Discovery Global Multi-Asset Fund

Market background

After a challenging first quarter, there was little respite for markets during the second quarter with broad-based declines across assets driven by a number of factors. This included inflation, which continued to prove far more persistent than consensus expectations. These dramatic beats drove the expected path of tightening by central banks around the world sharply higher. As the quarter progressed, there was a growing fear that central banks' hopes for a 'soft landing' were misplaced and tighter monetary policy was increasingly likely to cause a recession thanks to weak economic data, uncertain forward guidance, and the threat of a Russian gas cut off in Europe. The other major story impacting markets during the quarter was the continued spread of covid in China, their strict lockdown response, and the downstream impacts on supply chains and markets.

Growing fears about a recession saw global equities decline significantly. US equities led the declines and suffered their second worst quarterly performance since the GFC turmoil in Q4 2008 (-16%). This was largely attributed to mega-cap tech stocks which were worst hit, in part due to rising discount rates that negatively impacted valuations across the sector. Chinese equities were the exception, ending the quarter in positive territory having put in stronger performance after an improvement in China's PMIs in June as covid restrictions eased, helped further by the backdrop of policy easing. Credit was not immune from volatility; spreads at one point widened to levels not seen since March 2020 as investors began to focus on downside risk with respect to credit risk, with European bonds underperforming those in the US. Elsewhere within fixed income, growth concerns together with a strong US dollar proved to be headwinds for emerging market debt.

With markets expecting tighter monetary policy, Defensive assets also sold off across the board with sovereign bonds building on their losses from Q1. Investment grade corporate bonds were also negatively impacted by a move in rates and prices fell in both the US and Europe. The US dollar was the best performing of the G10 currencies in the second quarter as it became clear that the Fed would tighten more aggressively than the market initially expected.

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Performance review

For the quarter, the Fund delivered a positive absolute return and outperformed the benchmark.

The largest contributor to relative returns was asset allocation, driven by an overweight to cash, with underweights in both equity and fixed income. Fixed Income selection was a detractor to relative performance due to weakness in select Emerging Market Debt holdings and positions in New Zealand government bonds, all of which underperformed.

Portfolio activity

Over the period we made a number of additions to the equity allocation, taking advantage of opportunities that had emerged as a function of volatility. We added positions to SSAB and Grupo Mexico to gain cyclical exposure to areas with structural growth tailwinds from the energy transition with their commodities increasingly required to meet net-zero goals.

We also added to our fixed income exposure, reducing the underweight relative to the benchmark given the broad repricing in yields, and increasing concerns over the weakening global growth outlook, which may also cap future inflation pressures. As a result, positions were added in US, and Germany, as well as areas which face structural headwinds such as the UK, where housing markets are stretched placing impediment on central banks tightening policy.

Outlook and strategy

Central banks, and the Federal Reserve in particular, have sighted that lowering the rate of inflation is their primary objective at present. This has and continues to present a headwind to financial markets and investors should question areas where the level of valuations remains elevated against a backdrop of much tighter liquidity conditions and a now moderating growth impulse. We see financial markets remaining volatile in the coming quarters as a result. The one area where policy dynamics are moving in the opposite direction is in China, where authorities were notably ahead in withdrawing policy accommodation through 2021 and are now moving back towards easing policy with a clear pivot having taken place coming into 2022. Although covid remains a challenge in China, we remain encouraged by the prospect of further easing and the moving away from some of the policies that hampered Asian markets (regulation and deleveraging) over the past year. Chinese policy appears more market friendly through 2022 and this should provide some support to asset markets in the region.

Our central scenario for financial markets continues to be that volatility remain high in the near future. As we look six to twelve months out, we believe investors should continue to focus on the change in liquidity dynamics in the developed world, while valuations in the US remain extended and growth will likely moderate as a function of policy tightening. In Asia, Chinese growth is likely to begin bottoming out and then strengthening heading into 2023 with Chinese policy makers having moved decisively towards easing and asst valuations are more attractive. The Strategy remains cautiously positioned, with an

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elevated exposure to Asian risk assets, as a function of these dynamics. We continue to watch the evolution of Chinese policy, the direction of developed market central bank policy, and the evolution of growth and inflation, believing that these are the primary forces driving financial markets from here. We hold a large amount of dry powder and will seek to take advantage of opportunities as they are presented.

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