cogence

Q2 2024

THE COGENT
QUARTERLY

MARKET BACKDROP

Overview of the last quarter's market movements

FUND HIGHLIGHTS

Update on portfolio performance and current positioning

SCOOP OF THE DAY

Spotlight on an exciting investment opportunity

CHARTING THE FUTURE

Insights on market outlook and future opportunities

Market **backdrop**

THE QUARTER IN SUMMARY:

A mixed second quarter for financial markets, with elections and inflation driving volatility.	Emerging market equities outperformed developed markets.	Bond markets were broadly negative as expectations for rate cuts from the Fed were pushed out.

Over the second quarter of 2024, financial markets saw mixed performance. Economic momentum seen over the first quarter continued into the second, leading to another positive period for equity markets. Stickier, though moderating, inflation numbers meant that returns from bond assets were broadly negative as expectations for rate cuts from the Federal Reserve were pushed out. The more positive disinflation backdrop in Europe led to the European Central Bank (ECB) cutting rates, though political uncertainty towards the end of the quarter led to yields rising.

Developed Market (DM) equities delivered a positive return of 3.2% over the quarter. US equities rose 4%, outperforming the Europe ex-UK markets which returned just 0.6%, as strong earnings from the US technology sector, particularly companies focused on Artificial Intelligence (AI), continued to drive US market returns. Within the US financials sector, we saw many banks announce plans to increase dividends after positive Federal Reserve stress test results.

US inflation also eased slightly with the labour market remaining strong, helping the consumer. Underperformance of European equity market returns was driven by the announcement of a snap election in France which led to increased market volatility, and reduced expectations for steep interest rate cuts. Continuing with the global technology theme, the information technology sector in Europe performed well with semi-conductors leading the way.

Sources: BlackRock, Thomson Reuters DataStream. All returns are in local currency terms unless otherwise stated. Equity performance is the MSCI Total Return Index for corresponding region.

Market **backdrop**

Emerging Market (EM) equities ended the quarter up 5.4%, outperforming their DM counterparts thanks to strong performance from Chinese and Indian equities. Government support for the real estate sector, and investors perceiving Modi's extended term as beneficial to economic policy were positive catalysts for their respective markets. The South African (SA) equity market also performed well as investors appeared comforted by the results of the general election leading to a Government of National Unity (GNU), a coalition between the incumbent African National Congress (ANC) along with the Democratic Alliance (DA) and Inkatha Freedom Party (IFP).

In bonds, returns were mixed with robust economic data leading to riskier areas such as US and European high yield delivering positive returns of 1.1% and 1.5%, respectively. As the Fed held rates, and now anticipates only one cut this year, yields rose and more interest rate sensitive areas such as government bonds and investment grade credit delivered negative returns.

US long credit was notably impacted and experienced a 2.8% decline over the quarter. Despite the ECB being among the first of major central banks to cut rates European government bonds still delivered a negative return as yields rose.

Locally, SA bonds posted a 7.5% return for the quarter. The 10-year SA government bond yields fell from 12% at the start of the quarter to 11.25% and South African inflation-linked bonds returned 2.4% over the quarter. The results of the general election and the resulting coalition led to improved investor confidence and a strengthening of the Rand over the quarter.

Elsewhere, precious metals continued to outperform amid ongoing geopolitical tensions, with strong performance from both gold (+5.1%, reflecting its status as a safe-haven asset during times of increased uncertainty) and silver (+14.8% benefitting from physical demand in China).

Sources: BlackRock, Thomson Reuters DataStream. All returns are in local currency terms unless otherwise stated. Equity performance is the MSCI Total Return Index for corresponding region.

Fund **highlights**

PERFORMANCE

Cogence Discovery Dynamic Asset Optimiser (DAO) Solutions – click here to view factsheets

Cogence was appointed as the investment manager of the DAOs in April 2024. Cogence transitioned the portfolios during May and June to the new strategic asset allocations (SAA). The portfolios now feed into the Cogence Global Growth portfolio for its global exposure (see factsheet here).

		3-month returns (ZAR)			12-month returns (ZAR)		
		Fund	Peer Group	Relative	Fund	Peer Group	Relative
DAO portfolios	Cogence Discovery Cautious Dynamic Asset Optimiser Fund of Fund	5.1%	3.3%	1.8%	11.8%	9.9%	1.9%
	Cogence Discovery Moderate Dynamic Asset Optimiser Fund of Fund	4.4%	3.6%	0.8%	11.7%	9.8%	1.9%
	Cogence Discovery Balanced Dynamic Asset Optimiser Fund of Fund	4.6%	3.8%	0.8%	10.7%	10.3%	0.4%

Source: Morningstar, 30 June 2024.
Note: Past performance is not necessarily an indication of future performance. Returns are quoted net of fees, in ZAR. Peer group category by risk profile: Cautious - ASISA SA Multi-Asset Low Equity, Moderate - ASISA SA Multi-Asset Medium Equity, Balanced – ASISA SA Multi-Asset High Equity.

The Cogence Discovery Dynamic Asset Optimiser (DAO) portfolio range outperformed over the quarter, delivering 1st quartile performance relative to peers across the three risk profiles. Robust performance over the last three months has contributed positively to the strong relative outperformance over the 12-month period to end June 2024. The change in the global exposure of the DAOs to the Cogence Global Growth portfolio has been a positive driver of performance over the period. The fund outperformed peers over the quarter, delivering 1.6% (net of fees, in USD) in absolute terms, compared to the EAA OE Aggressive Allocation sector average of 1.6% (net of fees, in USD). During Q2, asset allocation was the largest driver of performance in the Cogence Global Growth portfolio, while manager selection detracted slightly from returns. On the asset allocation side, our overweight to US and EM equities were beneficial for active performance. Also, in June there was a reversal of the underperformance at the end of May after the US rally due to a pricing mismatch, which added to returns. On manager selection, the BlackRock US Advantage Fund was the largest contributor, followed by the Schroders EM Fund. On the other hand, GQG Partners US equity and the BlackRock US Advantage Fund was the largest contributor, followed by the Schroders EM Fund. On the other hand, GQG Partners US equity and Payden Global Emerging Markets Bond Fund detracted from performance.

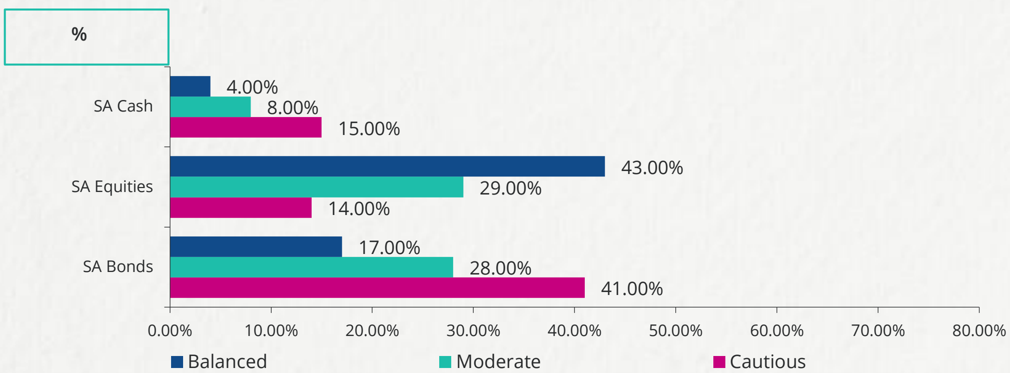
Outside of the global sleeve, across the rest of the portfolio, key contributors to performance included Ninety One SA Equity Fund, which outperformed its benchmark given its tilt towards SA Inc (shares that earn the majority of their earnings within South Africa), which responded positively to improved investor sentiment toward SA post-elections. Conversely, Ninety One Active Quants (underweight SA Inc) underperformed their benchmark, detracting from total performance. SA listed property rallied in the second quarter, which hurt the Discovery Flexible Property Fund given the portfolio's exposure to global property counters, which came under pressure. The Discovery Strategic Bond Fund underperformed, detracting slightly from relatively performance, but the strong showing in SA bonds in June helped total performance.

POSITIONING

Cogence Global Solutions

- The **Cogence Discovery Cautious Dynamic Asset Optimiser Fund of Funds** is constructed as a diversified portfolio of funds spanning various asset classes, and across both active and passive strategies. Asset allocation and global manager selection advice is provided by BlackRock, while RisCura provides local manager selection. During the second quarter of 2024, the portfolio's offshore (global ex-SA) allocation increased from 20.6% to 30.0%, in line with the long-term strategic asset allocation (SAA). This was enabled by reducing the SA bond and SA equity SAAs by 3.38% and 6.02%, respectively. The Discovery Global Feeder Funds were replaced with the Cogence Global Growth USD Portfolio. The local managers remained unchanged. The portfolio remains within the defined risk parameters of a low-risk profile as per the ASISA category's maximum equity allowance of up to 40%.
- The **Cogence Discovery Moderate Dynamic Asset Optimiser Fund of Funds** is constructed as a diversified portfolio of funds spanning various asset classes, and across both active and passive strategies. Asset allocation and global manager selection advice is provided by BlackRock, while RisCura advises provides local manager selection. During the second quarter of 2024, the portfolio's offshore (global ex-SA) allocation increased from 31.5% to 35.0%, in line with the long-term SAA. This was enabled by reducing the SA bond and SA equity SAAs by 1.77% and 1.73%, respectively. The Discovery Global Feeder Funds were replaced with the Cogence Global Growth USD Portfolio. The local managers remained unchanged. The portfolio remains within the defined risk parameters of a medium-risk profile as per the ASISA category's maximum equity allowance of up to 60%.
- The **Cogence Discovery Balanced Dynamic Asset Optimiser Fund of Funds** is constructed as a diversified portfolio of funds spanning various asset classes, and across both active and passive strategies. Asset allocation and global manager selection advice is provided by BlackRock, while RisCura provides local manager selection. During the second quarter of 2024, the portfolio's offshore (global ex-SA) allocation increased from 31.5% to 37.3%. The long-term SAA of the portfolio is 36.0%. This was enabled by reducing the SA bond and SA equity SAA by 0.76% and 5.04%, respectively. The Discovery Global Feeder Funds were replaced with the Cogence Global Growth USD Portfolio. The local managers remained unchanged. The portfolio remains within the defined risk parameters of a high-risk profile as per the ASISA category's maximum equity allowance of up to 75%.

Chart 1: Strategic Asset Allocation as at 30 June 2024



30 June 2024

Scoop of the day

AI stocks soar – is there potential for further gains?

In a recent publication by BlackRock's Jeff Shen, Co-head of Systematic Active Equity, he unpacks whether AI stocks have the fundamentals in place to sustain growth.

Artificial Intelligence (AI) optimism gained traction in 2023 and has extended into 2024, with technology companies driving indexes to record highs. AI enthusiasm shows little sign of subsiding, and the promise of continued innovation in the space has captivated investor attention. That said, the AI rally still invites its fair share of sceptics that have drawn comparisons to the dot-com bubble of the late 1990s.

To gain better perspective on similarities between these two tech-driven periods, BlackRock's Systematic investment team contrasted the features of the recent AI boom with the late 90s dot-com bubble.

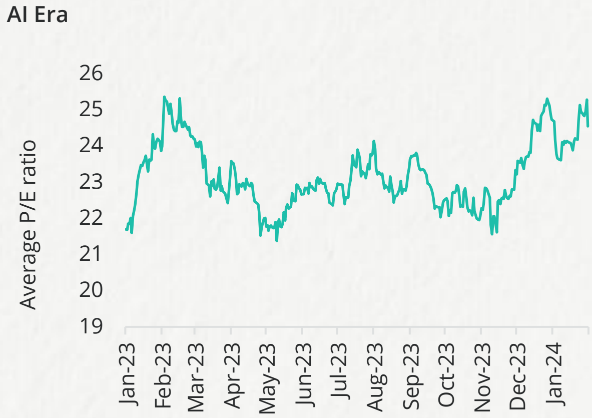
Key takeaways:

1. The nature of companies that are gaining exposure to AI today differ from the speculative valuations during the dot-com bubble.

2. The 1999-2000 period was characterized by declining earnings, extraordinarily high valuations and high levels of volatility. By comparison, AI beneficiaries today are characterized by steadier cash flow and a higher quality of earnings associated with these companies.

3. Due to the expensive cost of AI infrastructure and consequent barriers to entry, current AI leaders tend to be a smaller and more concentrated set of established tech corporations, as opposed to the new IPOs which drove the dot-com bubble.

Average P/E ratio in systematic active equities U.S. tech universe



The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results. Source: BlackRock Systematic, as of February 2024. This chart shows the average P/E ratio across investable AI stocks in comparison to the leading stocks of the dot-com bubble.

In 2023, total mentions of AI-related keywords increased more than three times over the course of the year, mostly driven by a handful of US technology incumbents. As the BlackRock Investment Institute shares, US stocks have climbed to all-time highs thanks to the technology sector. Ultimately, we see a small group of tech winners leading stock gains as a feature of the AI theme – not a flaw.

Why? First, excitement over AI is being met by tech firms delivering on and beating high earnings expectations. Second, profit margins for tech are leading the market, but they're also recovering in other sectors as cooling inflation eases cost pressures on margins.

What could halt the climb in tech stocks? Markets could lose favour for the sector if hopes for AI are dampened, such as if they feel corporate spending on AI hasn't paid off in a boost to earnings or margins. Any regulatory changes limiting adoption could also affect AI's potential to keep supporting tech. In a less likely scenario, other sectors could jump ahead of tech if growth accelerates, and inflation falls enough to allow the Federal Reserve to cut interest rates more than expected. We remain nimble in portfolio construction as this mega force – big structural shift – plays out.

Bottom line:

We stay overweight U.S Equities as a key beneficiary of the AI theme.

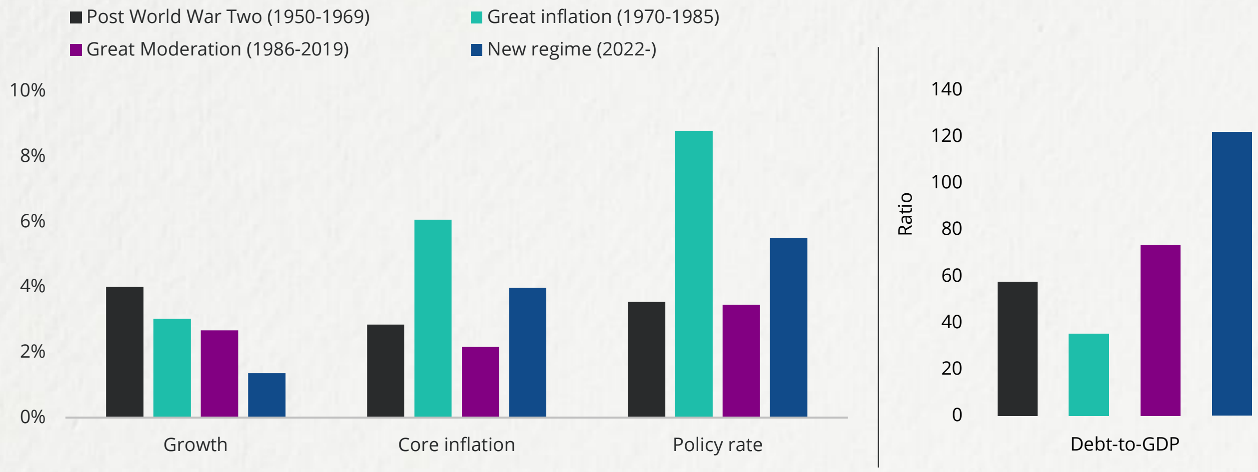
Source: BlackRock Investment Institute, 28 June 2024.

Charting **the future**

LOOKING AHEAD

01 **An unprecedented starting point:** We are in an unusual macro environment, shaped by supply constraints like shrinking working-age populations. We see higher inflation and interest rates – yet more subdued growth - relative to pre-pandemic decades.

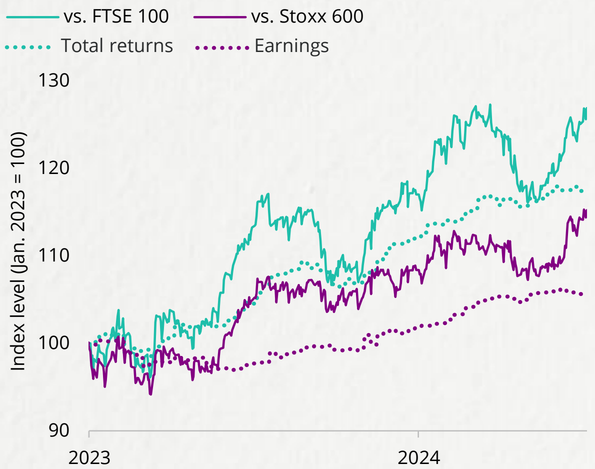
Key U.S economic status,1950-2024



Source: BlackRock Investment Institute, U.S. Bureau of Economic Analysis, with data from Haver Analytics, July 2024. Notes: The chart shows the annual average of three key economic gauges, the growth of GDP and GDI average, core inflation, and policy rate, from post-World War Two onwards. The policy rate for the new regime is the actual fed funds rate as of July 2024.

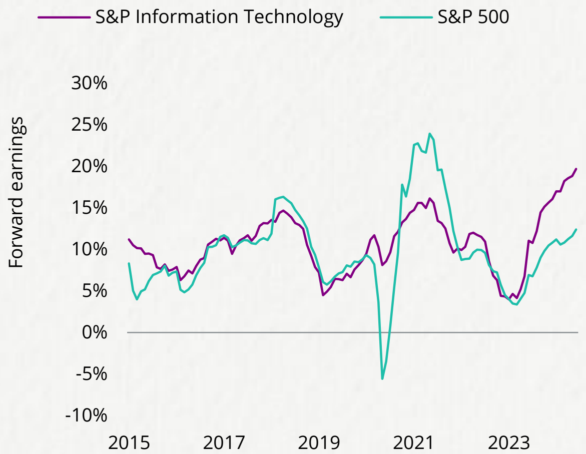
02 **Strong earnings growth fuels outperformance for US equity:** US stocks have soared past UK and European peers since the start of last year. We think it's backed up by steady earnings growth that could broaden out as the benefits of AI spread across sectors.

S&P 500 relative performance, 2023-2024



Forward looking estimates may not come to pass. It is not possible to Invest directly in an Index. Index performances does not account for fees. *Source: BlackRock Investment Institute, with data from LSEG Datastream, July 2024. Notes: The chart shows the S&P 500 relative performance of total returns and 12-month forward earnings vs. the UK's FTSE 100 and Europe's Stoxx 600 indexes.*

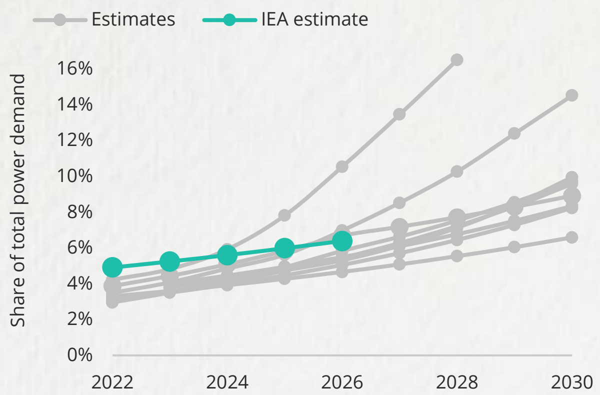
12-month forward earnings growth, 2015-2024



Forward looking estimates may not come to pass. *Source: BlackRock Investment Institute, with data from LSEG Datastream, July 2024. Notes: The chart shows analyst estimates for earnings per share growth over the next year.*

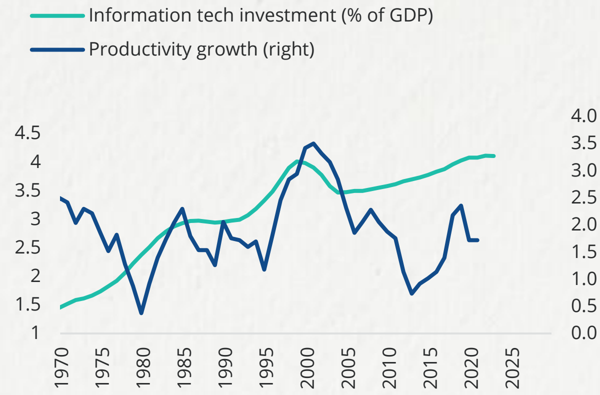
03 **AI’s rapid build out now could boost productivity later:** AI and the low-carbon transition could significantly boost future growth – and more quickly than previous technologies. The rapid investment required could boost productivity, but it may take some time for that to materialise.

Estimated data center power needs (U.S.)

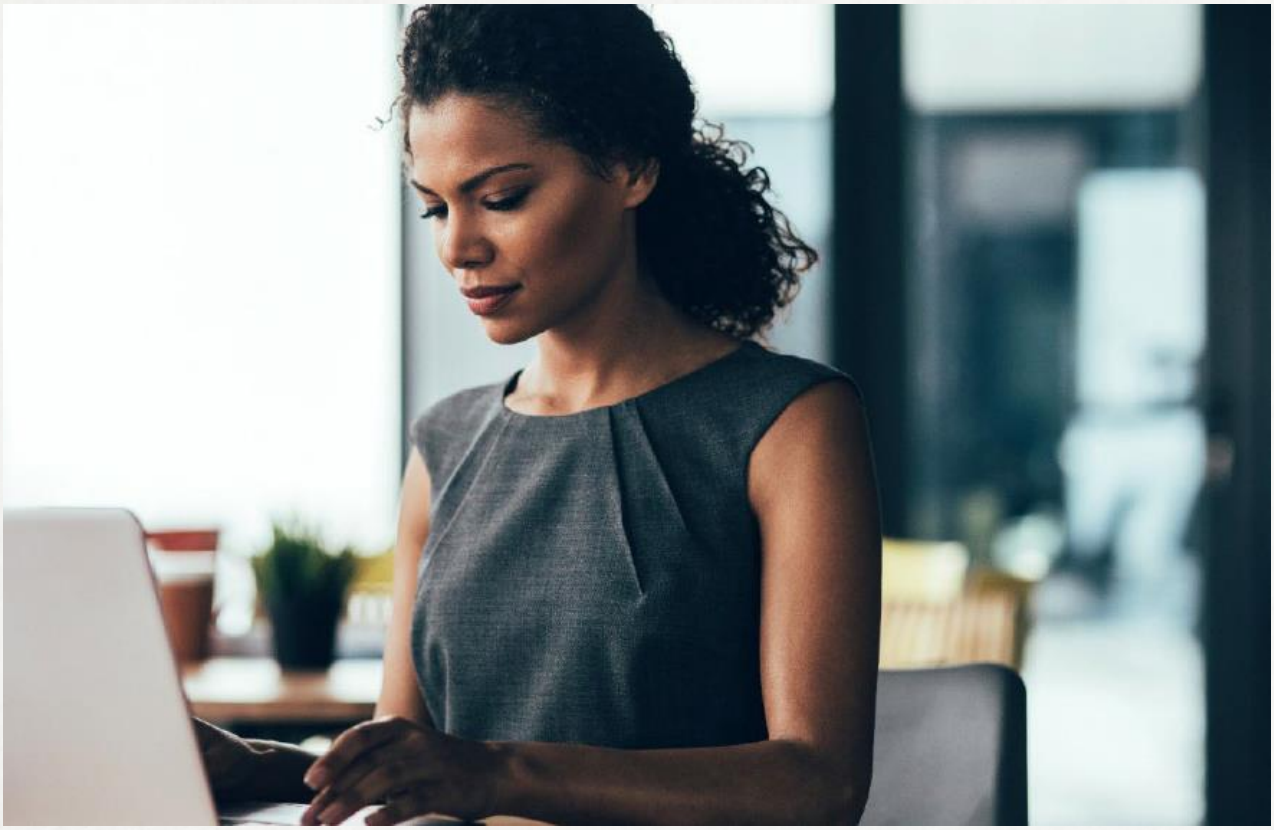


Forward looking estimates may not come to pass. *Source: BlackRock Investment Institute, International Energy Agency (IEA), Goldman Sachs, BGIF, Bank of America, Schneider, Semianalytics, Bernstein, McKinsey, Boston Consulting Group, and BlackRock's Fundamental Equities team, May 2024. Notes: The chart shows data center power demand as a share of total U.S. power demand in 2022. Data center power demand includes those form traditional data centers and artificial intelligence (AI) computing/dedicated AI data centers. and excludes consumption form crypto currencies and data transmission networks.*

Investment and productivity during the “IT era”



Source: BlackRock Investment Institute, U.S. Bureau of Economic Analysis with data from Haver Analytics, July 2024. Notes: The chart shows the historic productivity growth and rate of investment in information tech processing equipment and software as a share of nominal GDP.



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