Discovery Target Retirement Date Funds

Market background

February witnessed a continuation of heightened volatility, with markets buffeted on two fronts – increasingly hawkish expectations of interest-rate hikes amid soaring inflation and escalating geopolitical tensions as the Russo-Ukrainian crisis triggered a sell-off in risk assets.

As Western sanctions were imposed on Russia, its businesses and politically-exposed persons, there were substantial moves across capital markets, while rising prices for oil, and commodities will put even more pressure on inflation in the rest of the world.

Global equities posted another month of negative returns, with the MSCI All Countries World Index (ACWI) down 2.6% for the month. Growth stocks absorbed heavy blows over the period, while value continued to outperform. Developed market stocks (MSCI World Index) closed 2.5% lower, while emerging market stocks (MSCI Emerging Markets Index) were even weaker, down 3.0% over the period. Regionally, the US benchmark S&P 500 notched back-to-back months of negative total returns, down another 3.0%, while the tech-heavy NASDAQ gave up 3.4%, bringing the year-to-date return to a hefty -12.0%. Across the Atlantic, the Euro Stoxx 600 closed the month 3.5% in the red, with banks leading the declines. Asian markets fared better, with Japan's Topix losing 0.5% and China's blue-chip CSI 300 Index (+1.2%) bucking the negative trend.

In fixed income markets, strong labour data and high inflation prints spooked the market, though expectations were delayed by the uncertainty caused by the Russo-Ukraine war. US Treasuries lost 0.7% for the month, while UK gilts, German bunds and Italian BTPs lost 1.5%, 1.6% and 2.4%, respectively. The Bloomberg Barclays Global Aggregate Bond Index closed 0.8% lower.

The Bloomberg Commodities Index rose 6.2% in February. Most commodities gained, with oil breaching the US$100/barrel mark for the first time since 2014 on anticipation of supply disruptions, while gas prices in Europe rocketed c.70%. Precious-metals prices also soared, with bullion prices topping their highest levels in more than a year as gold's safe-haven appeal shone through amid heightened global tensions. Industrial metals also had a good run over the month, with aluminium rallying to record highs. Meanwhile, iron ore plunged as Beijing stepped up efforts to rein in overheating prices.

All returns are quoted in US dollars.

South African equities continued to buck the downbeat global trend, with the benchmark FTSE/JSE All Share Index (ALSI) gaining 3.0% over the month, and the Capped SWIX not far behind at +2.7%. At a super-sector level, resources (+16.1%) and financials (+2.7%) helped prop up the bourse, while industrials were down a hefty 7.4%. In yield-oriented assets, foreigners were net sellers of local bonds in February. The JSE All Bond Index eked out +0.5% over the period, with some yield-curve flattening as yields in the front end edged higher, while the long end remained largely steady. Weakness persisted in the listed property sector, with the JSE All Property Index 3.0% in the red over the month. Cash, as measured by the STeFI Composite Index, returned 0.32%. In currencies, the rand just about stayed afloat amid the risk-off mood, recording a flat 0.1% against the US dollar.

At the sector level, resources have been the main support for the local stock market, with materials continuing to rally amid growing fears of supply delays and shortages as a result of events in Eastern Europe. Basic materials recorded a strong performance, led by forestry and paper as Sappi's results exceeded expectations on strong growth for the pulp and paper producer. Precious-metals miners enjoyed a good run over the month, with 'safe-haven' demand and growing supply fears respectively helping gold and palladium. Financials had another positive month, extending gains on the back of a corporate-friendly budget speech, which outlined a reduction in corporate tax. Consumer sectors were weaker over the period, with the consumer-goods sector weighed down by index bellwether Richemont, as luxury retailers came under pressure, while consumer-services were held back by retailers and travel and leisure sub-sectors.

Performance review

For the month, the portfolio delivered positive absolute returns.

Key positive contributions:

- On the local front, platinum-group metals (PGMs) stocks (Impala Platinum, Anglo American Platinum and Northam Platinum) and diversified miners (Anglo American, Glencore and BHP Group) contributed strongly to absolute performance over the month. Performance was further enhanced by our exposure to South African banks (Nedbank Group and Standard Bank Group) and our position in Shoprite Holdings.
- The offshore equity component of the portfolio benefitted from exposure to the energy and materials sectors.
- The allocation to South African bonds contributed positively to absolute returns over the month.

Key negative contributions:

- Naspers and Prosus came under pressure over the month. Positions in Richemont and Mondi also weighed on returns.
- Offshore equities broadly had a weak month and weighed on absolute returns.

Portfolio activity

Over the month, within the local equity component, we trimmed some our exposure to Shoprite, Sasol and Anglo American after a strong run. We also continued to reduce exposure to Richemont. Some of the proceeds were redirected to building a position in British American Tobacco, where we feel the earnings revisions, cycle has the potential to inflect positively along with the announcement of share buybacks and the valuation is attractive. We also allocated more capital to MTN Group on weakness, where the upside to market consensus forecasts remains positive and the valuation is very attractive. We also continued to add to our existing position in Sibanye-Stillwater as PGM commodity basket is finding support from strong demand/supply dynamics and low inventory levels.

Within the offshore component of the Fund, we used the strength earlier in the month to continue to trim our overall offshore equity exposure.

Outlook and strategy

Looking forward, we are monitoring the unfortunate events in Russia/Ukraine and its impact on the inflation and growth outlook. Commodity and energy markets, as well as supply chains have been disrupted with the resultant upward pressure on the inflation outlook, which will likely have a negative impact on growth and also creates an issue for the US Federal Reserve's policy actions.

To navigate through this, we continue to have balanced and diversified exposure across asset classes, geographies, sectors and individual assets. In assessing the environment and making asset allocation decisions, we continue to tilt the portfolio to those asset classes (and underlying assets) that score well in terms of our compelling forces framework: fundamentals, valuations and market price behaviour.

The offshore allocation to equity has been reduced (some in early January and then some in early February) and we continue to prefer South African equity. In the context of a rising interest rate environment and potential quantitative tightening, one cannot rely on the expansion of valuations to contribute to returns. Earnings and dividends will drive the bulk of the return for investors. The South African equity market has more valuation support as it did not enjoy the multiple expansion seen in developed markets. This, coupled with strong earnings revisions profiles across our holdings, has tilted the portfolio to the domestic market.

Regionally, in our offshore equity allocation, we continue to have a positive skew towards Asia, as Chinese markets continue to exhibit reasonable valuations following the high-risk premium embedded in the stocks post the regulatory crackdown in 2021, while earnings have substantial upside over the medium term, in our view. The Chinese government policy is on an easing path versus the US, where policy is being tightened over the year.

The local equity composition is well diversified, and the portfolio remains tilted towards select cyclical exposures at the expense of more defensive holdings. Our defensive exposure is in the Naspers-Prosus stable, where earnings revisions appear to be troughing and sentiment is weak. We also continue to build a position in British American Tobacco, where we believe the earnings revisions, profile is at an inflection point, as the loss making businesses start to improve, as well as the business being in a position to signal potential share buybacks going forward. This sits alongside an allocation to global cyclical stocks (diversified miners, Sappi, Mondi, Sasol and a reducing allocation to luxury goods maker, Richemont) geared to the global economic cycle and continuing to exhibit favourable earnings revisions profiles. Most of the exposures in this bucket are benefitting from tight commodity markets and low inventory levels, in our view. Our allocation to PGM miners (Impala Platinum, Anglo American Platinum and Sibanye-Stillwater) will benefit from the rising global auto production given low inventory levels and strong demand, and hence we believe the earnings revisions have bottomed. We also continue to have a healthy allocation to South African banks, where earnings revisions are strongly positive (with recent trading updates confirming our investment case), and valuations are attractive. This sits alongside our slightly reduced exposure to select apparel retailers, which display good earnings revisions profiles, trading at reasonable valuations. The South African consumer has proven to be more resilient than the market initially feared, but caution is warranted as there is a lack of momentum in the jobs market. Our exposure to local defensive businesses has increased steadily over the past 12 months. This is mainly via holdings in MTN Group, Bidvest Group, Life Healthcare and Shoprite. The earnings revisions profile of Life Healthcare appears to have troughed on the back of an improving occupancy profile into 2022 which results in strong positive operating leverage that the market appears to be underestimating, in our view. We also continue to have a position in Shoprite holdings where they continue to take meaningful market share through their Checkers brand as well as evidence of improved capital allocation by the management team that bodes well for future returns.

We continue to maintain the material allocation to local sovereign bonds, especially within the context of the global fixed income universe. Within fixed income, SA government bonds continue to perform very well, and we believe the high income will continue to buffer the asset class through volatility from global fixed income markets. The South African Reserve Bank will continue its hiking cycle into a normalised neutral rate for South Africa. Growth is likely to revert to trend, and we continue to look for signs on investments in the power sector and consumption, supported by a normalisation in employment. With higher commodity and oil prices, we do see some upside risks from second-order effects to core inflation. This remains a tailwind to the rand. Overall, we expect this to be a supportive environment for domestic investments.