Discovery Target Retirement Date Funds

Market background

After several weeks of weakness, global markets rallied in November. While central bankers maintained the higher for longer narrative, data was broadly weaker across the board, which provided further evidence that the US economy and labour market are cooling. This together with a downside surprise in inflation, led to mounting speculation by investors that the US Federal Reserve (Fed) and other central banks were at the end of their rate hiking cycles.

As expectations for a soft landing and dovish central bank pivot gathered pace, global equities rallied, delivering high single-digit returns as both developed markets and emerging markets moved higher. US equities outperformed, with the S&P 500 breaking three months of consecutive declines, although the gains remained concentrated in the tech sector. European equities were also strong. Chinese equities lagged due to continued weakness in property stocks despite the regulator indicating that they would provide more policy support.

Defensive assets also moved higher in November. US treasuries rallied and delivered their best monthly return since August 2019 on rate cut expectations, caused by speculation that inflationary pressures have come to an end. EU sovereign bonds also made advances. UK gilts moved higher following fiscal easing from the UK government in the Autumn statement. The price of investment grade corporate bonds moved higher, with the US outperforming its European counterpart. Finally, the Japanese yen appreciated versus the US dollar on speculation that the Fed would cut rates.

Softer-than-expected inflation data from the US ignited a strong rally in South African government bonds, luring foreign investors back into the nation's debt instruments. This contributed to extended gains for the rand, which gained the most against the US dollar since July. Further tailwinds which contributed to the rand's recovery included risk reversals, the higher carry trade and lower implied volatility levels. In equities, the FTSE/JSE All Share Index (ALSI) saw some gains throughout the month, boosted largely by the performance of mining shares. However, the earnings sustainability of some companies may come under question as the country saw a return to consistent Stage 4 loadshedding after a brief respite, with planned maintenance and increased demand applying further strain to an already debilitated energy system.

In terms of monetary policy, the South African Reserve Bank (SARB) continued its fight against inflation by maintaining its repo rate at 8.25%, with the aim to stabilise inflation around the midpoint of its target range of 3-6%. Although headline inflation reached a level near the upper target limit in October, with food, transportation, health, and restaurants & hotels contributing to the increase, downward revisions were made to the forecast for the rest of this year and 2024. The SARB also revised its GDP growth forecasts upwards for the rest of 2023.

With the geopolitical backdrop increasingly fragile, the demand for safe havens saw gold reach a 6-month high in November, ending the month at US$2,036/oz.

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Performance review

For the month the portfolio delivered a positive absolute return.

Sentiment switched from risk-off in September and October to risk-on in November, with both equity and bond markets experiencing strong rallies towards the end of the month. As a result, global bonds, which were the worst performers in October, delivered the best return for the portfolio in November.

Similarly, SA equities delivered strong returns in US dollars and SA bonds also performed well. Cash was the worst-performing asset class, unlike in previous months where it was the only safe place to hide.

Key positive contributions:

- Gold mining stocks: our domestic positions in Gold Fields and Anglo-Gold Ashanti, and offshore positions in Barrick Gold and Agnico Eagle continued their run and delivered positive returns
- Rand strength: together with a lower oil price this provided a tailwind to SA Inc. stocks, including banks (Capitec, FirstRand) and retailers (The Foschini Group)
- Naspers and Prosus: strong results from Tencent supported performance
- SA and global bonds: these were positive on an absolute basis
- Defensive equity: the portfolio holds small positions in offshore property and utility stocks which reversed their positions to make meaningful contributions to the portfolio
- Software and semiconductors: our holdings in these sectors continued to do well

Key negative contributions:

- Energy: ExxonMobil and BP gave up recent gains
- Selected SA Inc.: Impala Platinum shares fell following an accident on site; Woolworths took a breather following strong performance; Bidvest fell following a negative trading update

Outlook and strategy

Given the late-cycle environment, volatility will continue, with market swings dictated by the narrative of the moment rather than changes in underlying fundamentals. Sentiment has swung from 'higher for longer' to anticipating that rates will be cut in the first half of 2024. This is despite communication from the Fed remaining hawkish. Volatility will remain until there is clarity on the timing of rate cuts. This will be when the Fed is convinced that inflation has truly begun to fall, or the economy enters a recession. The only other driver would be a credit event or evidence that liquidity is drying up.

The local market continues to be impacted by global market developments. We do not expect that the upswing in markets seen in the last month will be sustained and remain cautiously positioned. We outline some of the factors that are potentially at play over the last month of the year and could test the asset class:

- Evidence continues to build, in the **US and outside,** that growth is slowing. This is more apparent in the eurozone, which continues to teeter on the brink of a recession.
- In the **US,** delinquencies are rising, and retailers are reporting anxiety over top-line growth as fiscal support for consumers is dwindling. Recent results have remained robust, but many companies have downgraded earnings expectations for Q4 results.
- We will monitor economic data releases in the coming months to confirm our thesis of a recession in 2024. In addition, while inflation is coming down, the base effects in the coming months may create volatility in the data.
- **Volatility** and uncertainty will remain.
- We are monitoring **China** closely. After months of negative data releases there are some early signs that the bottom may have been reached. The policy dynamic is highly supportive; local government debt problems are being resolved; extra bond issuance is injecting liquidity into the system, and the iron ore price is holding up, suggesting ongoing investment in infrastructure.
- **Liquidity** is tightening and will likely impact risk assets in the months ahead.

Given this backdrop, we remain cautious. In terms of our compelling forces framework, we still believe that valuations are looking full in the context of earnings, which are likely to remain under pressure. Thus, our **overall equity exposure remains neutral,** with our equity mix still tilted towards companies with strong earnings fundamentals, which can manage through the slowdown. We continue to deploy some of our cash into 'SA Inc.' stocks, those with attractive entry points. These include Woolworths, FirstRand and Mondi.

On the global side we are taking advantage of volatility and sold Partners Group to zero, following strong performance, and continue to add to positions in stocks where earnings expectations have reset and valuations are attractive.

We believe our position in **European bonds** will add value in time. We have also topped up our allocation **to SA bonds which have an attractive yield underpin.**

The portfolio has a healthy cash balance, which continues to yield an attractive risk-free return. This dry powder in cash puts us in a better position to take advantage of future opportunities.

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