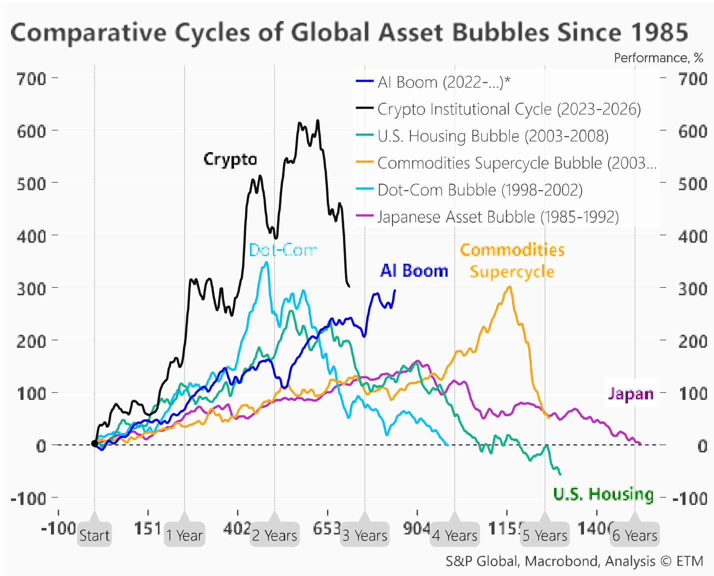
Key points

- AI earnings and spending remain the dominant swing factor for markets and EM FX. Strong Q2 tech results pushed the S&P 500 to fresh records, though the rally is uneven, with unease over AI capex weighing on names like SpaceX. Nvidia's August 26 report is the key test of whether valuations are justified. The VIX sits below its long-run average despite stretched valuations, sticky inflation, fiscal deficits, Fed uncertainty and geopolitical risk, and rising demand for downside hedges suggests calm is fragile.
- The usual VIX-to-EM-asset link, chiefly via bonds, still holds even though it broke down twice over 18 months. Both spikes were US shocks, notably April 2025's tariff shock, and a weaker dollar eased EM debt costs while improved EM fundamentals cushioned contagion. Domestically, compressed US-SA 10-year spreads, near 19-year lows, reduce SA bonds' carry appeal, weakening a pillar of ZAR support. ZAR performance, therefore, remains tied to global risk appetite, US rates, and equity volatility, rather than to domestic drivers alone.

BASELINE VIEW: The VIX-EM FX relationship confirms that the ZAR's recent recovery has largely tracked offshore risk sentiment, and the current convergence between the VIX and EM FX performance suggests the ZAR has now completed the bulk of its short-term move. This implies there is limited room for further appreciation from here. Going forward, ZAR performance will depend in part on how US equities and the VIX behave and on how US rates and USD dynamics evolve. The ZAR retains some vulnerability, suggesting importers should identify with the value which exists.

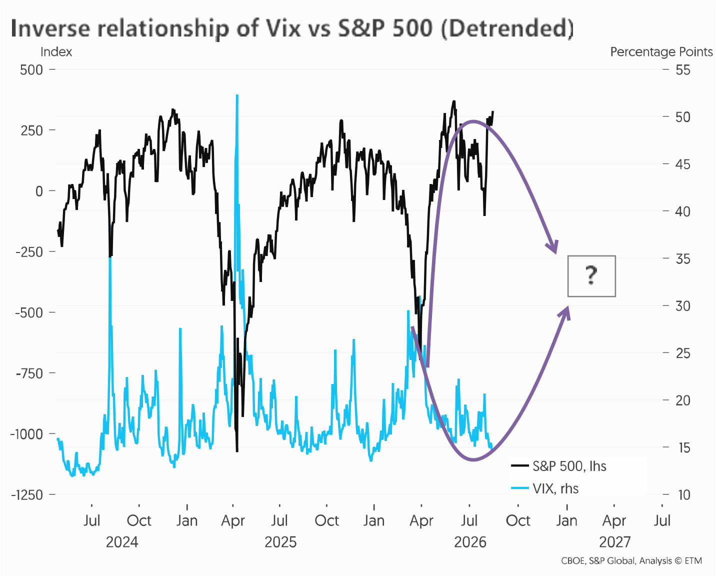
AI valuations still central to the performance of EM FX



In a world so heavily dominated by AI company spend, capital raising and investment, it is natural for investors to look to these companies with interest. Much of that interest has revolved around whether the market is justified in its current valuations or whether 'this time will be different' given that many of these companies are income-generating, the leverage being applied is not unsustainable, and the productivity gains that they could generate are difficult to quantify.

Furthermore, AI earnings have driven the broader market this month. Big tech's Q2 results have generally beaten expectations, pushing the S&P 500 to fresh records and its strongest week since April, helped by a cooler CPI print. But the rally is uneven: even companies posting strong growth, like SpaceX, which is up 92% in revenue, have seen their share prices fall as investors grow wary of runaway AI capital spending. Nvidia's August 26 report is now the key catalyst everyone's watching, seen as a referendum on whether AI infrastructure spending justifies current valuations, or whether the "AI trade" is due for a reset.

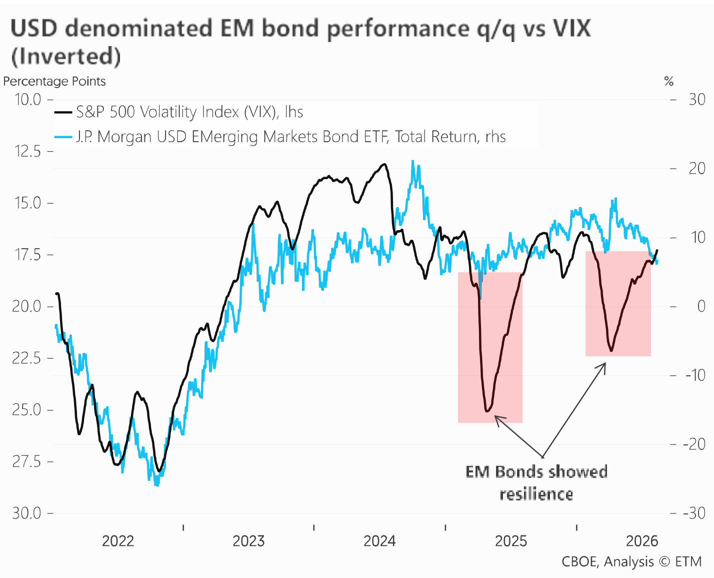
VIX remains a useful barometer of market sentiment



Any speculation about valuations is tied to debate about associated markets. A prominent one is the VIX as a hedge against any equity market volatility. The more concerned investors become about the prospects of a major correction, even if only in the short term, the greater the demand for a hedge against that volatility, and the higher the VIX. It is therefore notable that the VIX is trading at subdued levels.

Spot VIX near ~17 (recently sub-11 in April) sits well below its long-run average even as valuations stretch to record highs and macro crosswinds build. The disconnect itself is telling. Investors are "quietly" buying crash protection even as the headline gauge remains calm, a classic sign of rising skew, in which downside puts are bid up faster than the index itself. That asymmetry often precedes vol spikes, since low realised volatility breeds complacent positioning (leverage) that's fragile to shocks. Sticky inflation, fiscal deficit concerns, Fed policy uncertainty, and geopolitical flashpoints are all plausible catalysts, none of which priced meaningfully into spot VIX today.

VIX matters for bonds

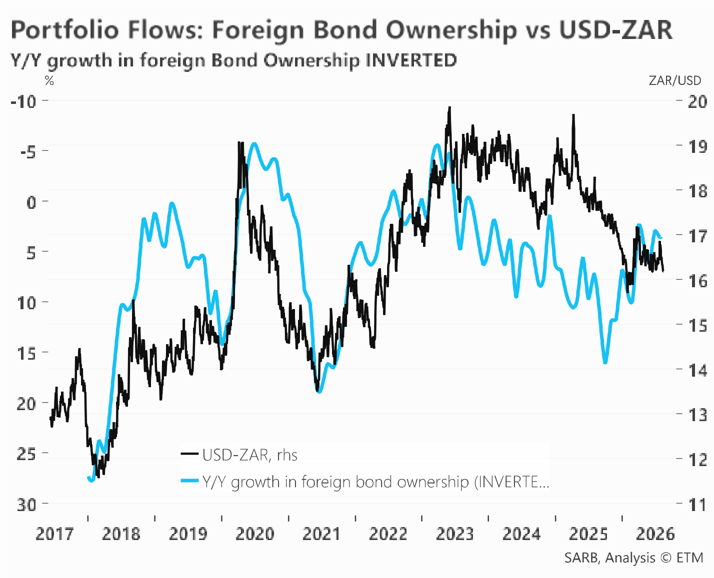


Historically, there has been a relationship between the VIX and emerging market assets. The market that is often the most influential in driving portfolio flows is the bond market. It is therefore important to pay attention to this relationship, although one should address the two elephants in the room: the phases of divergence that manifested over the past 18 months.

The breakdown likely reflects that both VIX spikes were US/developed-market-centric shocks, and not EM credit events. The first (April 2025) coincided with the US tariff shock, which hit US equities and sent the US dollar lower rather than sparking EM stress; a weaker US dollar eases servicing costs for USD-denominated EM debt.

EM fundamentals (reserves, current accounts, fiscal discipline) had also structurally improved into 2025–26, reducing typical "risk-off contagion." With capital rotating away from expensive US assets, EM debt likely benefited from diversification inflows, even as US volatility spiked, temporarily decoupling the traditional inverse relationship. The point is that, logically, the relationship still holds and should be carefully monitored as a guide to portfolio-related pressures.

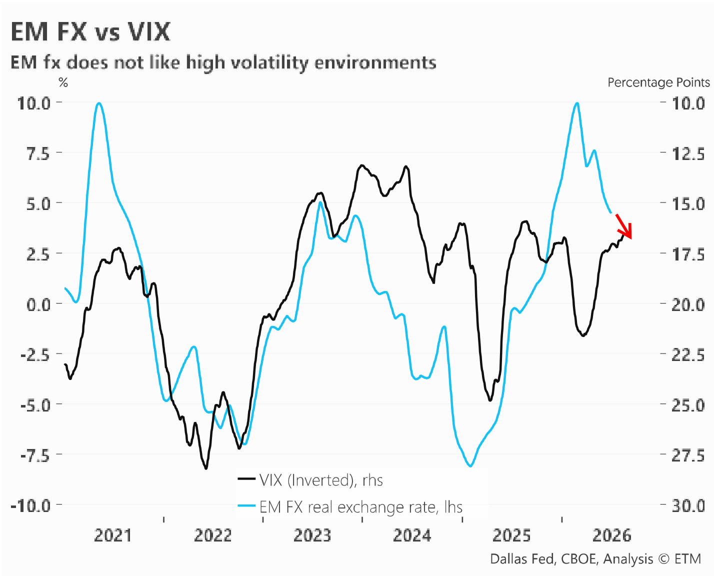
Bonds matter for ZAR



The global forces impacting portfolio flows more broadly will find expression in SA markets. The domestic bond market pays attention to the performance and behaviour of US Treasuries, as they offer a window into the carry attractiveness of SA bonds relative to US Treasuries. The compression of yields between the US 10yr and the SA 10yr and 19yr lows is a significant development and will, to some degree, weigh on the performance of SA's bond market.

The less attractive SA's bond market is, the less support it provides for the ZAR. It therefore follows that major geopolitical events, and their impact on risk appetite, inflation, central bank response functions, and financial markets, will heavily influence ZAR performance. The purpose of today's article is to paint a picture of the causality between what happens in US stock markets and the implications this holds for FX markets and the ZAR.

EM FX is justified in trading where it is



This evidence is corroborated by the accompanying chart, which shows the relationship between the VIX and emerging-market FX performance. Given the bond market's causal relationship with the US equity market and the VIX, it follows that there should be a relationship between EM FX and the VIX, and this data confirms that.

What is particularly interesting about this chart is that it also explains where the ZAR, and indeed other emerging market FX currencies, have drawn their resilience. The chart suggests that the recent appreciation in emerging market FX and the ZAR is not out of kilter with offshore market forces, although the imperative to recover is ending.

The convergence of the blue and the black lines suggests that EM FX is just about at the right level, suggesting that significant further emerging market FX appreciation might be

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