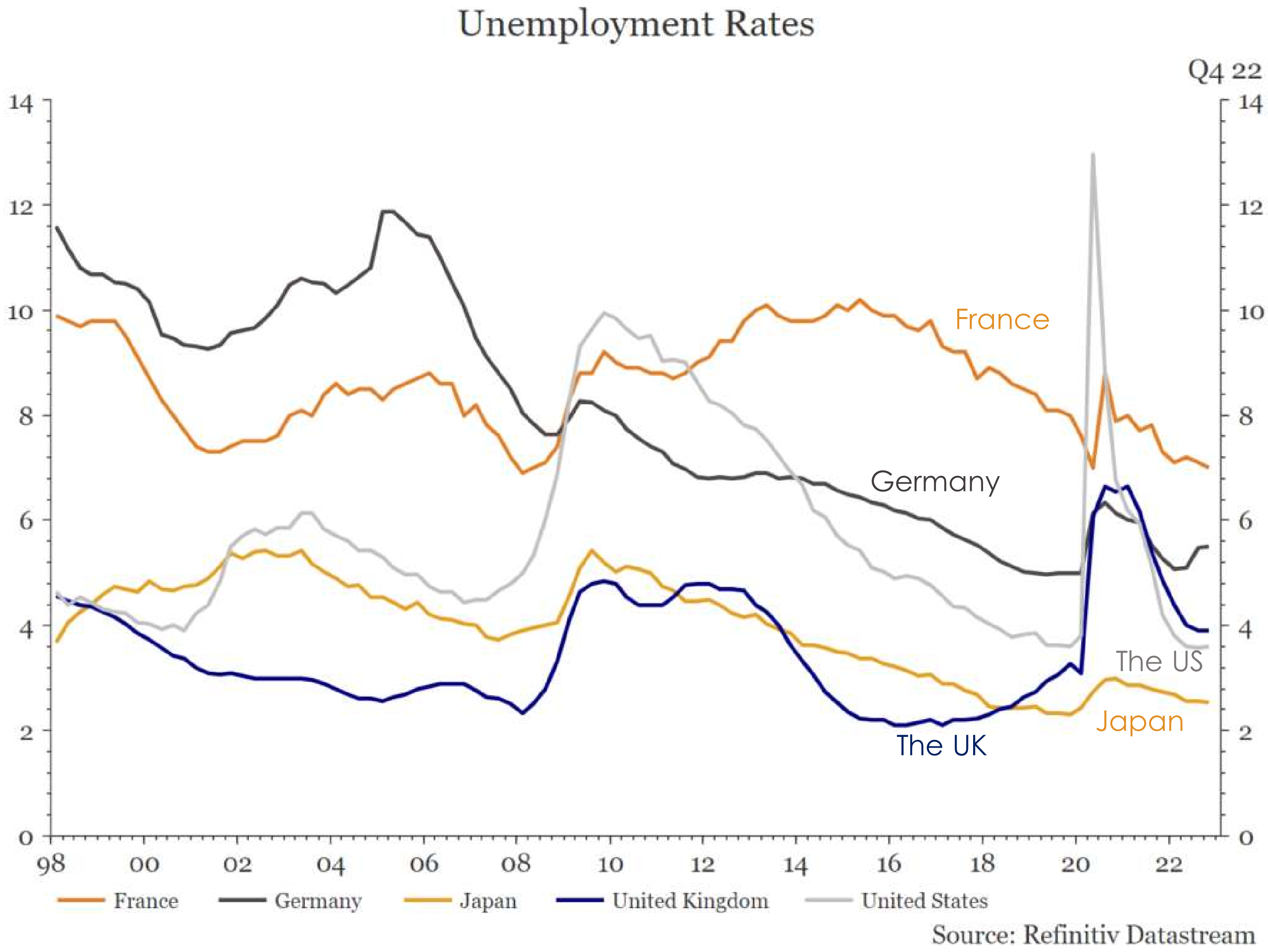
1. Peak global **inflation**
2. Peak **interest rates**
3. Peak **USA dollar**
4. **Unsynchronised** global economic activity (slowdown in the **west** vs recovery in the **east**)
5. **De**-globalisation (**less** global integration, **more** fragmentation & **more** friction)
6. Excessive & rising government **debt levels**
7. Global energy crisis / **energy** transition
8. Geopolitical **tension** (Russia / China / Taiwan / Iran / North Korea)
9. **SA** economy's structural hurdles & pace of reform progress

The Global Economy

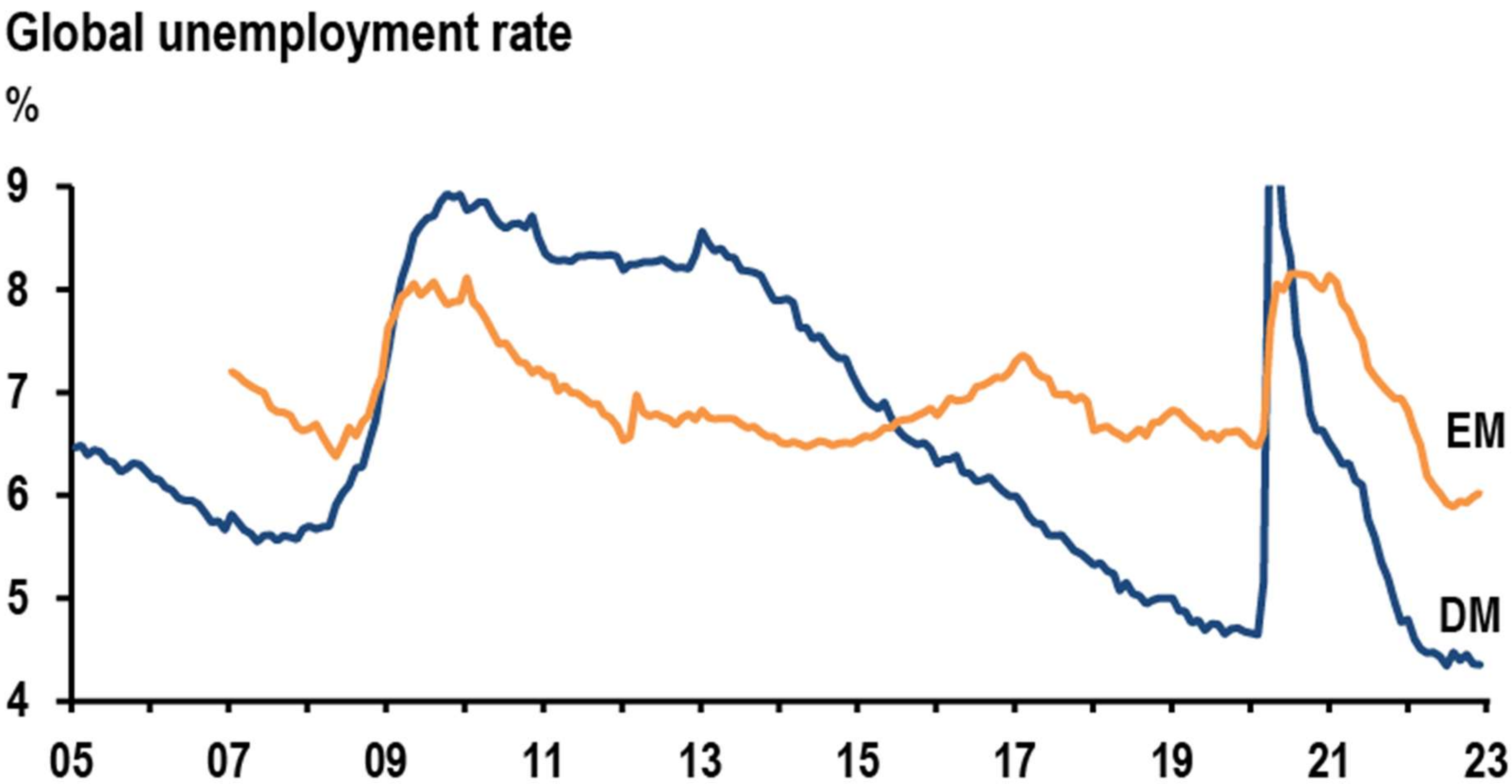
Economic size: levels have almost recovered to pre-covid



Employment is still solid…



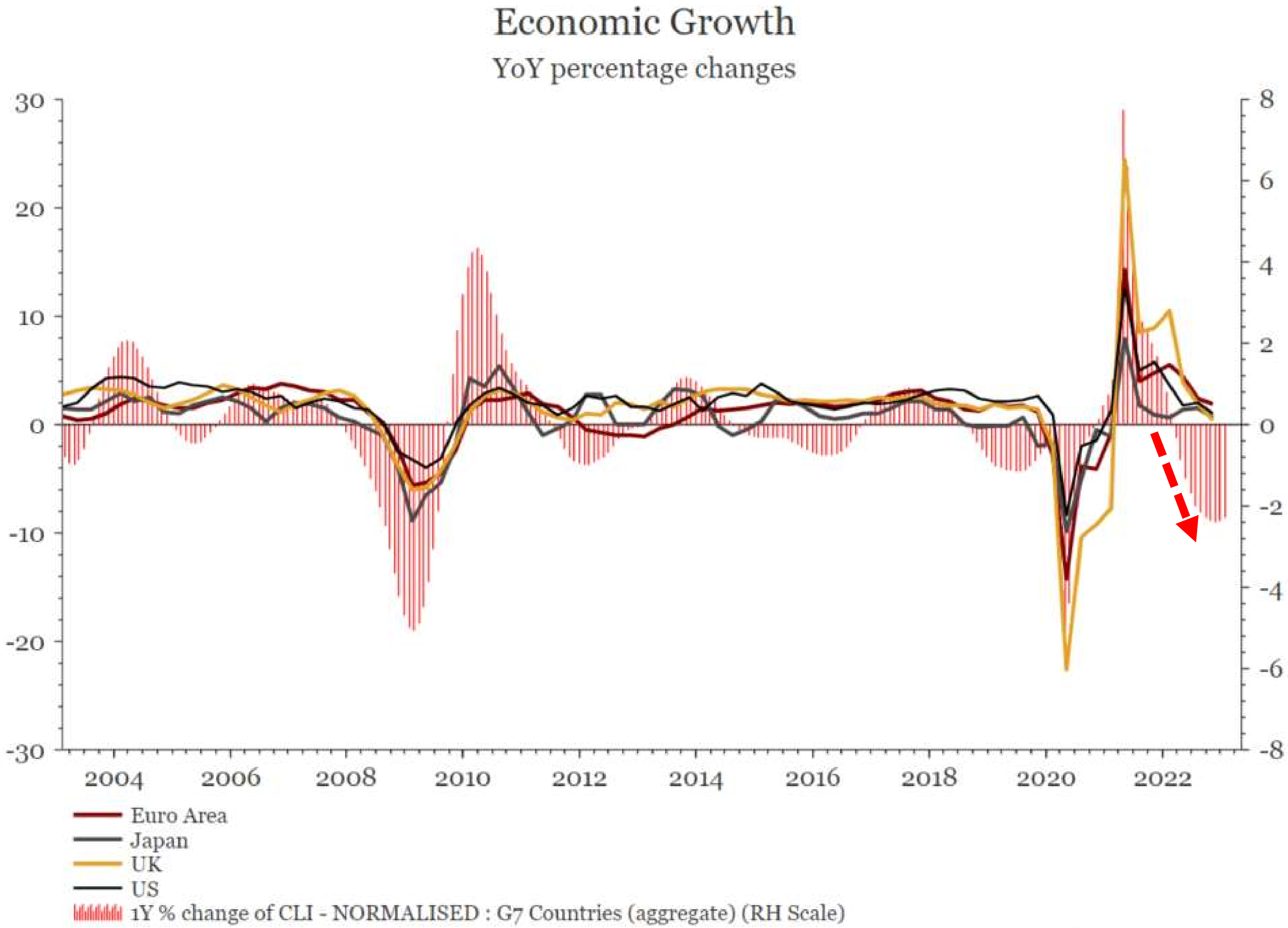
…in both developed & emerging countries



Source: J.P. Morgan Global Economics

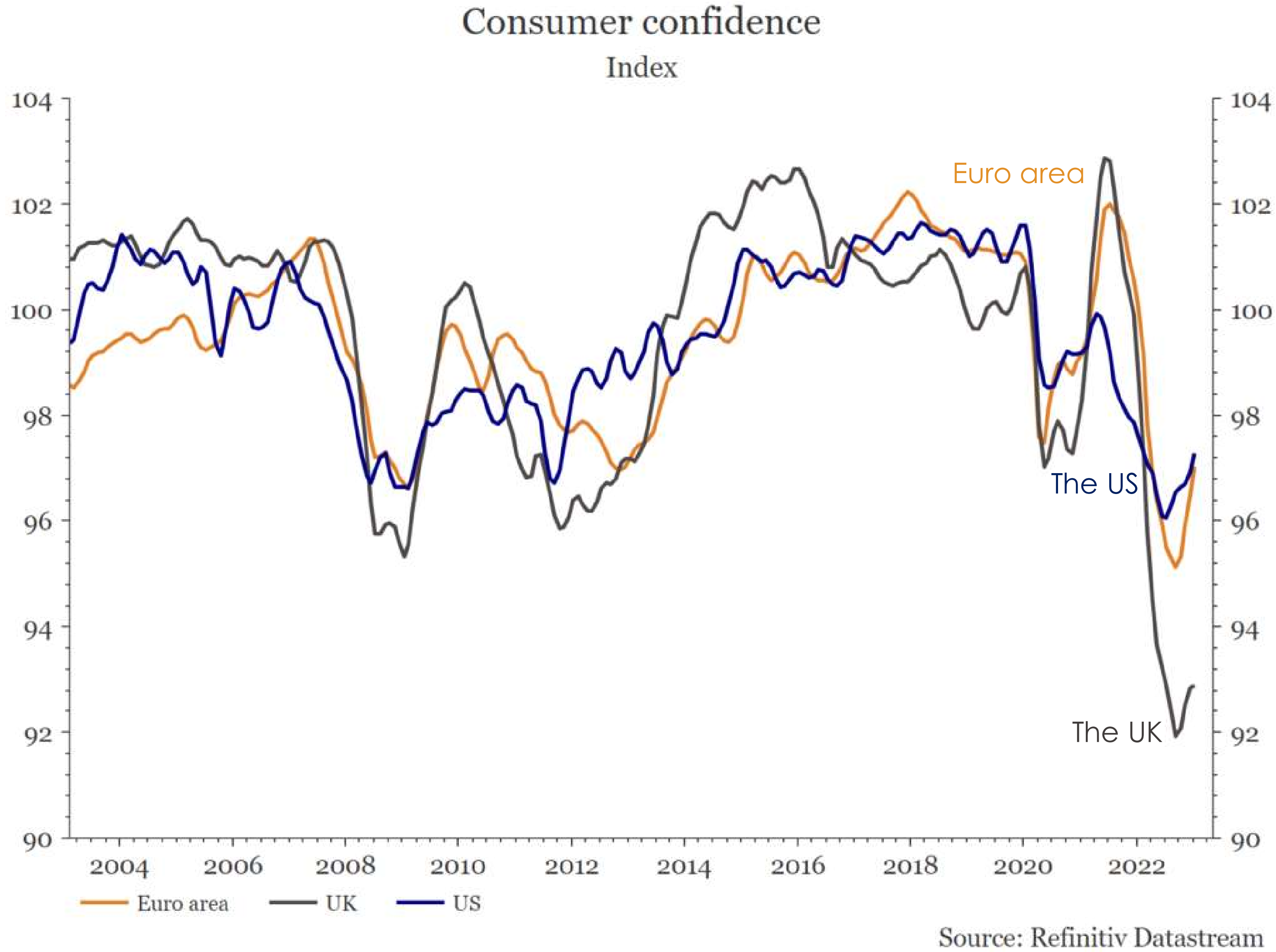
JPMorgan Daily Economic Briefing, 15 February 2023

But, G7 leading indicator suggests there's a recession ahead



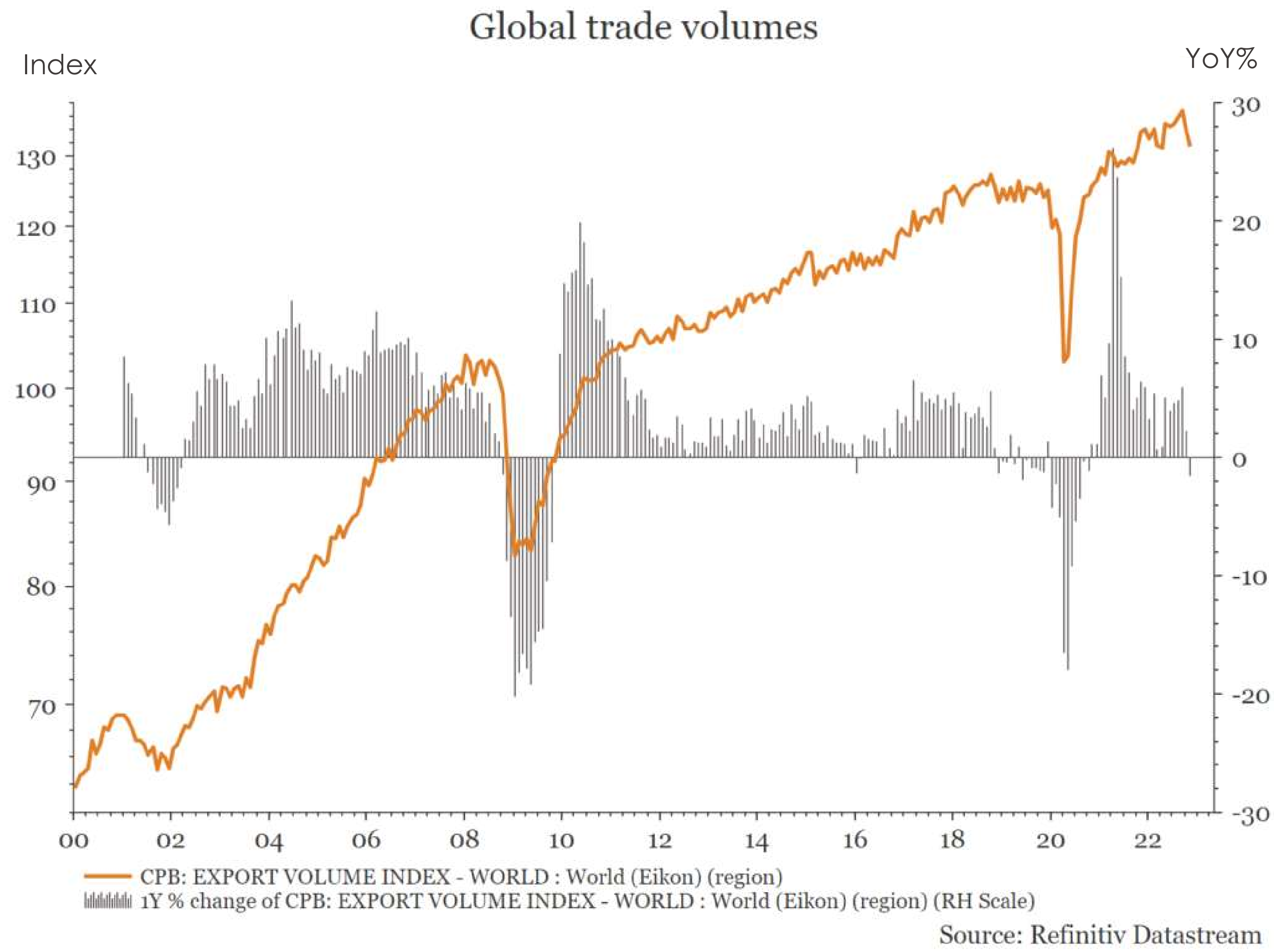
Source: Refinitiv Datastream

Consumers are not happy



- Record-high **inflation** (cost of living crisis)
- Highest **interest rates** in decades

Global trade is under pressure



- Economic slowdown
- Start of less globalisation, more fragmentation?
  - shorter supply chains
  - more onshoring

Citadel's recession scorecard

January 2022
Yield curve
Unemployment
Leading indicator
Consumer confidence/Consumption
Household debt
Debt servicing costs
Wage growth
Monetary conditions
Trade
Equity market / profits / valuation

25%

Citadel's recession scorecard

January 2022	February 2023
Yield curve	Yield curve
Unemployment	Unemployment
Leading indicator	Leading indicator
Consumer confidence/Consumption	Consumer confidence/Consumption
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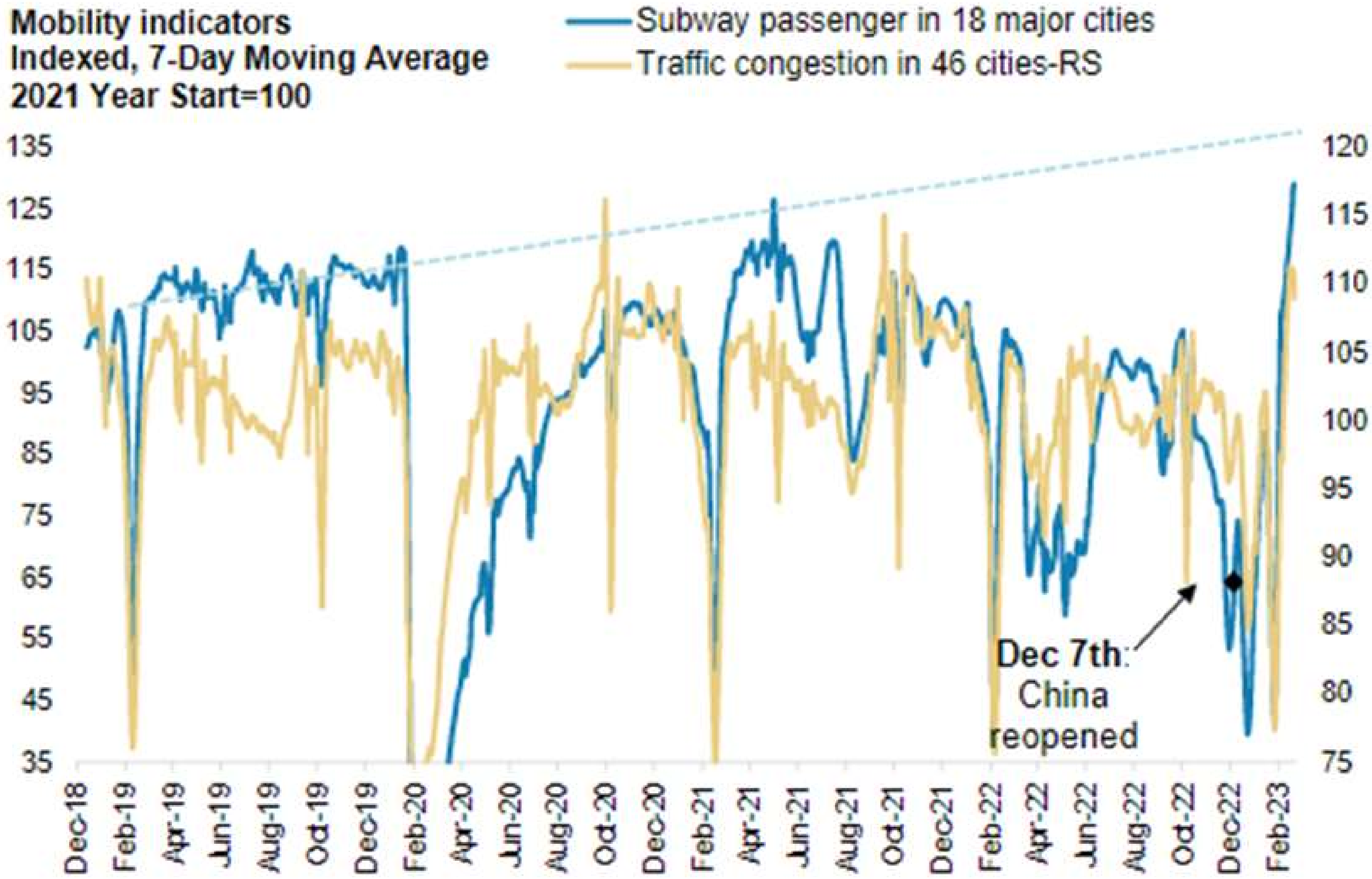
Debt servicing costs	Debt servicing costs
Wage growth	Wage growth
Monetary conditions	Monetary conditions
Trade	Trade
Equity market / profits / valuation	Equity market / profits / valuation

25% → **90%**

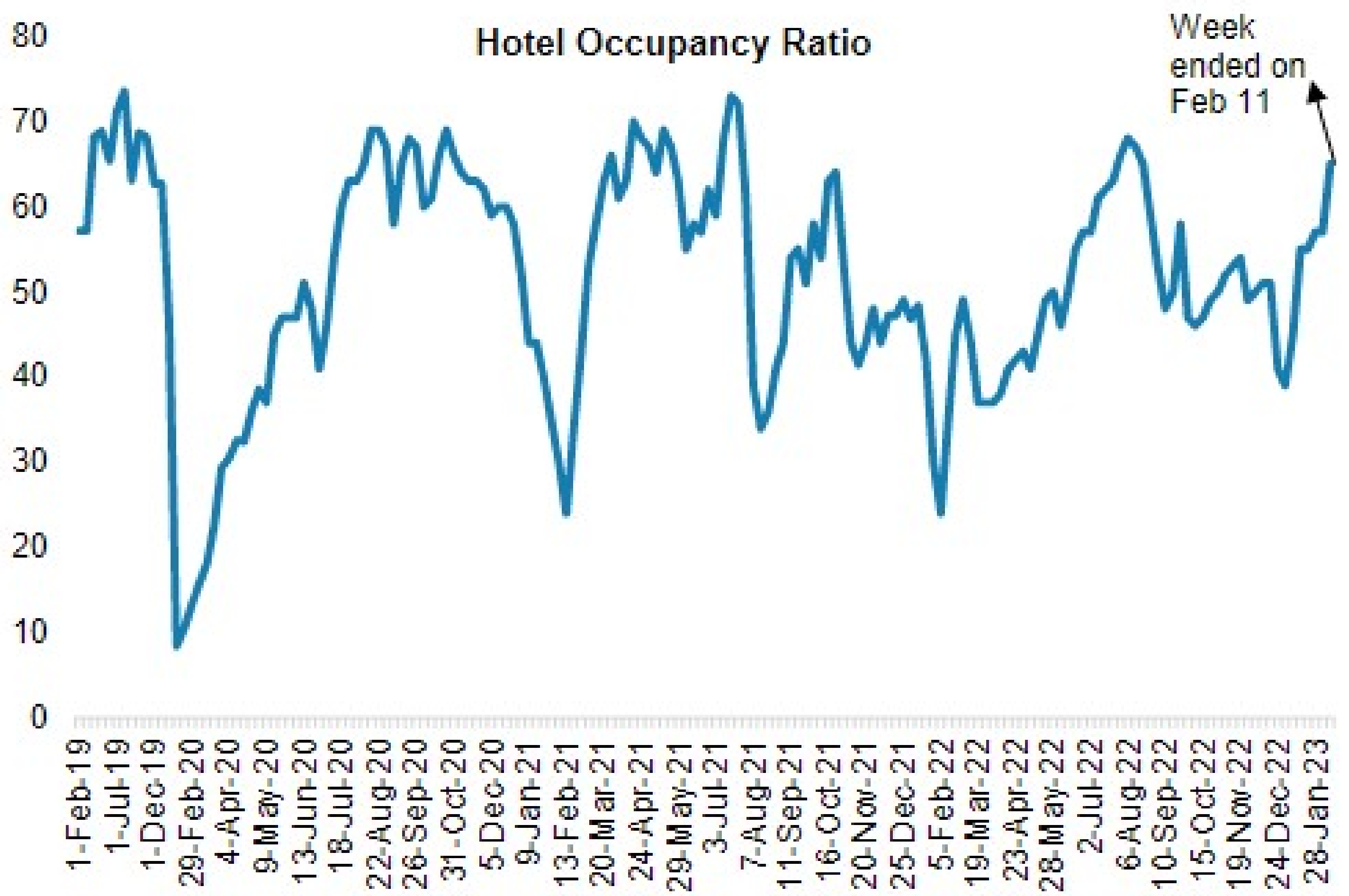
Can China not save the world economy?

The Chinese economy is rebounding beautifully



RMB/Morgan Stanley note, 23 February 2023

It will contribute to global growth in 2023



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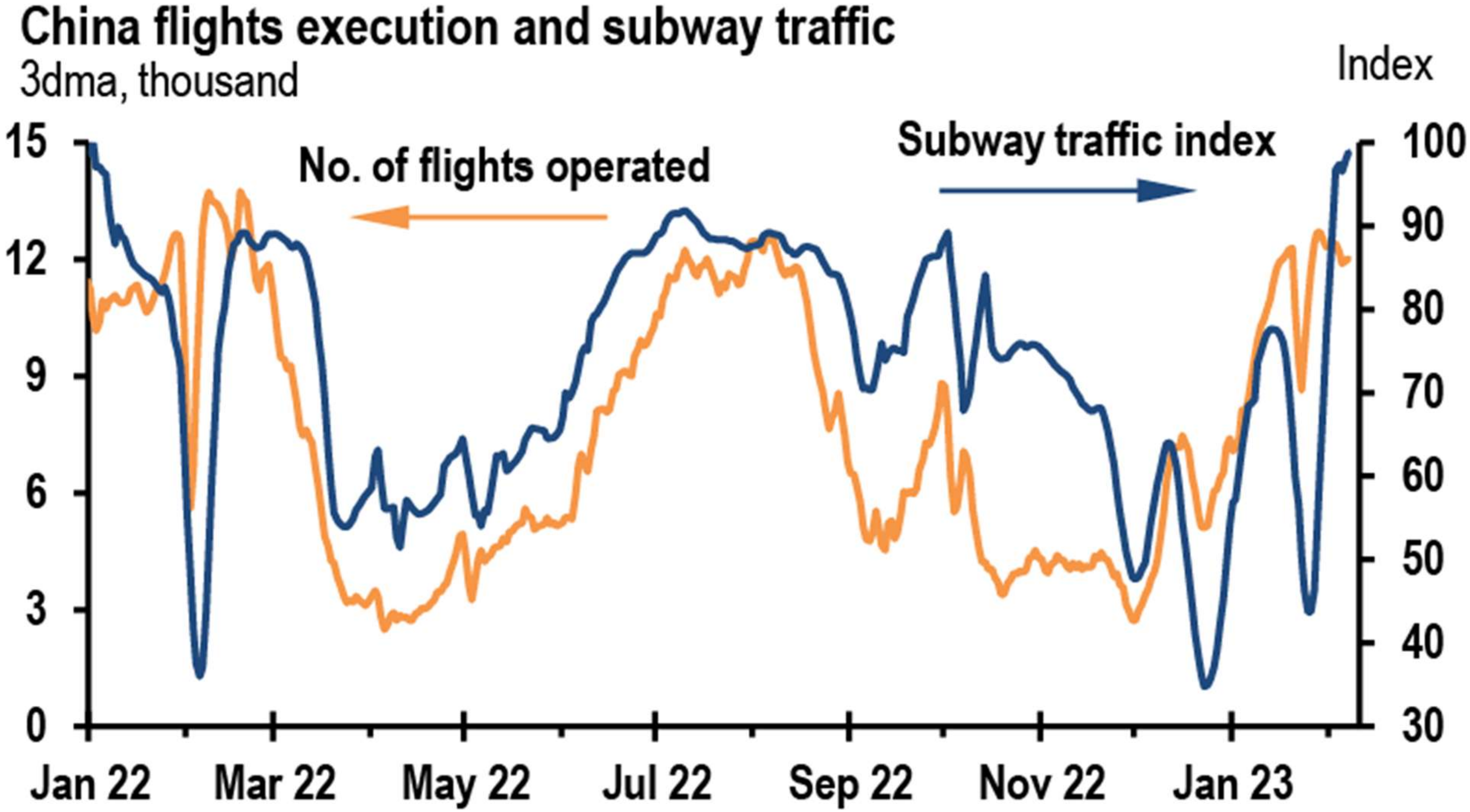
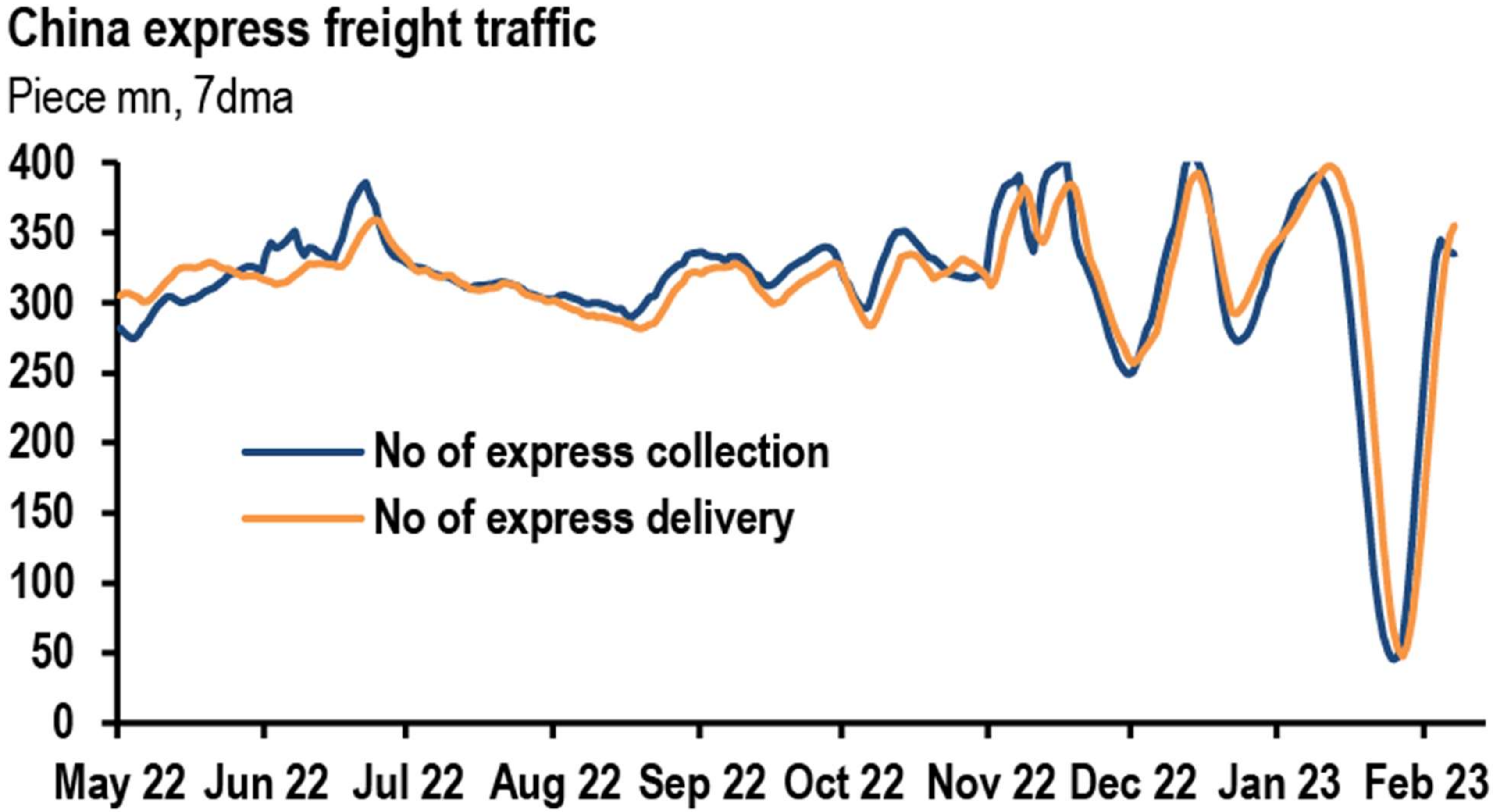


Source: Wind, J.P. Morgan; The subway indexation base is the maximum level for 2022.

JPMorgan Daily Economic Briefing, 10 February 2023

…it will contribute to global growth in 2023



Source: Ministry of Transport, J.P. Morgan; Note: Data is available from late April 2022.

JPMorgan Daily Economic Briefing, 10 February 2023

Policy support is complimenting China's reopening dynamics

In the past week:

- **Liquidity**: PBOC injected a **record** Rmb 630bn (USD 90bn) into financial system.
- **Special government bond issuance**: for Jan + Feb 2023 = **2nd highest on record**.
- **Property sector**: home prices stabilized in January (after declining for 11 months)

Policy support is complementing China's reopening dynamics

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China's real economic growth:

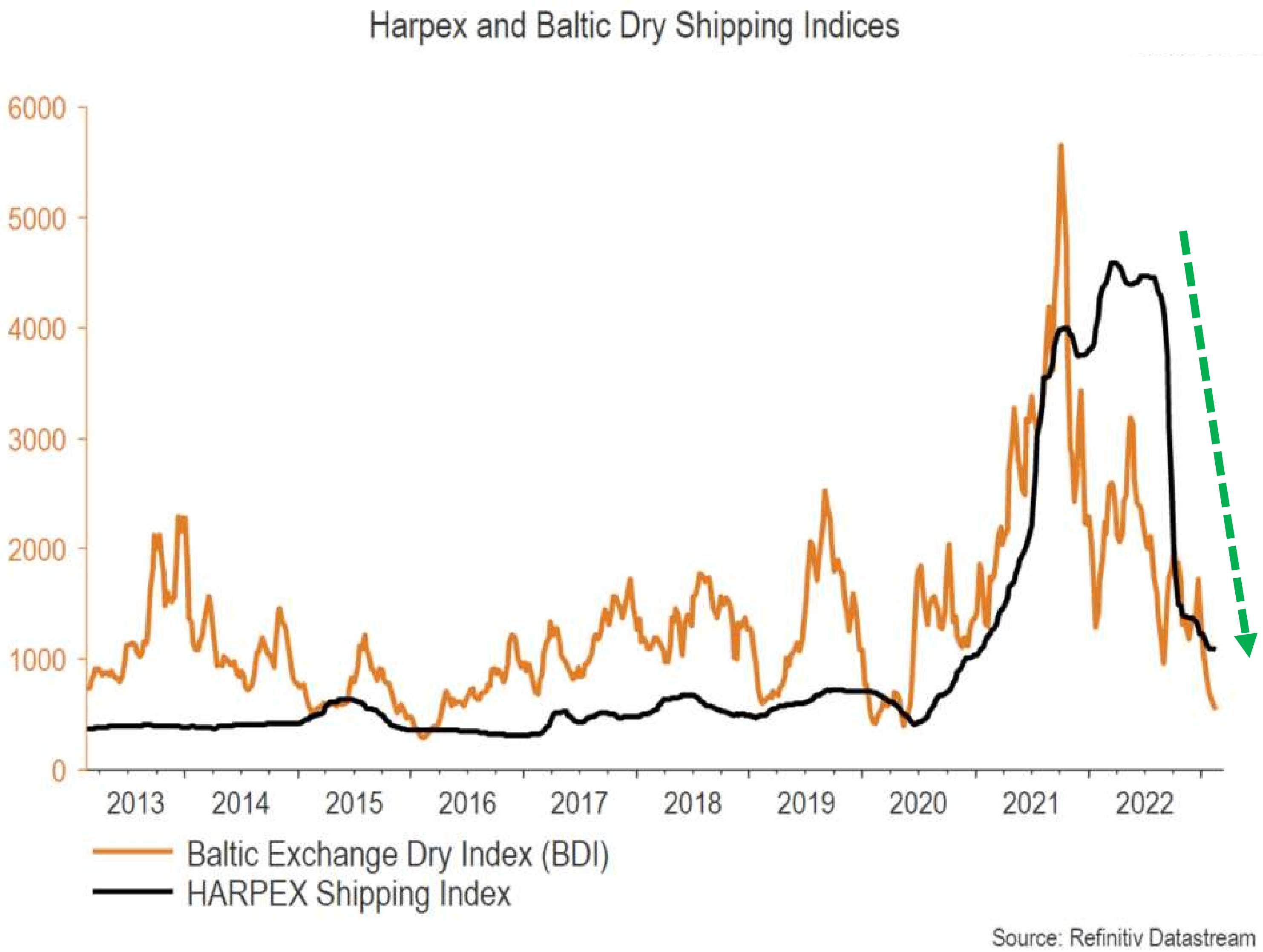
- 2020: 2.2%
- 2021: 8.1%
- 2022: 3.0%
- *2023: 5.5% (our current estimate)*
- *2024: 5.0% (our current estimate)*
- Longer term: +/- 4% p.a. (demographic challenges + lower productivity growth)


Inflation Watch

Global inflation watch: summary

- Major global headwinds have turned into tail winds, including:
  - Shipping cost
  - Energy prices
  - Second-hand vehicle prices
- Data suggests US inflation has peaked. Other countries to follow.
- PPI (factory gate prices) paving the way for peak inflation during 2023.
- Inflation expectations are adjusting downward.

Headwinds are turning into tailwinds: shipping cost



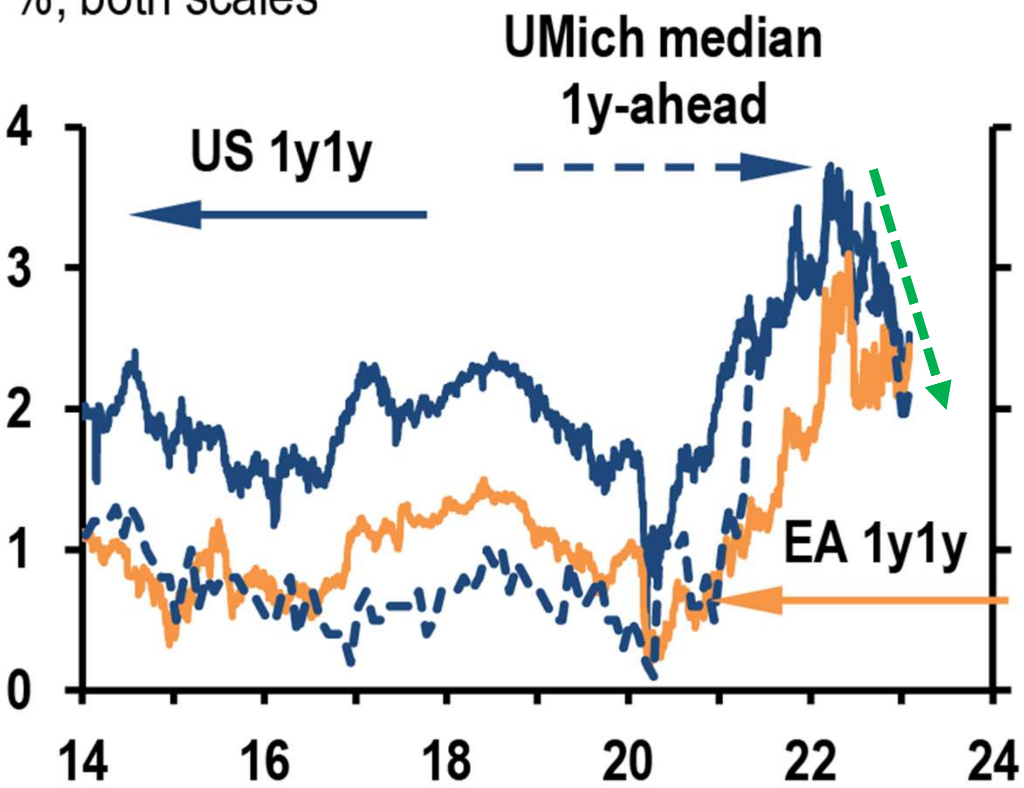
Headwinds are turning into tailwinds: energy prices

Source: Tradingeconomics.com, 22 February 2023

And, inflation expectations are also normalising

Figure 1: Short-term inflation expectations

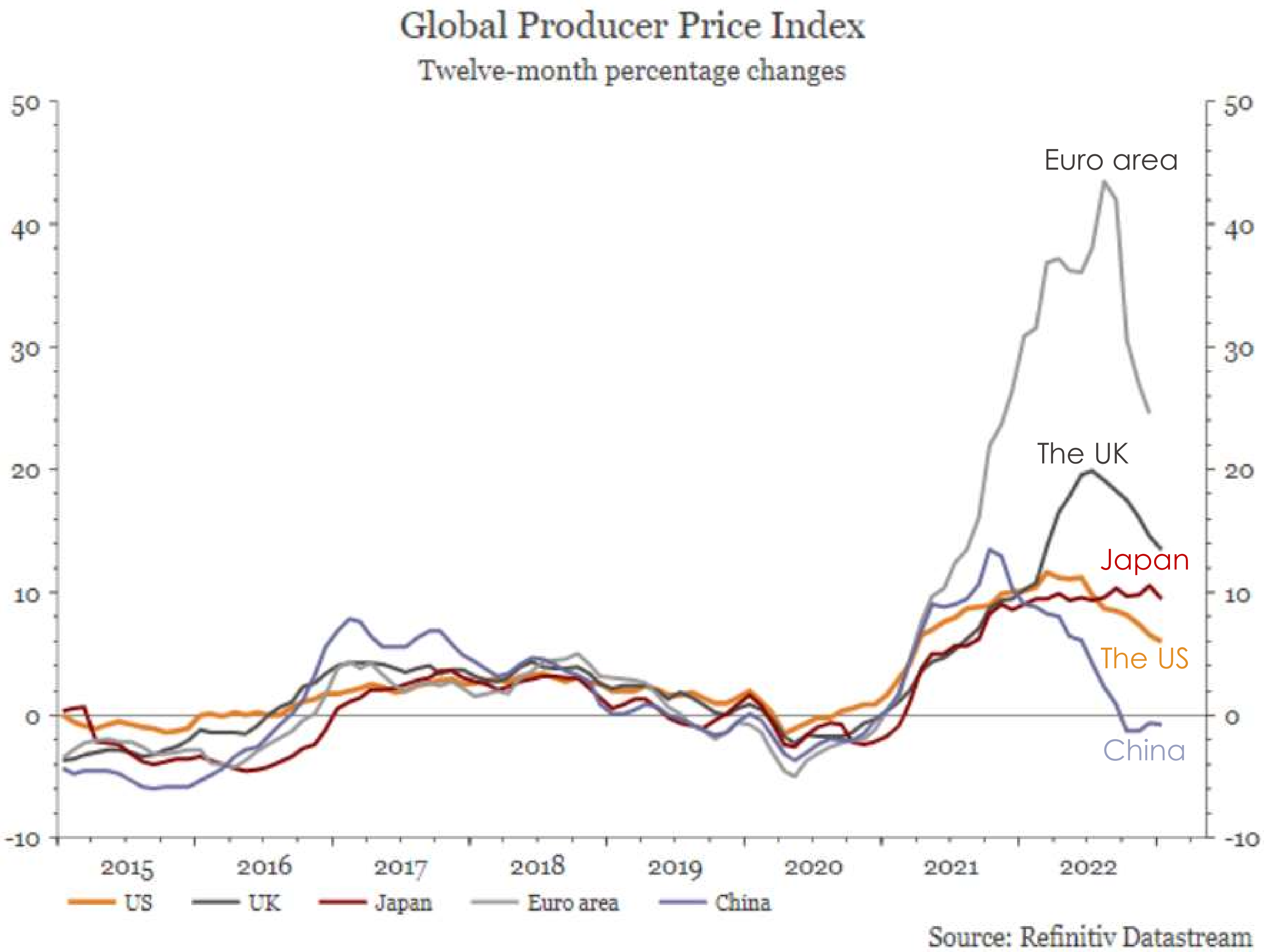
%, both scales



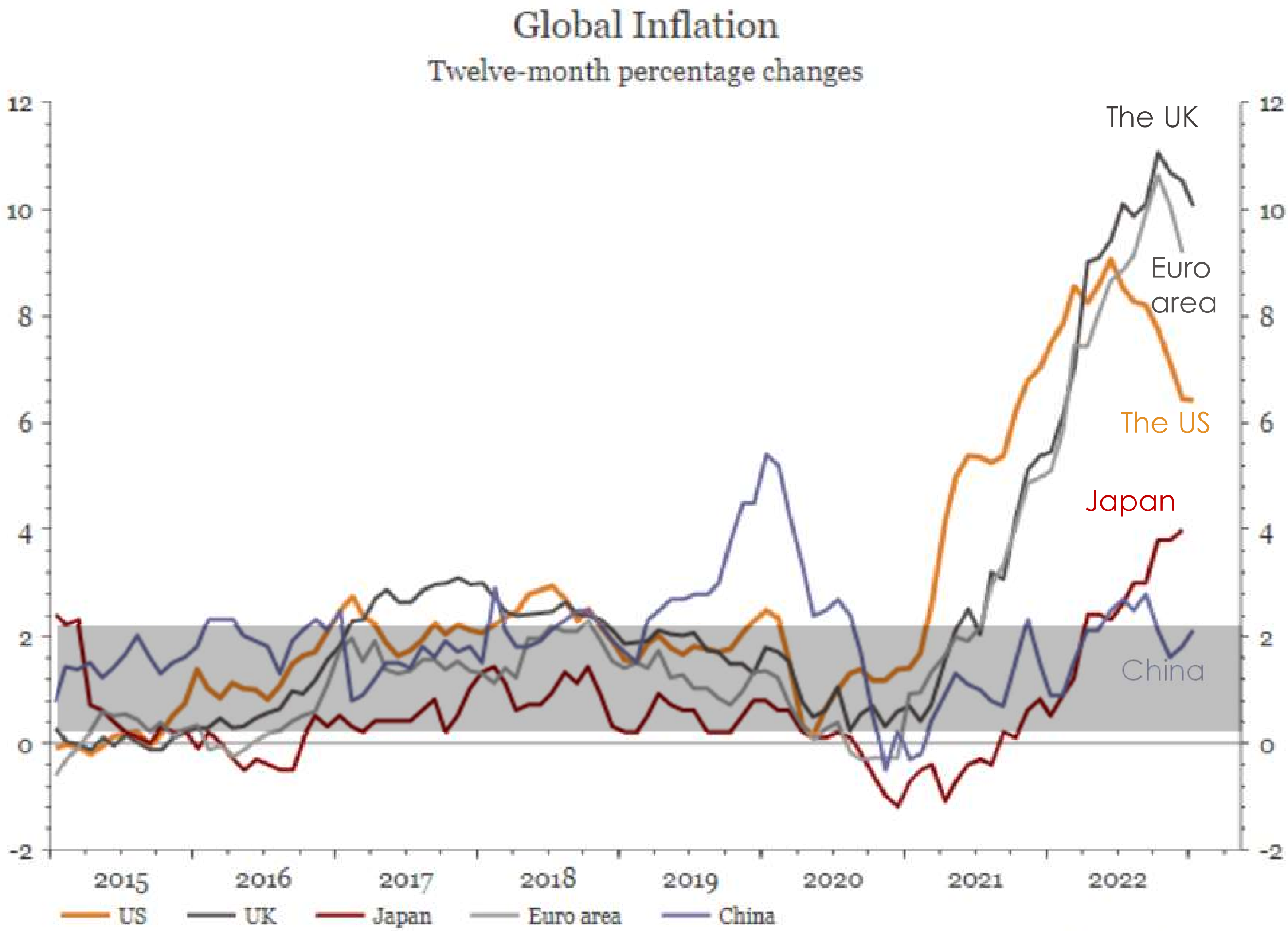
Source: University of Michigan, J.P. Morgan

JPMorgan Daily Economic Briefing, 13 February 2023

Factory gate prices have peaked



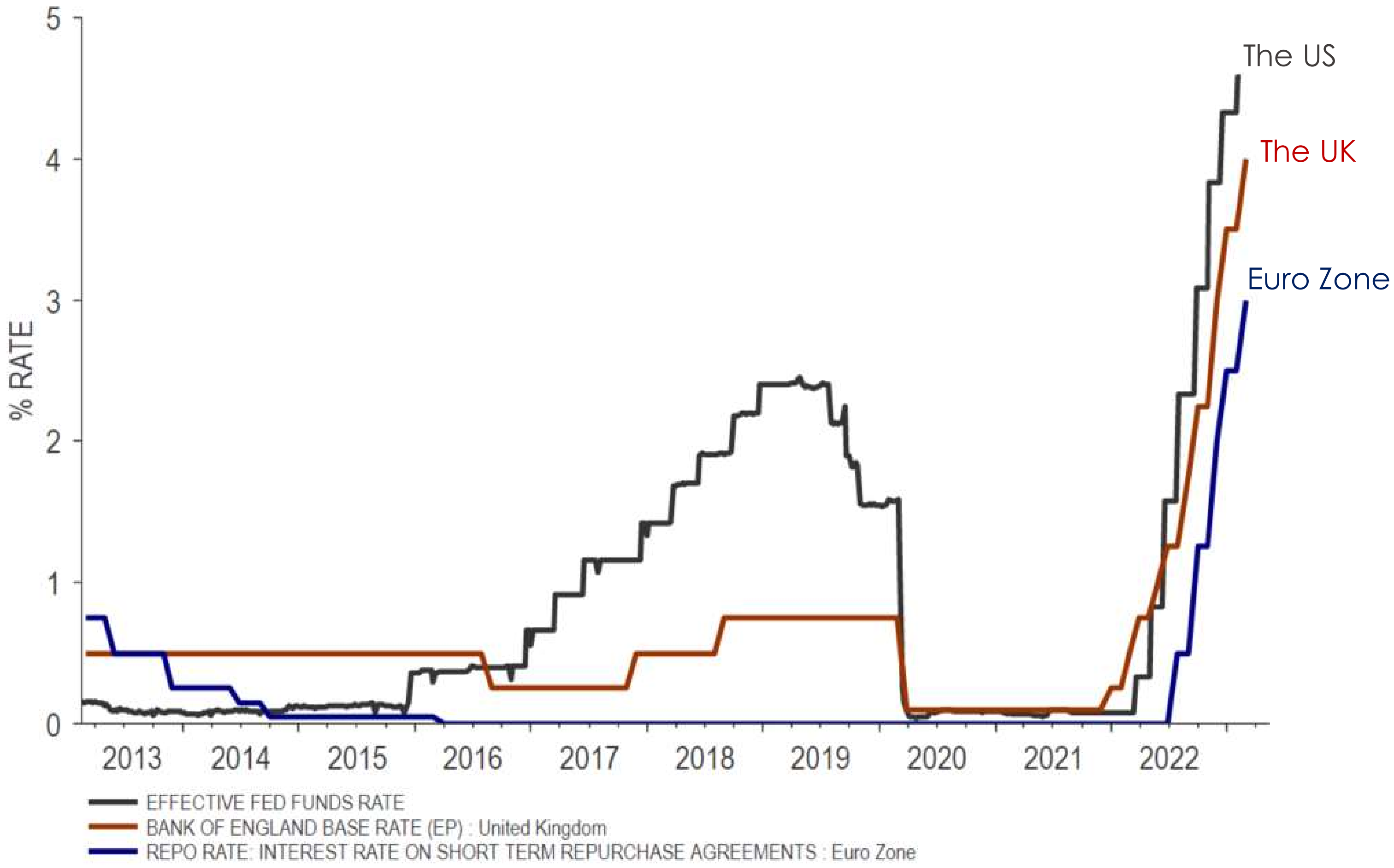
Consumer inflation is topping out globally, but… sticky…



Source: Refinitiv Datastream

Are short term interest rates close to peaking globally?

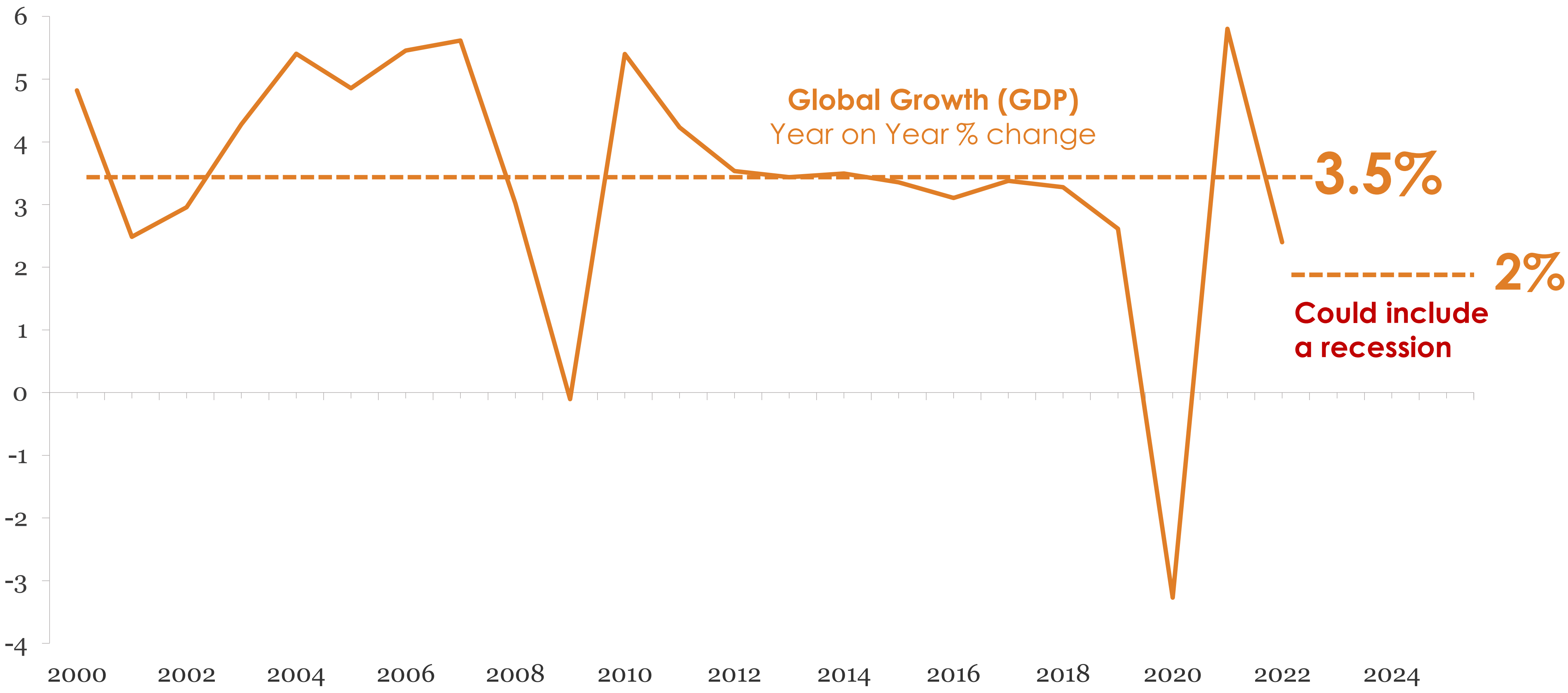
Tight labour markets + sticky inflation = a challenge for developed market central banks



Source: Refinitiv Datastream

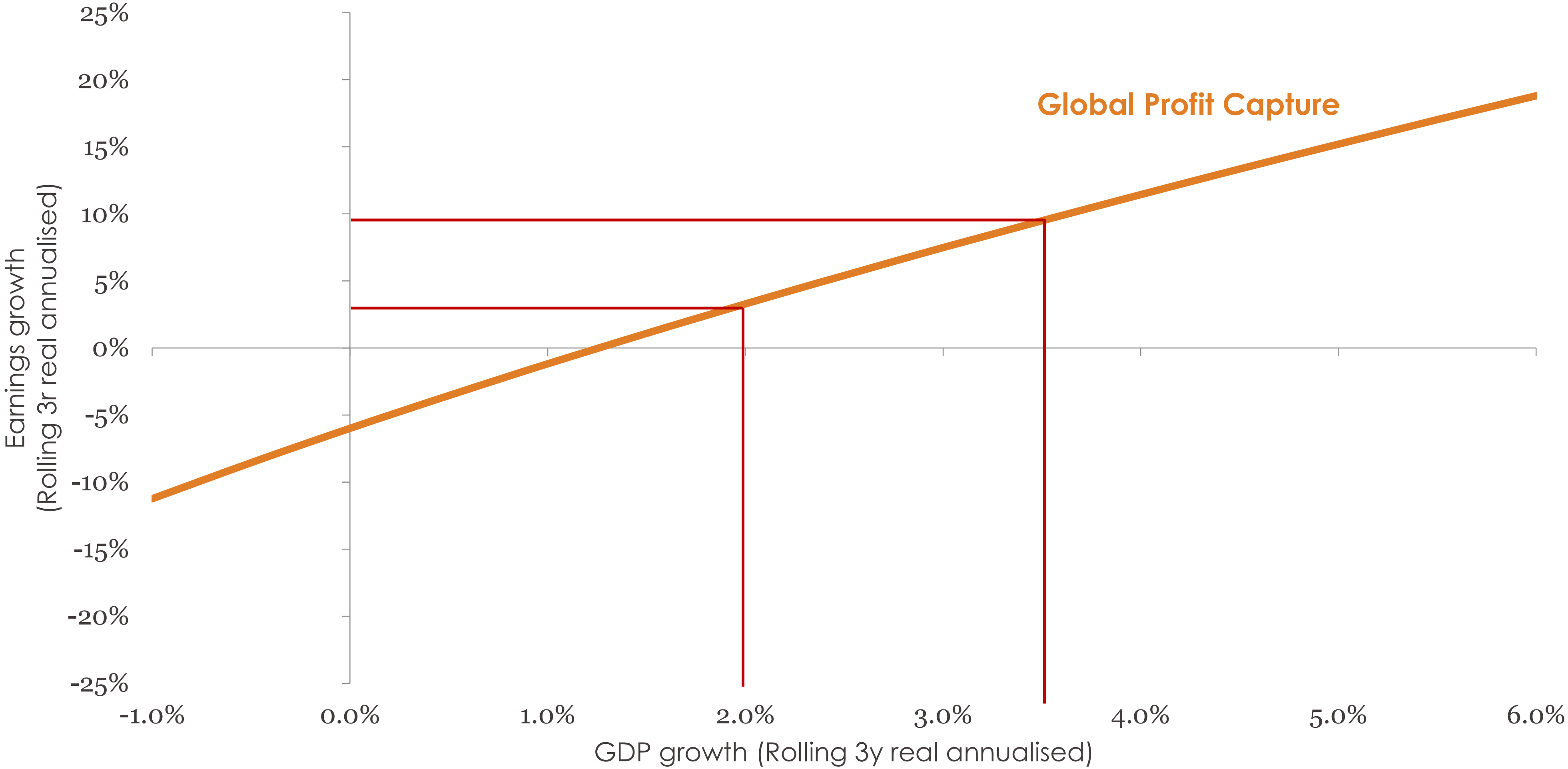
The full economic impact of higher rates still to be felt

Expecting below capacity growth over the next few years



Source: WorldBank and Citadel Asset Management

Slower growth = headwind for company profits



Source: Citadel Asset Management

The South African Economy

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WEALTH MANAGEMENT

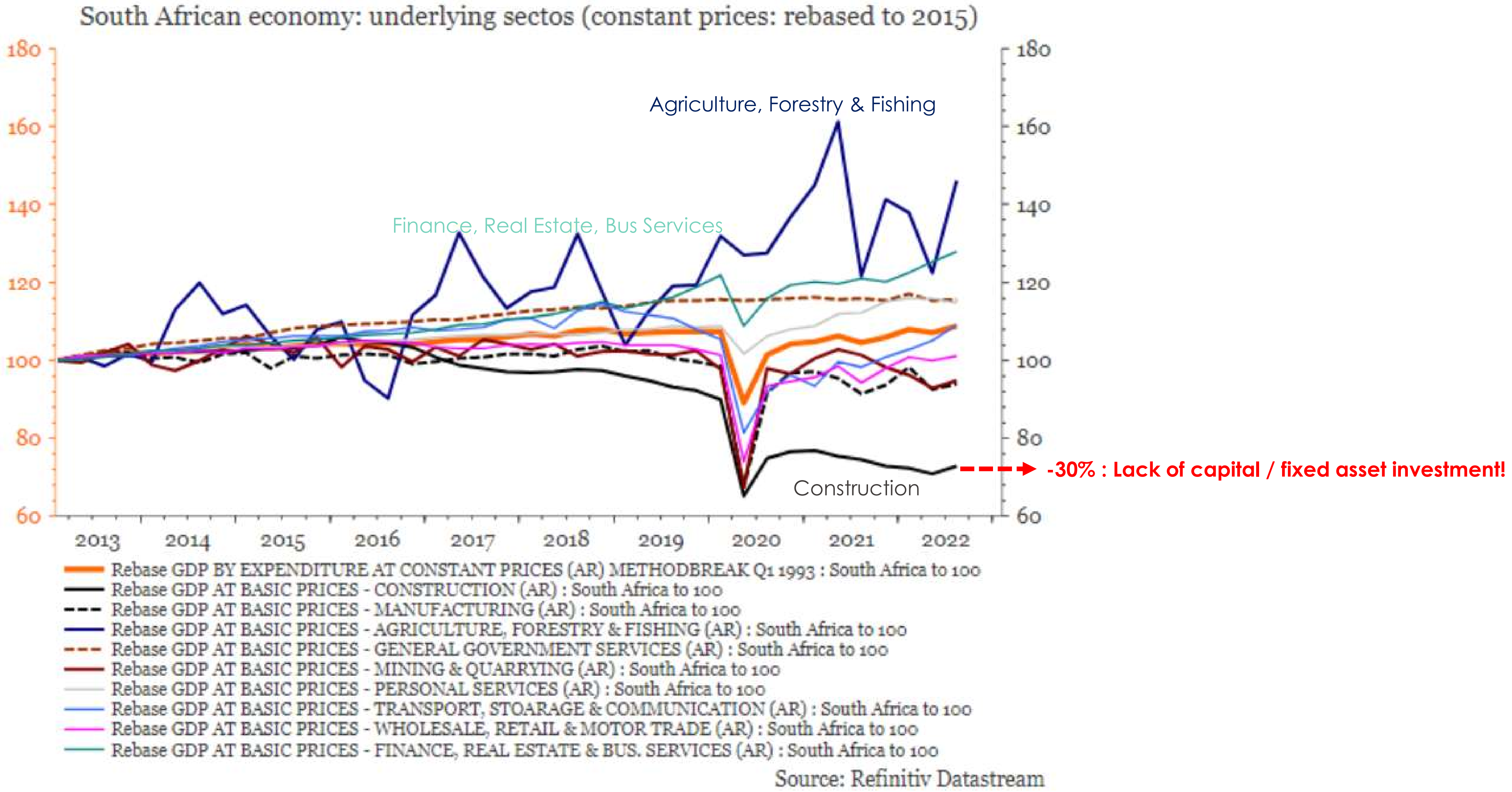
30 YEARS BEYOND REMARKABLE

SA economy: structural impediments to growth

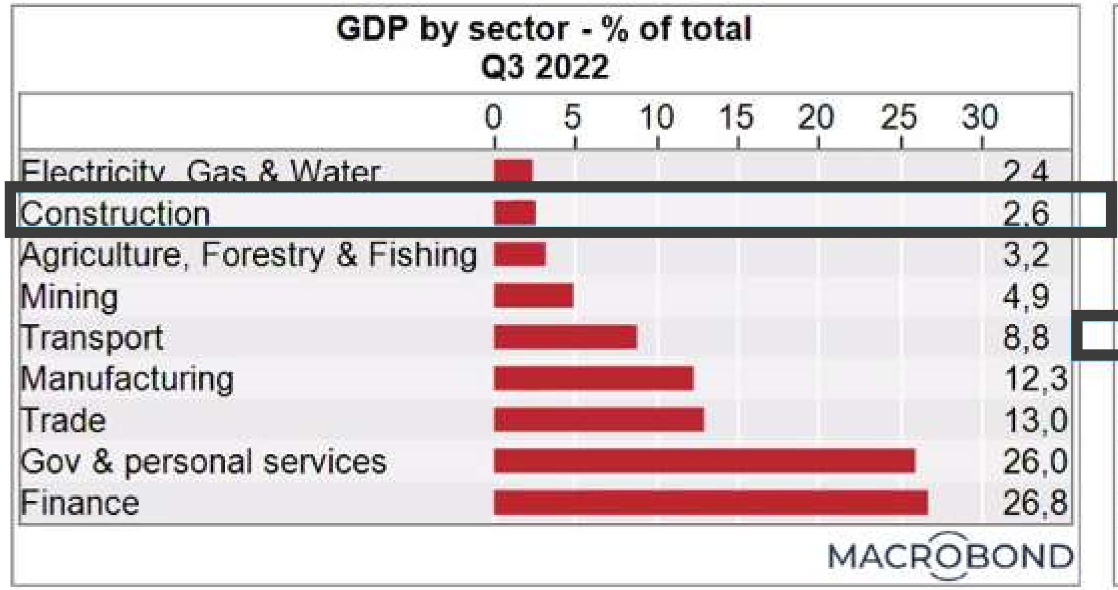
- Government **policy tussle**: privatisation vs nationalisation
- **Low** savings rate & **low** investment rate vs consumption
- **Weak education** system & **skills** at ground level to **implement** initiatives
- Overregulation and **bureaucracy**
- **Corruption**
- Lack of consistent, reliable & sufficient **energy supply**
- Troubled **network industries** (rail, ports etc.)

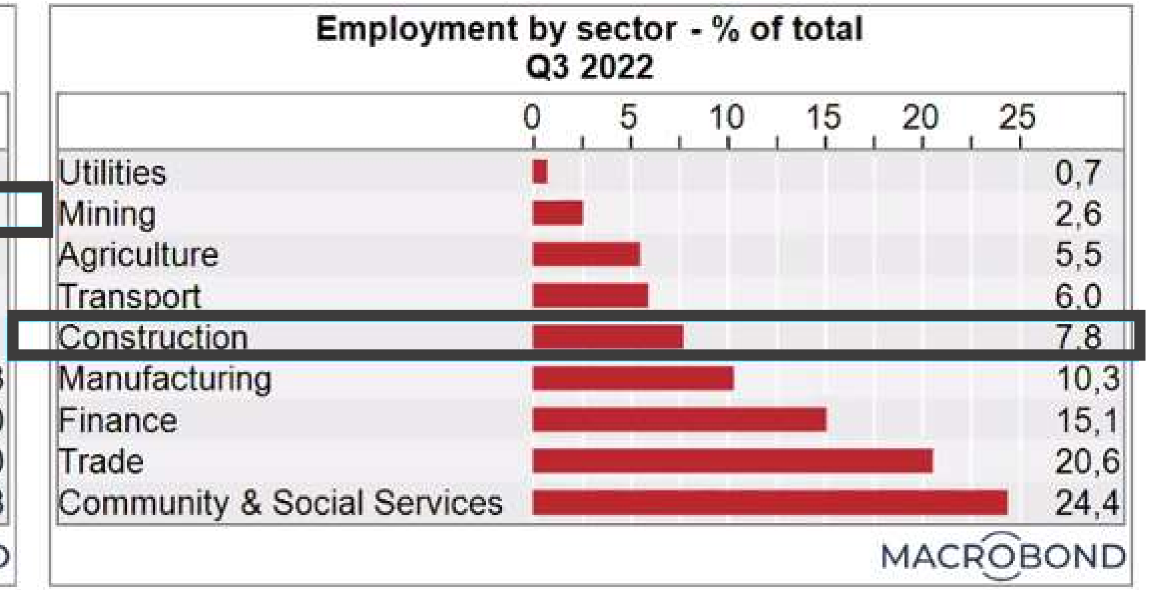
Size of economy: now back to pre-covid levels

SA economy: divergent sector growth over 10 yrs!



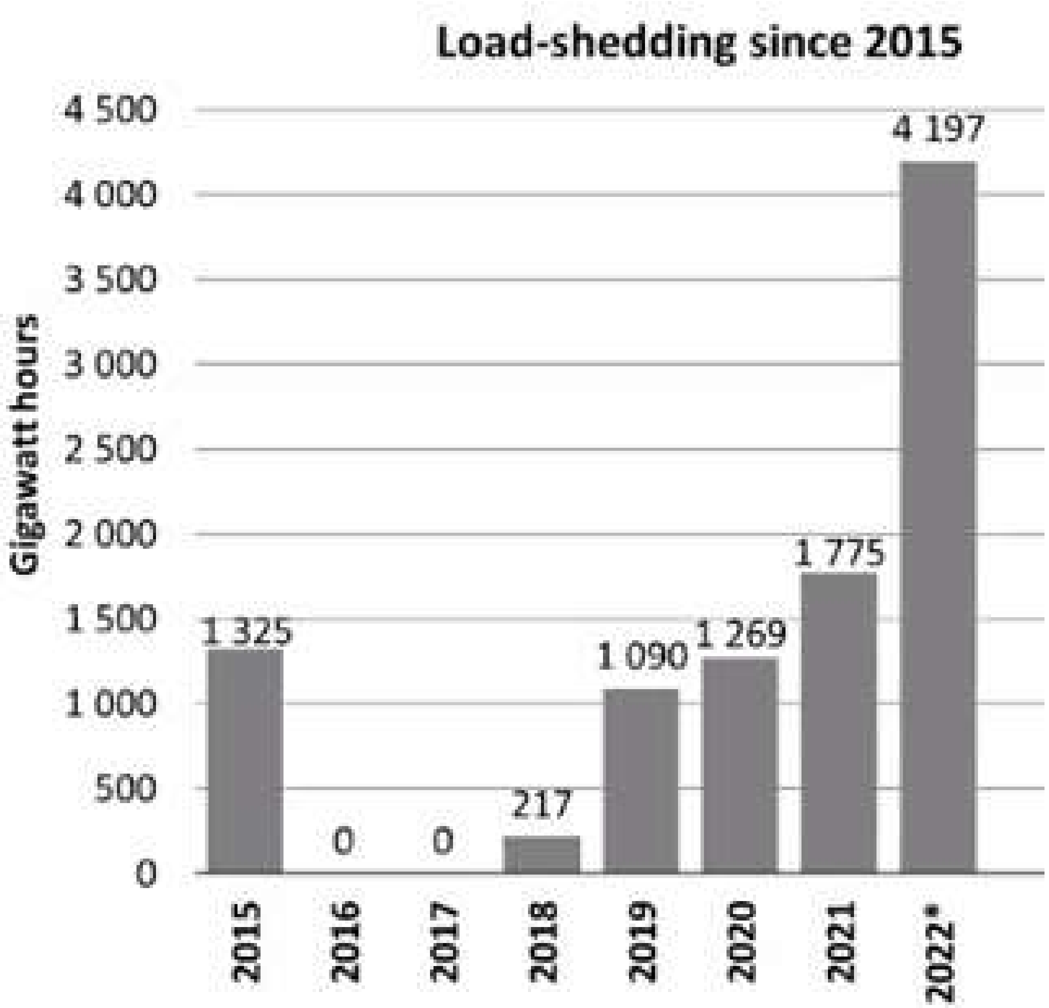
Construction is a small sector, but a big employer





Source: Econometrix, 3 Feb 2023

The impact of loadshedding: -2% economic growth p.a.?



Source: Econometrix, 3 Feb 2023

Examples of cost impact:

Spending on diesel, for generators:
- Pick n Pay at Waterfront : R150 000 p.m.
- A PGM mine in North West: R40m p.m
- Shoprite budgeted : R560m for H1-2023

-

Mining: mineral production -7% yoy

Mining = 5% of GDP & employs 480 00 people & generate R880bn in exports

Mining Production: year-on-year growth (%)

	2021 Average	2022 YTD Average	Weight
Total Minerals	**17,0**	-7,4	100,0
Gold	**19,7**	-15,5	**15,9**
Iron Ore	**39,2**	-12,4	**11,9**
Platinum Group Metals	**44,2**	-12,0	**23,0**
Coal	**-5,7**	-2,4	**27,9**

Source: Econometrix, 3 Feb 2023

Sibanye Stillwater CEO: PGM production could fall by 25% in 2023!

Eskom's plans

National Energy Crisis Committee (NECOM), 31 Jan 2023

Looking to recover and add +/- 8 800MW of capacity <u>during course of 2023</u> in effort to reduce intensity of loadshedding

- **<u>Importing</u>** electricity from Botswana, Zambia and Mozambique: to increase imports by about **1 600 MW** overall;
- Implementing Eskom's Standard Offer to **<u>buy electricity</u>** at a set price from existing **<u>commercial and industrial</u>** entities with surplus generation, as well as through its emergency generator program: expected to secure **1 000 MW:**
  * **Sappi** (already supplies surplus energy from its Ngodwana biomass power plant & mill)
  * **Mondi**
  * **Sasol**
- Implementing a net-billing and/or feed-in tariff to unlock supply from **commercial and household <u>rooftop solar</u>** generators: to secure and initial **850 MW this year**
- Supporting the utility-scale **embedded generation projects**: could introduce nearly **1 600 MW in 2023**
- Completing the first **200 MW** phase of **<u>Eskom battery energy storage</u>** roll-out
- Mopping up **70 MW** of surplus supply available from existing renewable facilities; and
- Ramping up demand-side and energy efficiency programs to secure **savings** worth about **250 MW**
- Assuming the reintroduction of **2 160MW from 3 Kusile units** (issue with unit 1 flue duct impacting the other 2 units too) (requires temporary exemption from emissions regulations for 2 year)
- Assuming the introduction of **Kusile unit 4** (gas-heater fire incident)
- Loadshedding Reduction Program: Eskom be given authority to enter into 5 – 10 year **power purchase agreements** to provide electricity in the short term, but probably not during 2023. Could include **Karpowrships** agreement(s).
- National Treasury to back Eskom to raise **R5bn in loans** from commercial banks to enable it to buy **<u>diesel for gas turnes</u>**

Source: Engineering News, 31 January 2023

Network industry failure: impact on mineral sales

Mineral Sales: year-on-year growth (%), current prices

	2021 Average	2022 YTD Average
Total Minerals	**47,7**	3,4
Gold	**34,6**	5,9
Iron Ore	**49,0**	-25,4
Platinum Group Metals	**118,4**	-18,5
Coal	**18,9**	67,2

Source: Econometrix, 3 Feb 2023

Econometrix:
- **Transnet failures** are costing the SA economy **0.5% to 1%** per annum.

Sibanye Stillwater CEO: **coal arrivals** at main export port collapsed to **30 year low** in 2022 because of Transnet's poor performance. Sharp increase in prices is boosting the sales numbers but **volumes are down.**

Minerals Council of SA CEO, on 16 Feb 2023
- **Transnet** issues are catastrophic for the mining sector.
- Could have **exported R150bn more** last year **= R27bn** more in taxes paid
- Transnet and Eskom don't have the necessary skills to run their big operations.
- SA can achieve **4 – 5% p.a**. growth rates if we unlock **private sector** into the network industries + cut red tape + continue with the reforms.

Transnet: unexpected good news on 8 Feb 2023!

Surprise! Transnet stuns by launching biggest privatisation since 1997 after bailout fails

news24 Carol Paton SHARE

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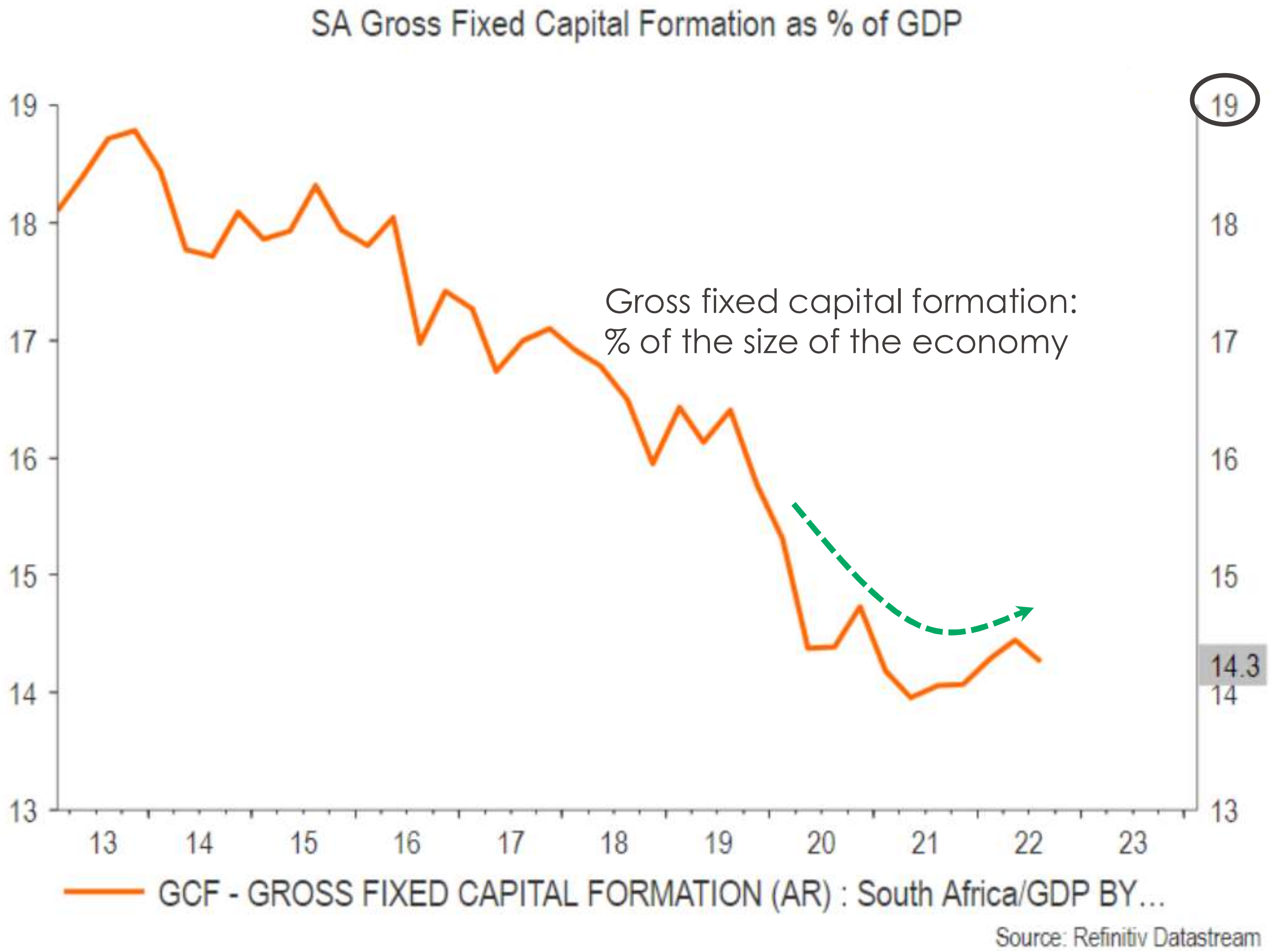
Transnet is looking for public private partnerships (PPPs) for/to:

- Help run Africa's biggest **container terminal** in KZN
- Operators for a liquefied natural gas terminal at Richards Bay
- A new port and rail line at Boegoebaai in N.C.
- Award a 20-year contract to **run and maintain** a rail line used to transport containers between **Jburg and the Durban** port
- Take up a majority stake in Transnet's leasing company
- A majority partner at the port of Ngqura in the Eastern Cape

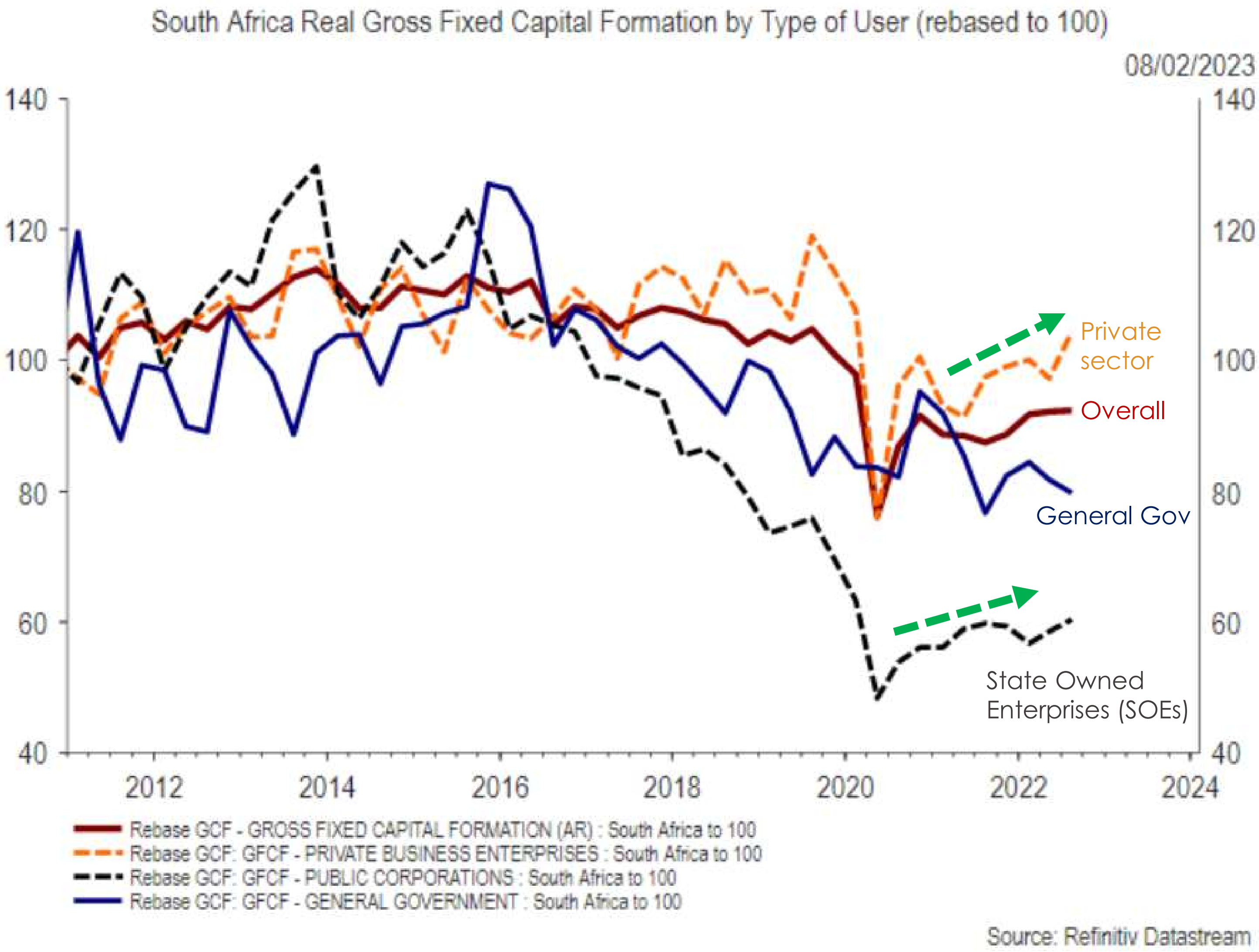
Source: Biznews.com, 9 February 2023
https://www.biznews.com/briefs/2023/02/13/transnet-taps-private-firms-run-south-african-ports-railways
https://www.biznews.com/briefs/2023/02/09/south-africas-transnet-shrink-rail-network-6500km

And… some other green shoots also appearing



NDP goal for 2030 : 30%
EM excl China : 25%

And… some other green shoots also appearing



President's investment initiatives:
To raise fixed investment spending by R1.2tr over 5 years (between 2019 and 2023).

R1.1tr in pledges received (by March 2022)

24/03/2022

2022 SOUTH AFRICA INVESTMENT CONFERENCE PLEDGES

Honourable President Cyril Ramaphosa announced that the 80 investment pledges received at the SA Investment Conference on **24 March 2022** amounted to R332 billion. With R1.14 trillion in investments to date, this translates to 95% of the initial investment mobilisation drive target of R1.2 trillion that was set out to be achieved within a five-year period.

Energy Sector

- ARE (African Rainbow Energy) – R 3 billion
- bio2watt – R 463 million
- Seraphim – R 437 million
- Polarium – R 30 million
- Scatec – R 16 billion

Automotive Sector

- Ford – R 16.4 billion
- Africa Auto Group – R 550 million
- BMW – R 800 million
- Daimler Trucks & Buses Southern Africa – R 190 million
- Formex – R 102 million
- Wheel Assemblers – R 180 million

Mining

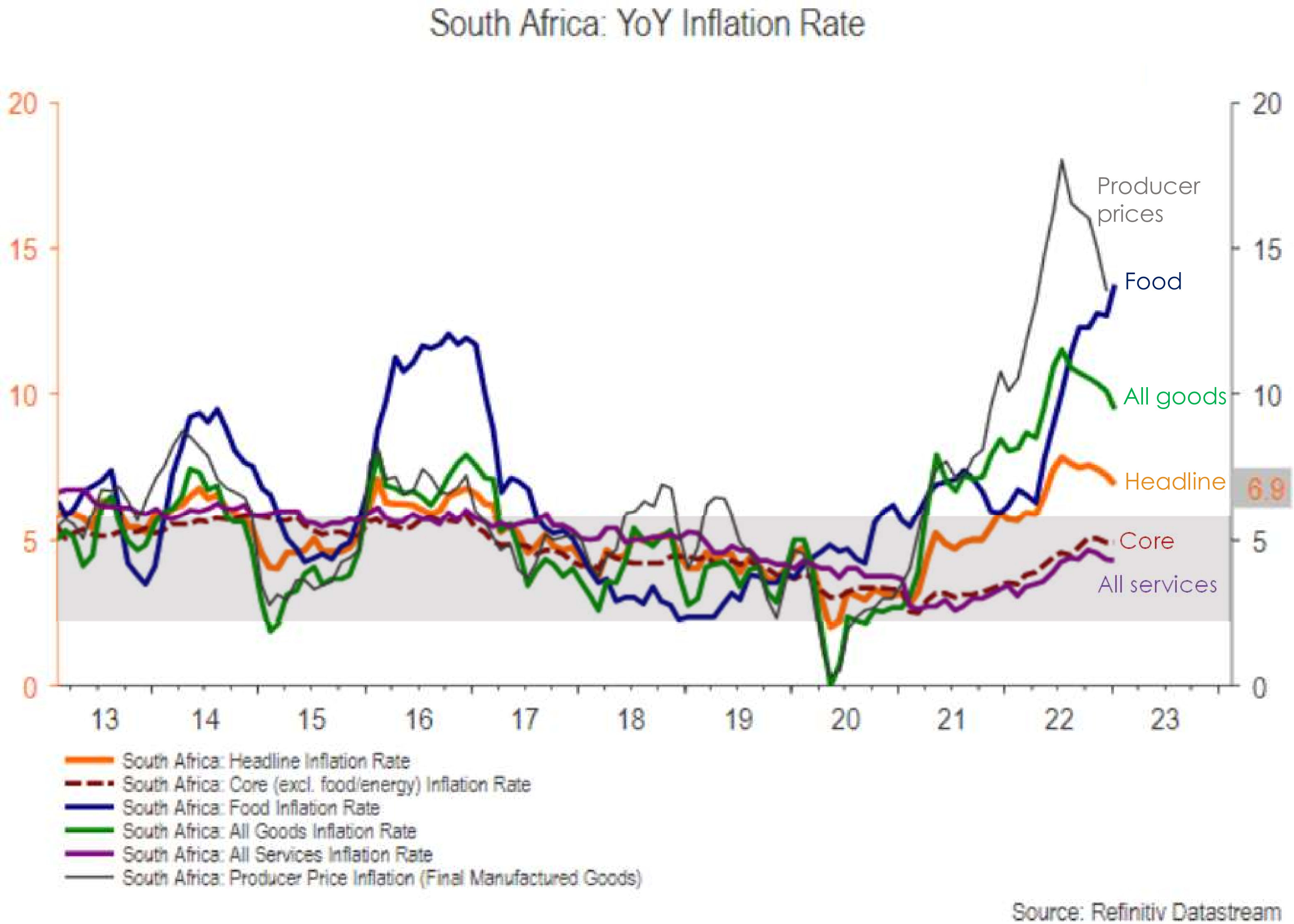
- ARM (African Rainbow Minerals) – R 11 billion
- AngloAmerican – R 10 billion
- Implats (Excellence in PGMs) – R11.8 billion
- Isondo – R 140 million
- Ivanhoe Mines – R 2.8 billion
- Sedibelo / Kell Process – R 9.4 billion
- Renergen (Future energy, today) – R 14 billion
- ARC / Kropz – R 497 million

Healthcare and Pharmaceutical Sector

- Biovac – R 2.5 billion
- aspen – R 500 million
- Cipla – R 150 million
- Pfizer – R 255 million
- BT Industrial Group – R 226 million
- IMT – R 20 million
- NantSA – R 3 billion
- Siemens – R 484 million
- Afrigen – R 652 million

https://www.sainvestmentconference.co.za/2022/03/24/2022-south-africa-investment-conference-pledges/

SA's consumer inflation rate has also peaked



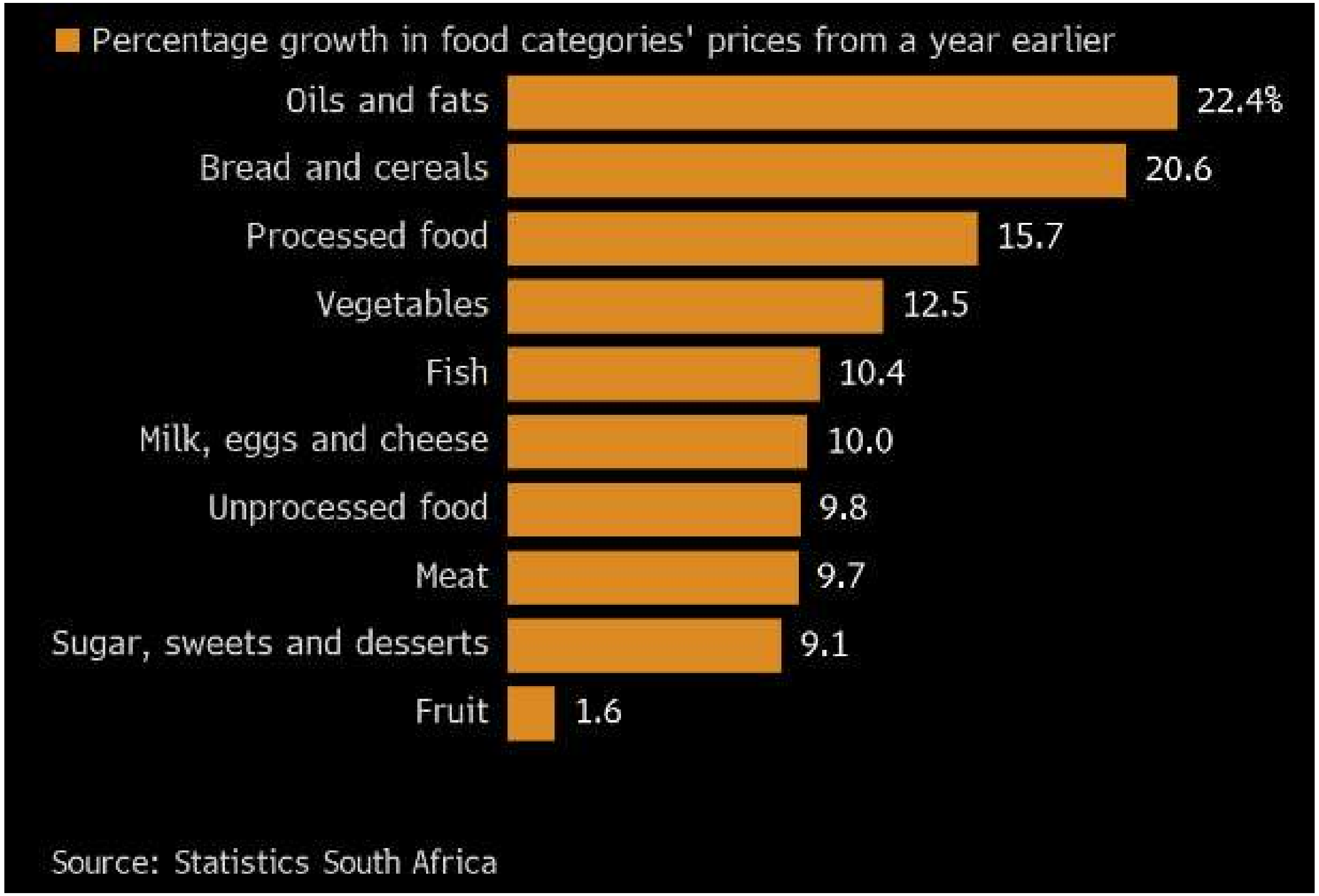
SA inflation peaked @ 7.8% in July

- Currently @ **6.9%**
- Still **outside** of SARB's range

Fuel price index: -10% mom in Jan (now +13% yoy from +23% in Dec)

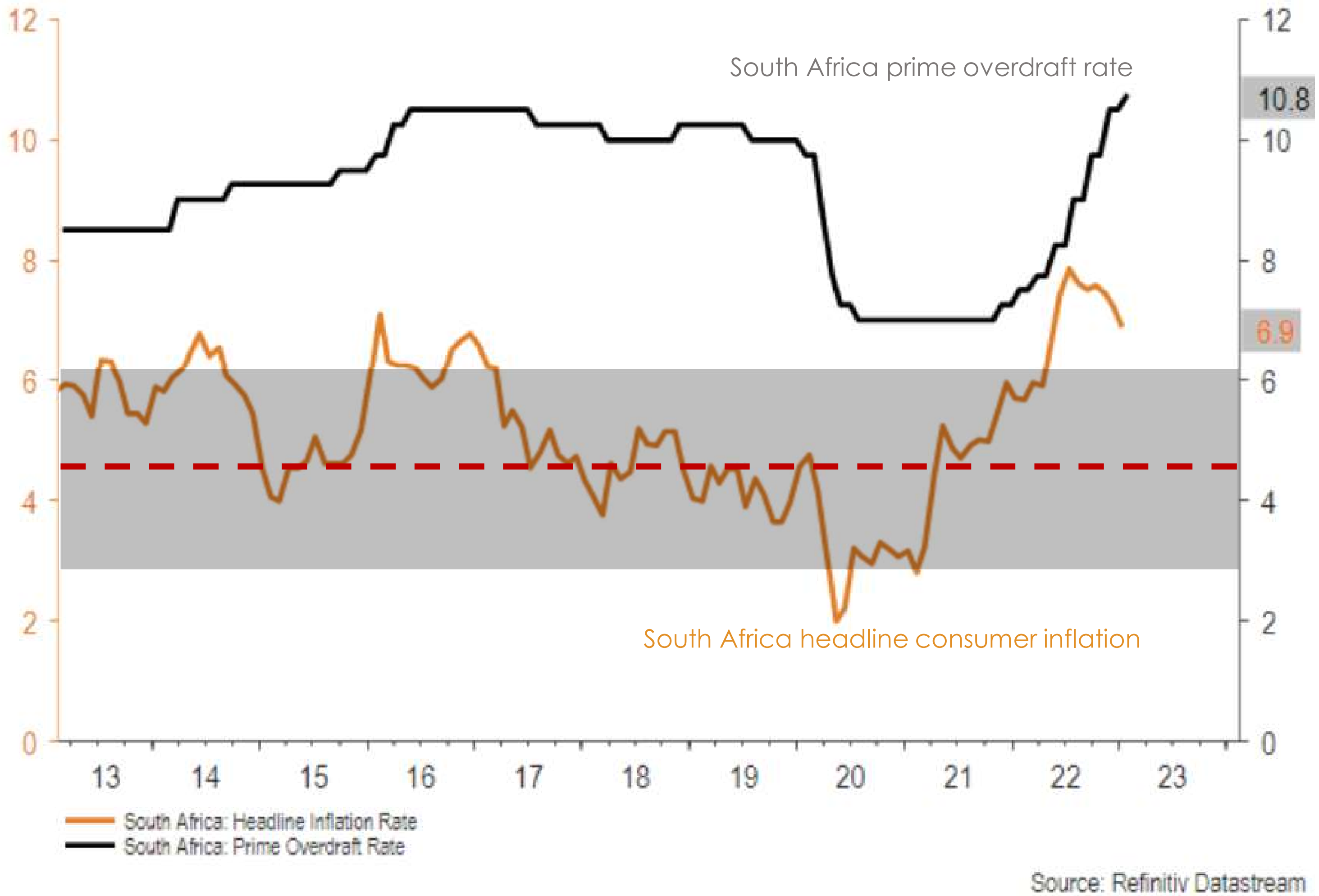
Food prices continue to rise: 13.4% (highest in 14 years)

Food prices remain sky-high in South Africa



Source: RMB/MS daily note, 16 February 2023

Are SA interest rates close to peaking?



A peak in SA interest rates depends on:

- **A peak in global interest rates**
- **The profile of the exchange rate**
- **Second-round effects… Wages …**
    - Public sector unions: 12.5%
    - Gov is offering 4.7%

Budget 2023/24: Consolidation focus, but with major risks

	SA economic growth forecast
2022	2.5%
2023	0.9%
2024	1.5%
2025	1.8%
	SA budget deficit to GDP ratio forecast
2022/23	-4.2%
2023/24	-4.0%
2024/25	-3.8%
2025/26	-3.2%

Source: Department of Finance, 22 Feb '23

The positives:

- Continued fiscal **consolidation** stance / plans
- No income & other tax **increases**
- Tax **incentives** for businesses & individuals for renewable energy investments for 1 – 2 years
- **Clarity** around Eskom debt relief:
  - Total Eskom debt responsibility : +/-R420bn
  - Government guaranteed portion : +/-R340bn
  - Government to take over : +/-R250bn

The negatives & risks:

- Possibly **over-optimistic** on SA's economic growth
- Government employee **wages**: 4.7% vs 12.5% vs 3% budgeted
- Eskom's R250bn debt relief weakens SA's **debt trajectory**
- Nothing noted about **Transnet**

Budget 2023/24: Consolidation focus, but with major risks

- **Government revenue: overshot budget by R90bn. Income growth to be lower going forward due to:**
  - Lower commodity prices
  - Lower domestic economic growth (load shedding intensification & global economic slowdown)

- **Government expenditure:**
  - Wages (budgeted previously for +/-3% increase. If 4% - 5% increase = R25bn to R30bn more in expenditure)
  - Extending the social relief for distress grant: R2.7bn per month = R33bn extra per year.
  - Further SOE bailouts/assistance
  - Interest on debt = now R1bn per day = R365bn per year!

- **Budget deficit as a % of the size of the SA economy:**
  - 2021/22 : -4.7% of size of the economy
  - 2022/23E : -4.9% (National Treasury), as at October 2022 MTBPS. Now -4.2%
  - 2023/24E : -3.9% (National Treasury), as at October 2022 MTBPTS. Now -4.0%

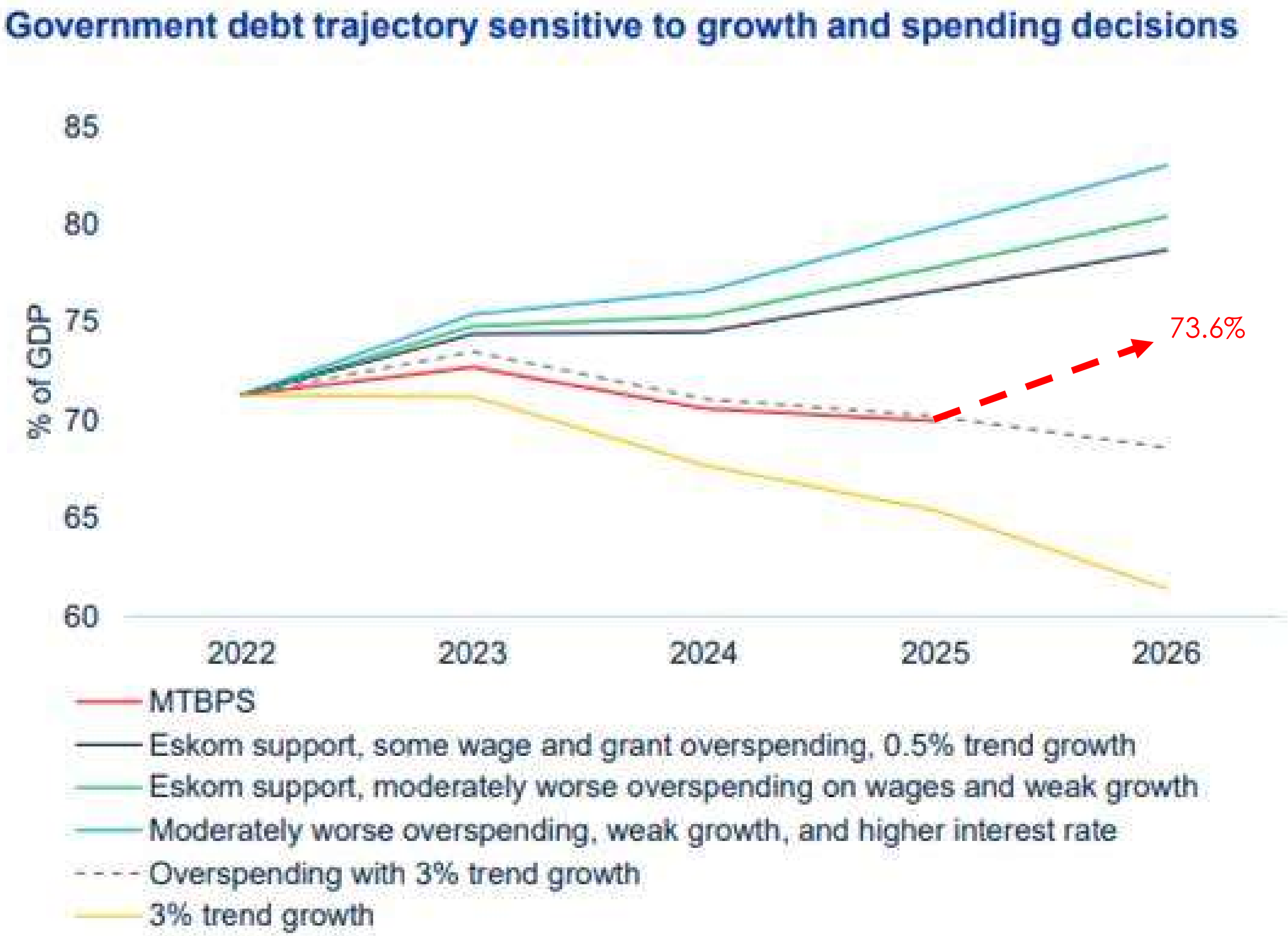
- **Small primary surplus** (income covering expenditure before interest): debt stabilization can happen earlier

- BUT… from a **cash flow** perspective: probably now as good as it gets (mining sector profits = softening as prices ease + economic slowdown to reduce tax receipts)

- **Eskom's debt**: +/- R420bn (R337bn is Government guaranteed). Fiscus is taking on R254bn of this (loan, with conditions).

- Overall **debt trajectory**: grind higher to 74% of GDP by 2025/26

Government's projected debt trajectory

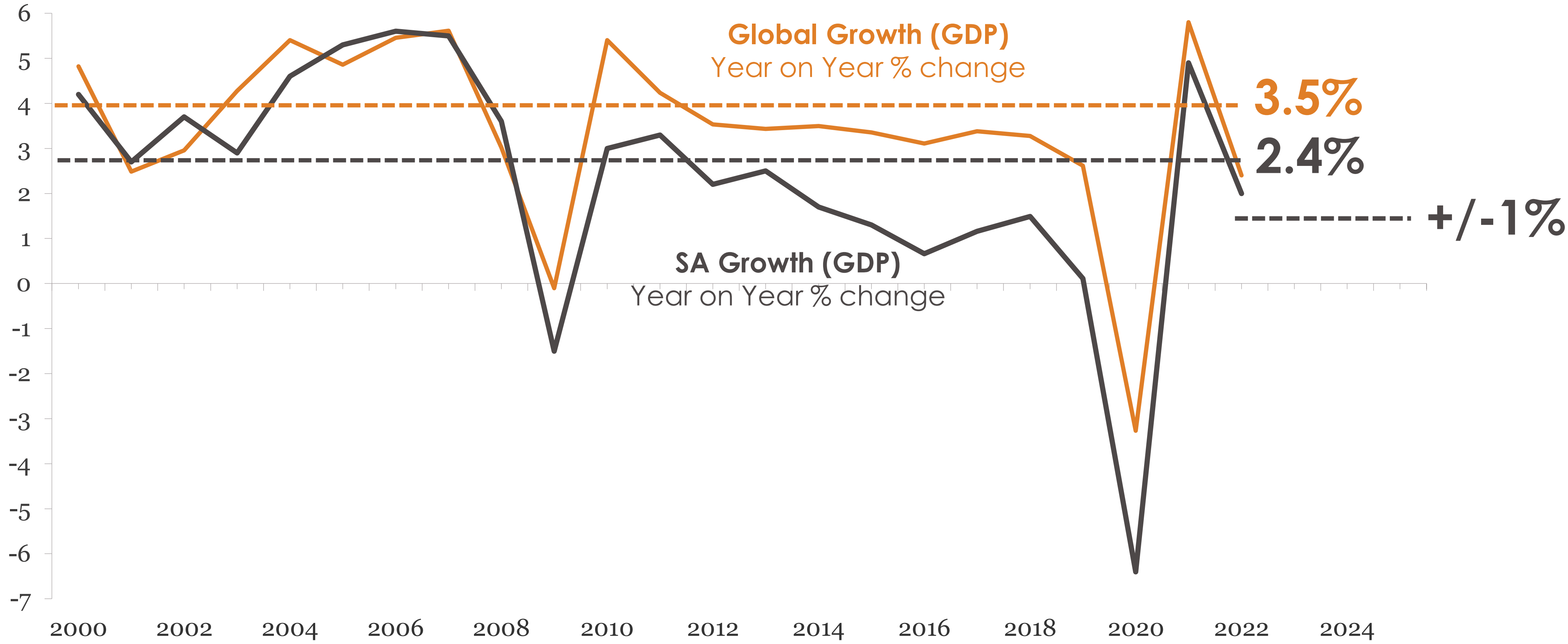


Source: SBG Securities, 21 February 2023

	Gov debt as % of size of the economy
USA	129%
Japan	260%
Germany	69%
France	113%
The UK	87%
China	77%
India	89%
Mexico	49%
Brazil	80%

Source: Tradingeconomics.com, accessed on 22 Feb '23

South Africa: economic outlook



Economic Outlook: Summary

- Expect more volatility toward **“peak” themes**
- **Below-capacity** global economic growth over next 2 - 3 years
- Global **recession** likely over next 12 - 18 months
- Inflation and interest rates to **peak** but should remain **higher than before**
- **Challenging** environment for business and consumers

30 YEARS

BEYOND REMARKABLE

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Bringing it all together:

1. Macro economic outlook
2. Asset class valuations
3. Efficient frontier
4. Outlook on the Rand

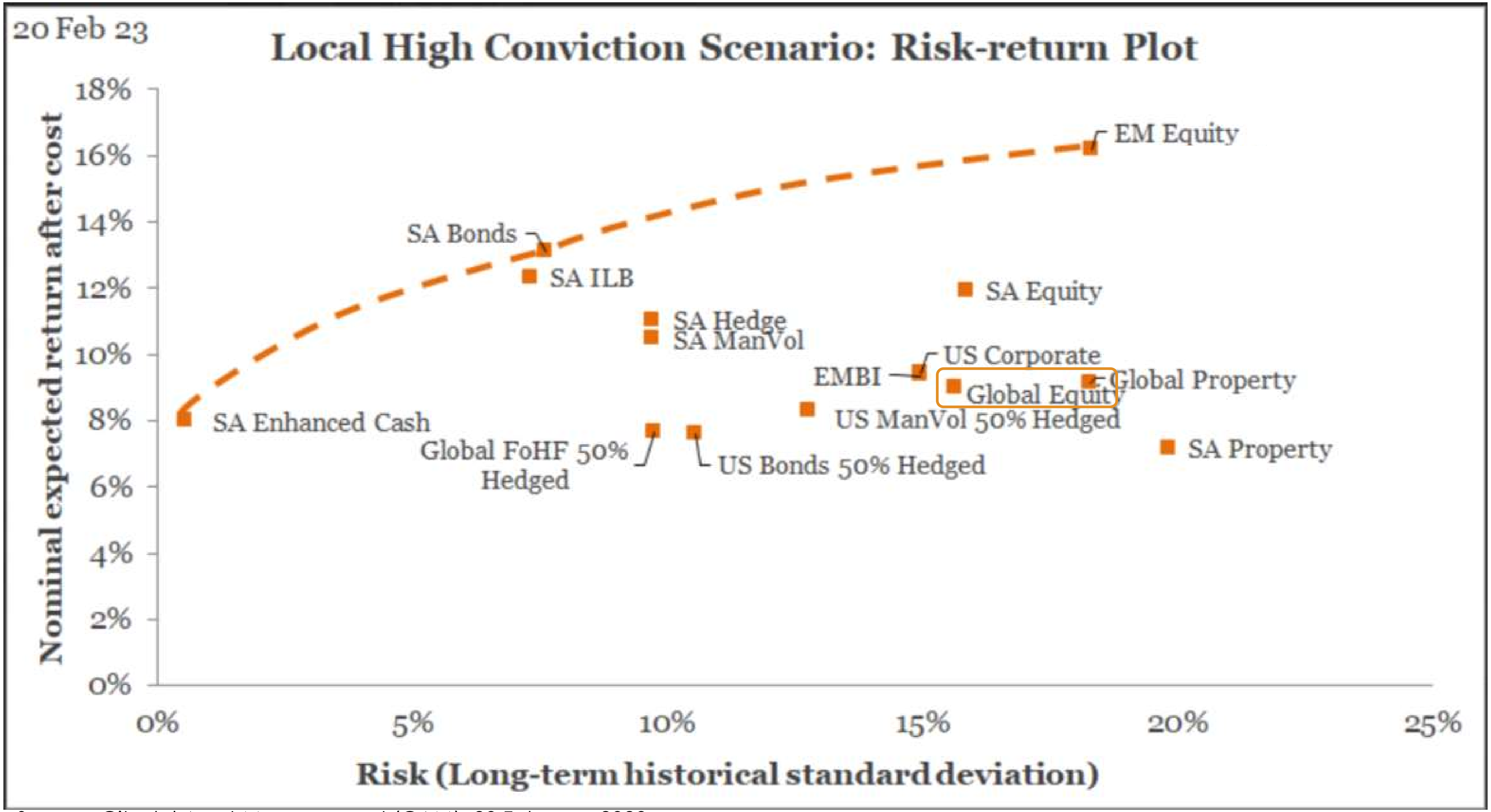
Citadel’s macro economic assumptions for next 3 years

High Conviction Assumptions: Average 3 Year or 3 Year Exit Inputs						
	GDP	Inflation	Cash	Bonds	PE Ratios	Property DPS
SA	1.4%	4.8%	6.7%	10.0%	14	6.0%
US	1.2%	2.8%	3.6%	3.0%	20	3.0%
Eurozone	0.9%	2.5%	2.2%	2.0%	16	3.0%
UK	0.8%	2.8%	3.2%	3.0%	16	3.0%
Japan	0.8%	1.2%	0.0%	0.5%	16	3.0%
China	5.0%	2.5%	1.5%	3.0%	14	
Global	2.3%	2.8%	0.0%	0.0%	17.5	3.0%

GDP GROWTH								
	Latest QoQ	Latest YoY	T+1	T+2	T+3	3Y Growth		IMF Potential Growth Rate
SA	1.6%	4.1%	1.2%	1.5%	1.5%	1.4%	Reduced to 1%	1.3%
US	3.2%	1.9%	0.9%	0.9%	1.8%	1.2%		1.8%
EUROZONE	0.3%	2.3%	0.7%	0.7%	1.4%	0.9%		1.4%
UK	-0.3%	1.9%	0.0%	0.8%	1.5%	0.7%		1.5%
CHINA		3.9%	5.5%	5.0%	4.5%	5.0%		4.9%
EM			4.2%	4.2%	4.2%	4.2%		4.4%
GLOBAL		-0.9%	2.0%	2.0%	2.7%	2.2%		2.7%

INFLATION							IMF Long-term Inflation
	Latest Core	Latest CPI	T+1	T+2	T+3	3Y CPI	
SA	5.0%	7.4%	5.5%	4.5%	4.5%	4.8%	4.5%
US	4.7%	7.1%	3.5%	2.5%	2.5%	2.8%	2.3%
EUROZONE	5.2%	9.2%	3.5%	2.0%	2.0%	2.5%	1.7%
UK	6.3%	10.7%	4.5%	2.0%	2.0%	2.8%	2.0%
JAPAN	1.5%	3.8%	1.5%	1.0%	1.0%	1.2%	1.0%
CHINA	0.7%	1.8%	2.5%	2.5%	2.5%	2.5%	2.0%

Citadel's latest asset class valuation signals



Source: Citadel Asset Management (CAM), 20 February 2023

Citadel's latest asset class valuation signals

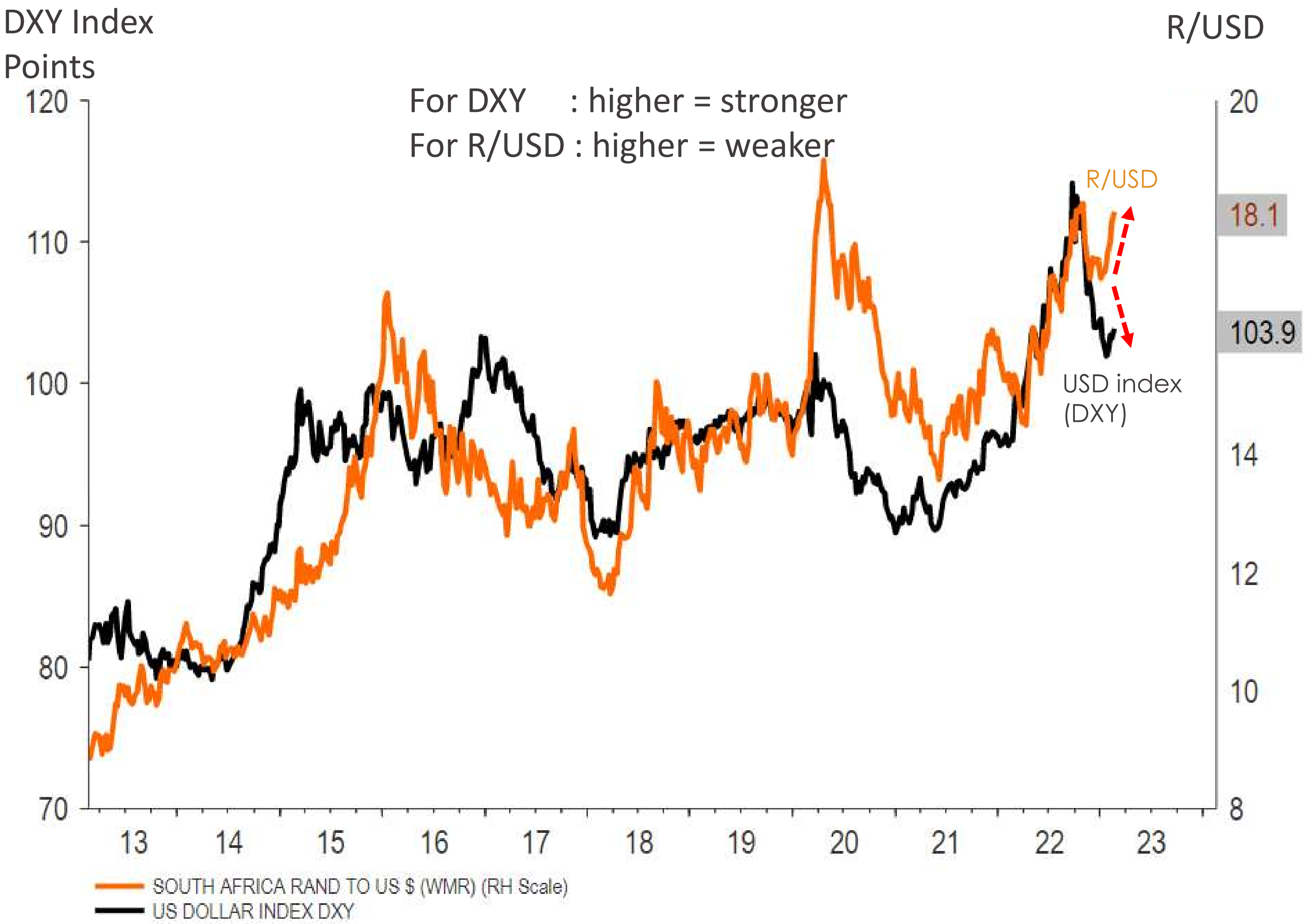
	Below Neutral	Neutral	Above Neutral
SA Enhanced Cash			X
SA Government Bonds			X
SA Alternatives		X	
SA Listed Property	X		
SA Equity		X	
US Enhanced Cash		X	
US Government Bonds		X	
US Corporate Bonds			X
US High Yield Bonds		X	
EM US$ Bonds		X	
Global Alternatives		X	
Global Listed Property	X		
Global Equity	X		
US Equity	X		
EU Equity		X	
UK Equity		X	
Japan Equity	X		
EM Equity			X

Source: Citadel Asset Management (CAM), 20 February 2023

Neutral outlook, over long term cycles:

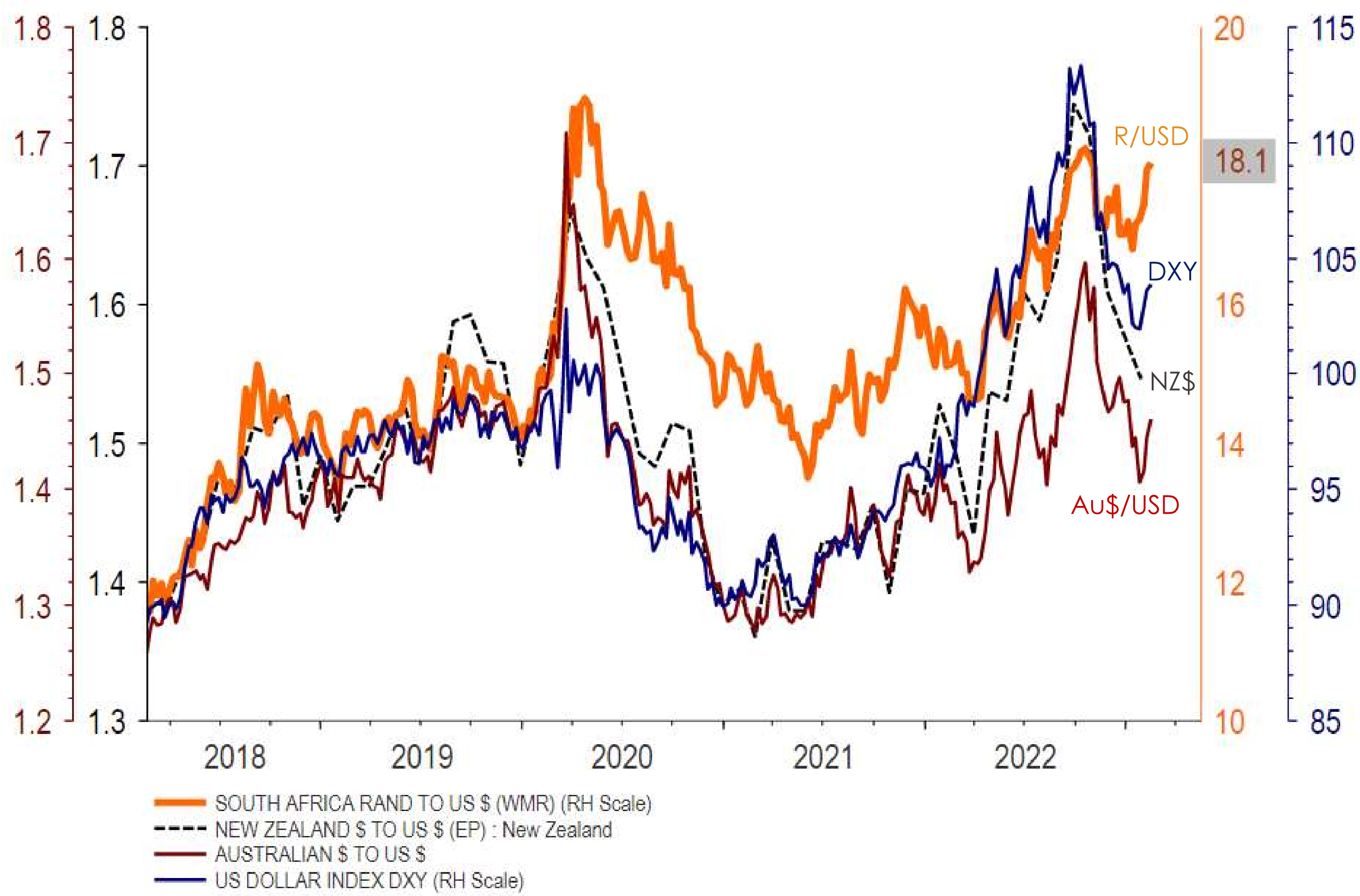
Cash : +/- 1% p.a. above inflation
Bonds : +/- 3% p.a. above inflation
Equity : +/- 6% p.a. above inflation
Property : +/- 6% p.a. above inflation

The Rand/USD & USD index ("DXY")



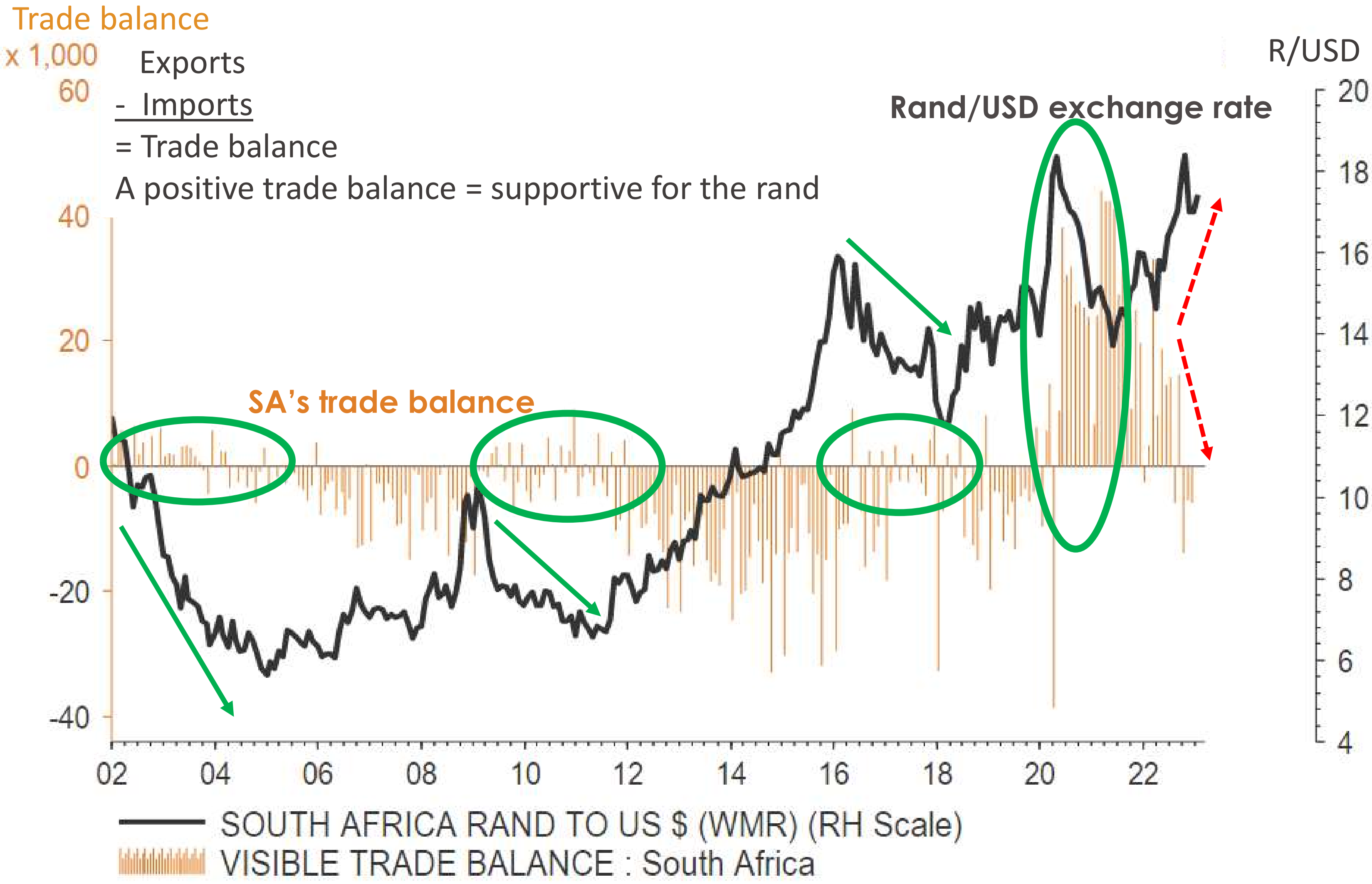
Source: Refinitiv Datastream

The Rand/USD & commodity exporters



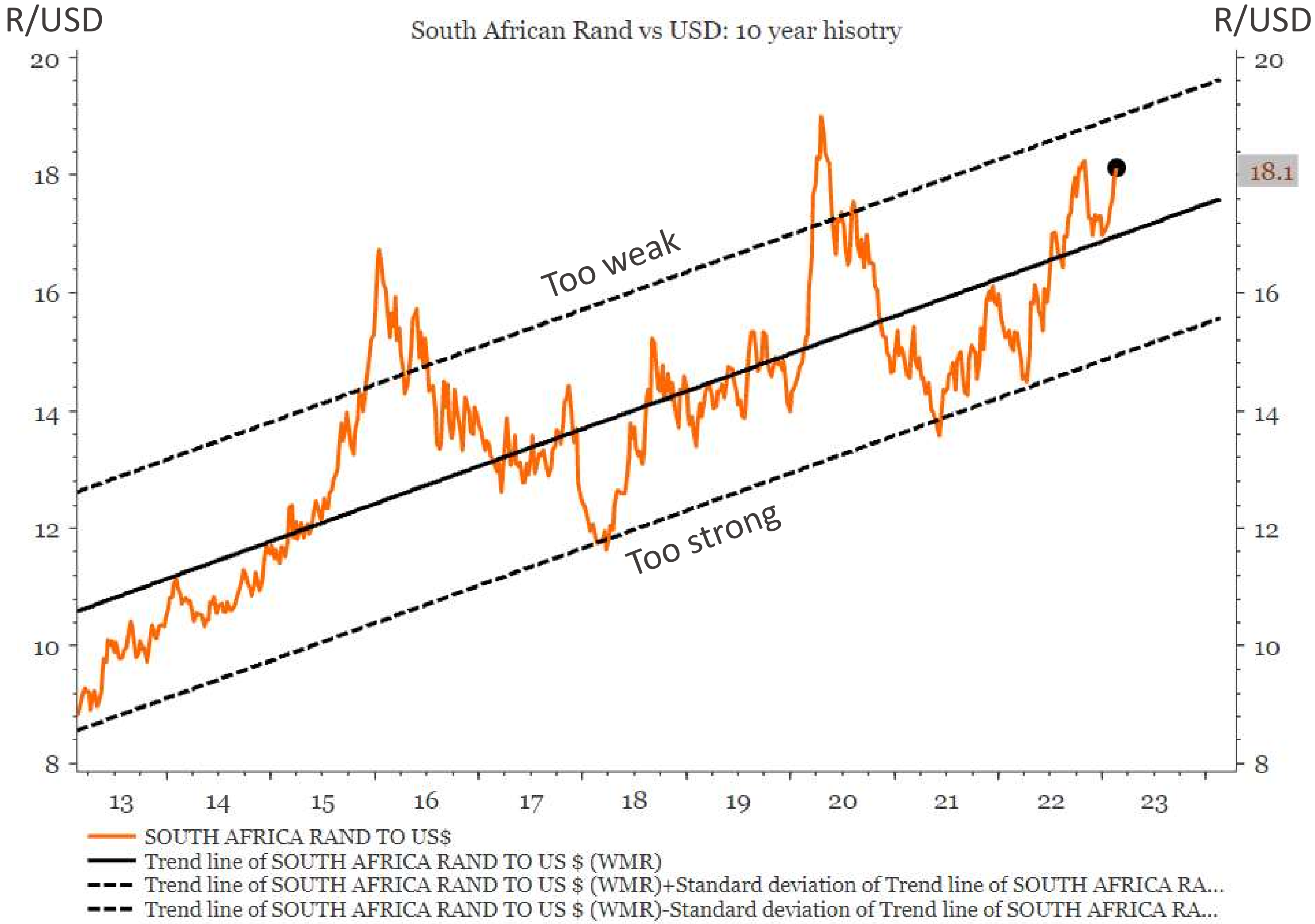
Source: Refinitiv Datastream

The Rand/USD & trade balance



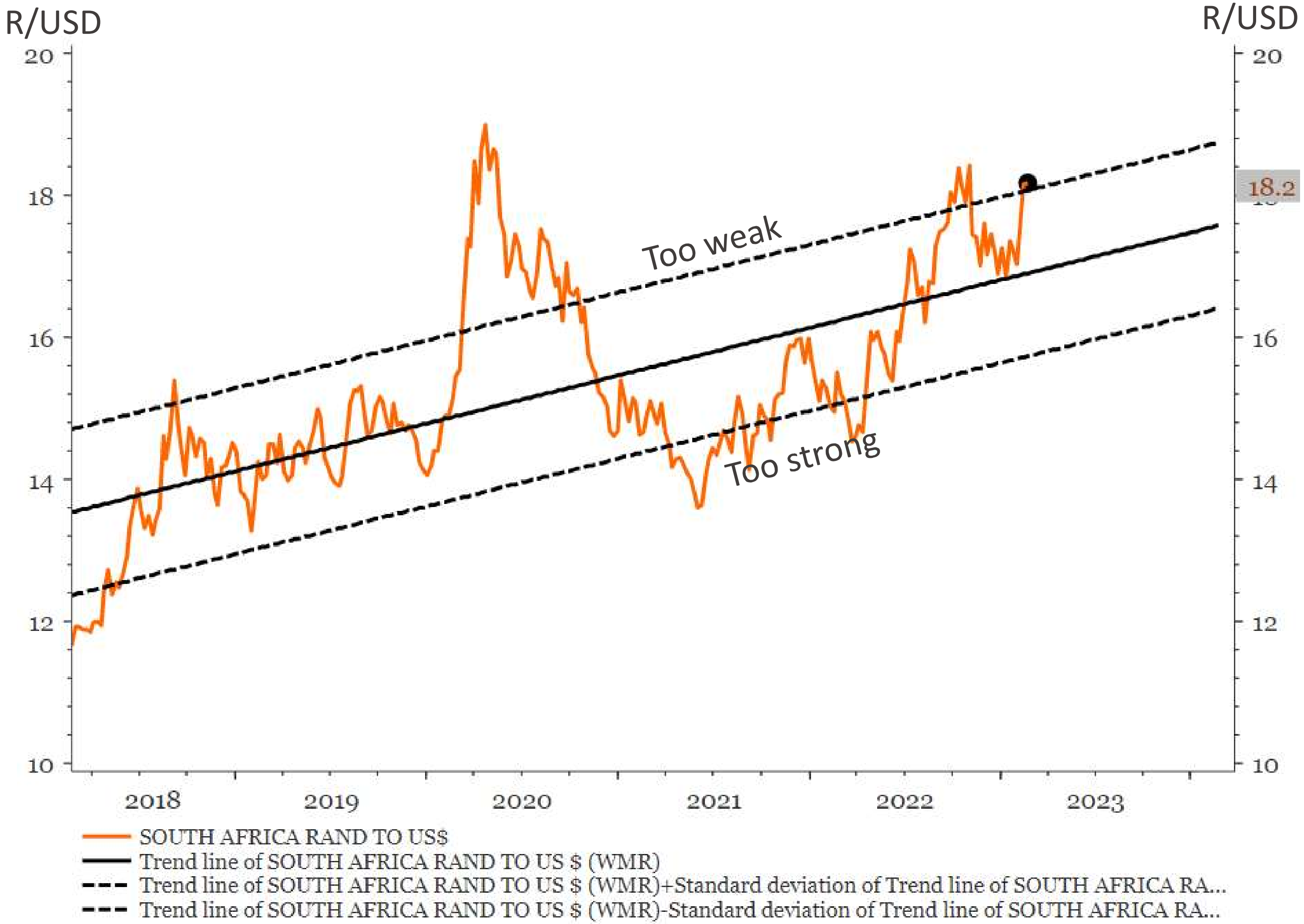
Source: Refinitiv Datastream

The Rand/USD vs its own history (10 years)



Source: Refinitiv Datastream

The Rand/USD vs its own history (5 years)



Source: Refinitiv Datastream

Overall synopsis

- Financial markets are reflecting a lot of uncertainty.
- Expect more volatility towards the “peak” themes.
- Crucial to have a cogent & robust investment philosophy & process.
- Vital to be willing & able to be nimble in both views and positioning is vital.
- Given our prudent economic views, we are currently underweight risk assets: diversification & defensive strategies = key for wealth preservation & growth.
- Most importantly, you need excellent financial advice in these uncertain times.
  - Important Citadel value-add: we stand between your emotions & your money
  - Blending expert investment management skills with expert financial planning advice to provide optimal client solutions
  - If you are young and accumulating & you need a financial plan (Ilse & Cornè)
  - If you are retired and draw from your portfolio, stick to your financial plan & cash flow discipline:

Citadel client portfolio construction framework

Sleep well

Stable
(in the harbour)

- 2 years' cash flow needs
- Very little volatility
- Some risk of not beating Inflation

Eat well

Prudent
(not too far outside the harbour)

- 4 - 6 years' cash flows
- Little overlap with Growth
- Shock absorbers
- Some volatility
- Beating inflation

Live well

Growth
(in the rough open seas)

- Only use it >8 years from now
- Proper capital growth
- Time in the market. Not trying to timing the market
- More volatile
- Very low risk of not beating inflation

Source: Citadel Asset Management


"To acquire wealth is difficult,
to preserve it more difficult,
but
to spend it wisely is most difficult of all."
Edward Day: 55th United States Postmaster General
CITADEL
WEALTH MANAGEMENT
30 YEARS BEYOND REMARKABLE


Thank You
Yolanda Naudè
yolandan@citadel.co.za
CITADEL
WEALTH MANAGEMENT
30
YEARS BEYOND REMARKABLE


"Nothing too good or too bad stays that way forever,
because great times
plant the seeds of their own destruction
through complacency and leverage,
and bad times
plant the seeds of their own turnaround
through opportunity and panic-driven problem-solving."
Morgan Housel article
https://www.linkedin.com/pulse/seeds-our-own-destruction-elliott-orsillo-cfa
CITADEL
WEALTH MANAGEMENT
30
YEARS BEYOND REMARKABLE

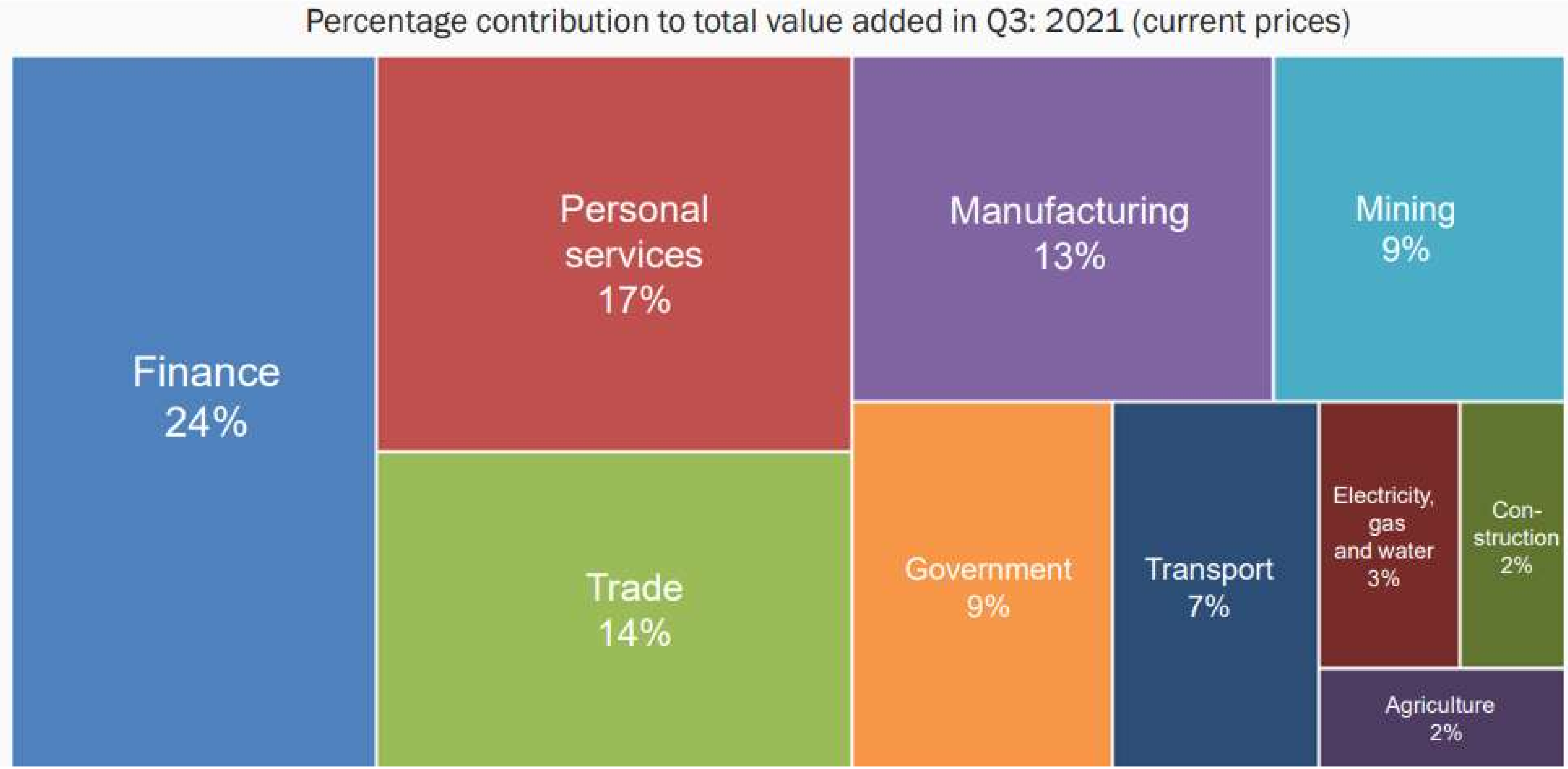
FATF: Grey-listing?

- FATF = **Financial Action Task Force**, established in 1989
- Focus: combat **money laundering** & illicit traffic in **narcotic drugs** & psychotherapy substances
- In 2001: FATF mandate expanded to include money laundering to finance **terrorism** & **weapons** of mass destruction
- FATF has **37 member** countries, including South Africa (we joined in 2003)
- These 37 member countries = +/- **90%** of the size of the global economy
- All the **G20** countries (excluding Indonesia) are members
- FATF's framework covers **40 recommendations**, which constitute best practice to combat money laundering in particular, with specific focus on **effectiveness of implementation**
  - Most recent assessment of South Africa was done in Nov 2019 & report published in Oct 2021
  - **SA failed to meet 20 of the 40 FATF recommendations**
  - SA failed in **all 11 effectiveness measures** (we have excellent laws but fail to enforce it)
- FATF **black-list** = countries which make **no effort** to comply with its guidelines: N.Korea & Iran
- FATF **grey-list** = countries which are **actively cooperating** with FATF to eliminate deficiencies
  - 23 countries currently on the grey list, but only 1 member of FATF (Turkey)
  - Nine of the 23 countries on the black-list are in Africa
  - Grey-listing does not need to be permanent: Mauritius, Pakistan, Nicaragua recently removed
- **Possible impact of grey-listing**:
  - Does not prohibit inward capital movement
  - But greater compliance costs on financial institutions…more scrutiny…enhanced due diligence etc.

Q4-2022 earnings growth (S&P 500)

Sector (GICS)	Reported	Sales Growth	Earnings Growth
11) All Securities	407 / 500	5.51%	-1.89%
12) > Energy	14 / 23	14.73%	64.46%
13) > Materials	26 / 29	-5.63%	-22.38%
14) > Industrials	62 / 70	10.79%	39.37%
15) > Consumer Discretionary	36 / 56	13.53%	22.02%
16) > Consumer Staples	24 / 33	5.95%	-3.58%
17) > Health Care	54 / 64	4.77%	-0.72%
18) > Financials	66 / 67	2.46%	-12.92%
19) > Information Technology	65 / 76	-1.67%	-8.95%
20) > Communication Services	19 / 22	-2.09%	-25.60%
21) > Utilities	19 / 30	16.63%	-16.19%
22) > Real Estate	22 / 30	9.26%	10.76%

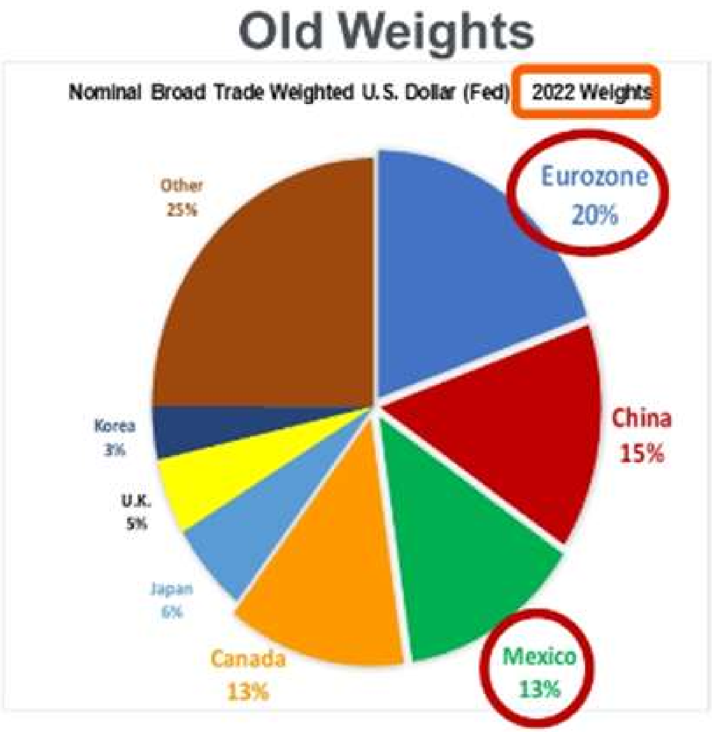
SA ECONOMY COMPOSITION

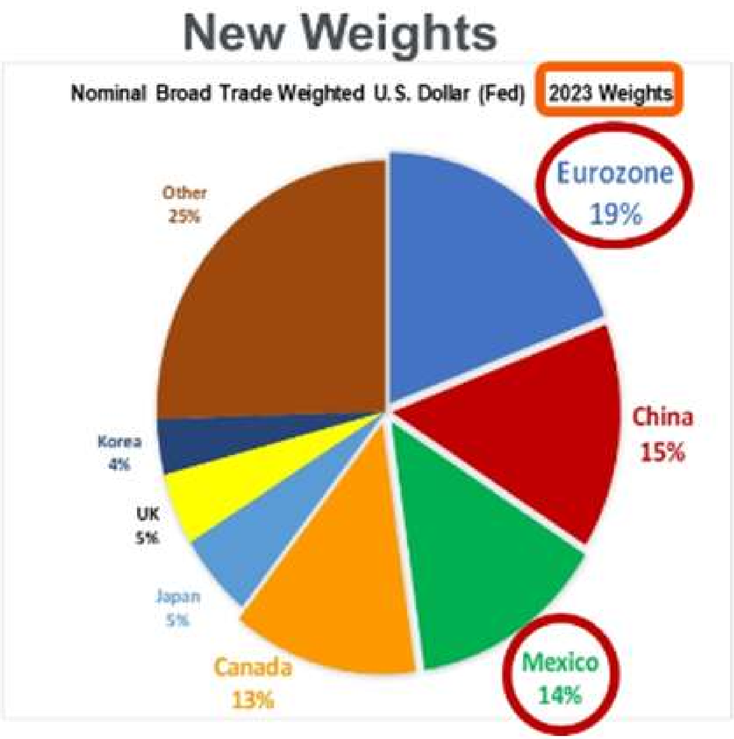


Source: Stats SA

COMPOSITION OF THE DXY

Here are the major currency weights in the Fed's trade weighted dollar index. Note the y/y decline in the euro's weight vs. the y/y increase in the Mexican peso's weight.





Source: Piper Sandler report, 21 Feb 2023

Thank you

Yolanda Naudè
YolandaN@Citadel.co.za
Tel: 083 297 4702

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