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Economic Commentary

Truffle Asset Management

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US stays strong, for now

The US economy remains resilient, supported by consumer, government and corporate spending. The main risk to this outlook continues to be elevated hyperscaler capex, as the market looks for clear evidence of a return on the enormous investment being made in AI.

Hyperscaler capex: The debate continues

Concerns around hyperscaler capex have centred on three main areas:

- An uncertain return outlook on an already large and still-growing capex programme.
- Commoditisation at the large language model (LLM) layer, as cheaper open-weight models gain market share, while hyperscalers remain predominantly tied to Western closed-model providers.
- Rising credit risk, as the funding mix for the capex shifts from internally generated cash flow towards debt.

Over the past month, these concerns have started to ease. Google, Microsoft and Amazon all reported accelerating cloud growth for Q2, while Google and Amazon also delivered expanding cloud margins. This margin expansion, together with reports of materially higher compute rental rates for newer chips, are promising signals for an improving return on investment.

Faster cloud revenue growth also suggests cheaper open-weight models are stimulating demand rather than replacing it: token usage is rising faster than per-token prices are falling, so aggregate compute spend continues to grow. If sustained, this could be an early sign that value is beginning to accrue to the infrastructure and cloud layer, a condition we identified last month as necessary for a more balanced AI value chain.

However, relative to historical levels and previous technology capex booms, the current capex build-out remains large and ultimately poses a risk to growth. This risk is being deferred as capex estimates continue to be revised higher. The eventual profitability of LLMs remains an open question and a collapse amongst the weaker players could cause meaningful supply chain disruption.

For now, however, the capex theme looks somewhat more supportive. Earnings upgrades continue across the technology sector. EPS growth for the median company in the mid-teens is healthy and broad based, although this is a coincident rather than a leading indicator.

Valuations are stretched relative to real rates

In absolute terms, valuations are not excessive. Relative to real rates, however, the equity risk premium is compressing. The pressure that higher bond yields place on mortgage rates and the fiscus leads us to expect the recent upward drift of long bond rates to pause, most likely through a more hawkish stance from the Fed at its next meeting. Over the medium term, persistently high budget deficits and waning demand for US assets should maintain upward pressure on bond yields and downward pressure on the dollar.

South Africa: growth still lacklustre

Economic growth in South Africa remains subdued. The labour market continues to soften while worsening consumer confidence is reflected in low single digit retail sales growth. However, SA trade and fiscal balances remain strong and are currently outperforming expectations while progress on Transnet reform continues. These factors may be sufficient to support a further credit upgrade which would in turn be supportive of the bond market.

The sluggish local growth outlook remains a headwind for the earnings outlook of domestically exposed equities, although valuations have already been marked down accordingly. Where earnings have proved more resilient, for example financials, valuations are closer to long-run averages.

We maintain meaningful exposure to high quality offshore-based companies trading at compelling valuations such as Prosus and Bidcorp. We also continue to favour diversified miners over precious metal miners, reflecting our relative preference for copper over precious-metal prices.

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