Discovery Cautious, Moderate, Balanced Funds

31 August 2024

Market background

August began with a sharp selloff in equities, driven by weak US employment data and a surprise rate hike in Japan, causing turmoil in currency carry trades. However, markets recovered as central bankers in the US and Japan signalled dovish policies, boosting global bonds and equities on expectations of aggressive rate cuts.

Developed markets outperformed emerging markets, with US equities capping their fourth consecutive monthly gain, even as the ‘Magnificent 7’ stocks declined. European and UK equities posted positive returns, while Japanese equities lagged. Chinese equities were flat on mixed economic data releases over the month.

Developed market sovereign bonds had a strong month, particularly US treasuries, as investors priced in more aggressive cuts. UK gilts lagged but still delivered a positive total return.

In South Africa, equities rallied, with the FTSE/JSE ALSI closing just shy of its all-time high reached earlier in the month. Growing optimism towards the South African economy supported a nearly 4% rise in the rand against the US dollar.

Geopolitical tensions, combined with expectations of rate cuts, provided fresh support for gold which moved above US$2,500/oz for the first time.

Performance review

Over the month the portfolio delivered a positive absolute return.

Key contributors:

- SA property led gains, along with SA bonds
- ‘SA Inc.’ stocks, including SA banks, insurance and retailers
- Naspers and Prosus: on the back of good Q2 2024 results from Tencent
- Defensive global equities: London Stock Exchange, utilities (Iberdola, NextEra and Enel) and healthcare stocks such as UnitedHealth Group
- Gold holdings: Agnico Eagle, Barrick Gold, AngloGold Ashanti
- Global bonds, which performed better than global equities

Key detractors

- Technology stocks: Amazon, Google, Nvidia as investors rotated into defensive stocks
- Despite a stronger gold price, Gold Fields fell following poor results
- Diversified miners: weak data from China led to weakness in commodity prices
- A stronger rand was a headwind for our global bond and equity returns

The portfolio held cash reserves coming into the month. We deployed some of this on the pullback earlier in August, buying back into JPMorgan Chase and topping up our holdings in Barclays, Apple and American Tower. In South Africa we added to our SA bank exposure. We also bought back into MTN Group on share price weakness. We consider the share undervalued on an absolute and relative basis.

Later in the month, we exited our position in Dutch semiconductor equipment manufacturer ASML, as well as Northam Platinum. In the case of Northam, we are deliberately managing our risk and exposure in the platinum-group metals (PGMs) space, reallocating the proceeds into Harmony Gold. Additionally, we trimmed our holdings in Google parent Alphabet, as we no longer exceed the earnings expectations of the market. We also trimmed British American Tobacco, Shoprite and Bidcorp on share price strength.

Outlook and strategy

The market remains fixated by how much the US Federal Reserve (Fed) will cut rates in September, with each release of conflicting data causing sharp market fluctuations. If the Fed cuts, as is widely expected, the focus will then shift to how much and for how long the cuts will continue.

Rate cuts are just one factor contributing to the increased volatility expected during the final months of the year. Market concerns have evolved from a ‘no landing vs. soft landing’ scenario to a ‘soft landing vs. recession’ scenario. While our base case remains a slowdown in growth leading to a soft landing, this shift still tempers the prospects for market growth. Additionally, uncertainty surrounding the upcoming US election in November is also likely to further constrain growth and amplify volatility.

This volatility is expected to reflect in the rand, which strengthened against a weaker dollar during the month. However, the rand is likely to remain volatile as conflicting US economic data continues to create uncertainty around the direction of the US economy.

Locally, sentiment remains positive as inflation begins to slow, supported by additional fuel price reductions. While keeping an eye on the Government of National Unity, investors are focused on the upcoming earnings season and the possibility of a rate cut in South Africa.

In China, manufacturing activity sank to a six-month low in August as the property crisis continues to dampen domestic demand. While authorities have signalled that further stimulus is on the cards, we believe the government is holding back until after the US election, when there is more clarity on US trade policy.

The portfolio maintains a healthy cash balance, providing an attractive risk-free return. We have not allocated fully to equities, as we do not expect markets to run away in the coming months. Instead, we will continue to add or trim positions during market pullbacks. Our equity mix remains tilted towards companies with strong earnings fundamentals at a reasonable valuation and is presently tilted towards South African equities. However, global equities remain on our radar; the expected volatility in the US may present buying opportunities among our favoured stocks, which we will take advantage of as they arise. China’s recovery remains uneven, and we are cautious about rebuilding our positions in Chinese stocks until we have more conviction in growth opportunities. We have increased duration on SA bonds to marginally overweight and continue to hold some exposure to global bonds, which have performed well.