Discovery Balanced, Moderate Balanced, Cautious Balanced Funds

Markets got off to a strong start in January, as declining inflationary pressures across key economies drove speculation that central banks might be approaching the end of their rate hiking cycles. In the US, consumer inflation recorded its largest monthly decline since the beginning of the pandemic. While in Europe, falling energy prices and downside inflation boosted sentiment. The reopening of China's economy further supported risk appetite, as did signals from Chinese policymakers that they would put in place measures to help boost economic growth.

Emerging markets (EM) outperformed developed markets (DM) for the month, largely on the back of increased risk appetite across Asian markets following the resurgence in China. The MSCI Emerging Markets Index returned +7.9%, while the MSCI World Index returned +7.1%. The risk-on sentiment carried over to credit, with European and US high yield both delivering positive returns, while the rally across emerging market assets extended to both fixed income and currency, boosted by a weaker US dollar.

Developed market sovereign bonds enjoyed a strong start to the year, with US treasuries, Euro sovereigns and UK gilts all delivering positive returns for the month. US treasuries were particularly strong; however, the yield curve remains deeply inverted, a metric that is commonly used as an indicator of a pending economic recession. Meanwhile, investment-grade corporate bonds benefited from lower yields, with prices moving higher during the month.

All returns are quoted in US dollars.

South African equities tracked their international counterparts higher over the month, with the FTSE/JSE Capped SWIX gaining +7.0%. All major sectors closed the month higher, with financials gaining +3.9%, industrials +12.8% and resources +6.3%. The JSE All Bond Index gained +2.9%, while listed property (JSE ALPI) closed the month lower at -0.8%. Meanwhile, cash, as measured by the STeFI Composite Index, delivered +0.6%. It was a weaker month for the rand, depreciating against the US dollar, pound sterling, and euro.

Performance review

For the month, the portfolio delivered positive absolute returns.

Key positive contributions:

- There was broad based strength in SA and global equities over the month that added to returns, in particular:
  - Within the SA equity component, the Naspers-Prosus stable, Richemont and Sanlam contributed strongly to returns. Exposure to diversified miners (Anglo American, South32 & BHP Group), Woolworths and MTN Group also enhanced returns.
  - The offshore equity component benefitted from our exposure to Chinese equities. In addition, holdings in Barrick Gold, American Express and Teleperformance were standout performers.
- Our allocation to SA and global bonds also added to absolute returns.
- Rand weakness over the period positively impacted the offshore exposure of the Fund.

Key negative contributions:

- In the local equity component, platinum-group metals miners (PGM) miners (Impala Platinum & Anglo American Platinum), Capitec Bank and British American Tobacco detracted from returns over the period.
- The offshore equity's allocation to UnitedHealth, Elevance Health, and Waste Management held back returns.

Portfolio activity

We took advantage of the strength in the local market to trim some equity exposure and allocate to offshore opportunities. We will continue to do so in the months ahead as opportunities present themselves.

Within the local equity component, we trimmed some of our position in Bid Corp after a strong run. We also used the strength in The Foschini Group and Mr Price Group to exit the residual positions as we are concerned around the earnings revisions profiles, while also trimming Capitec and Anglo American Platinum due to similar concerns. British American Tobacco's earnings revisions have also played out as expected and with limited upside to forecasts from current levels, it has also become a funder for stronger ideas. We used some of the proceeds of the sales to top up existing holdings in Sanlam, MTN and Richemont – where the earnings revisions profiles are more supportive over the next 12 months. In the offshore equity component, we topped up existing holdings in TSMC and ArcelorMittal, while also initiating a position in Rentokil, where we believe earnings resilience is intact, given the current macro headwinds. These were funded from trimming some of our holdings in Philip Morris International and

JP Morgan into strength, while also exiting our full position in Experian, as the earnings revisions has played out and the valuation is less compelling.

In global fixed income, we took advantage of the sell-off in Swedish bonds to add a position and to take advantage of the structural headwinds and deteriorating economy. We also added long exposure to the Japanese yen versus the Taiwanese dollar, as the withdrawal of ultra-loose Japanese monetary policy is becoming highly likely, leading to a convergence in the Bank of Japan (BoJ) policy relative to other major central banks. The implementation of long yen vs the Taiwanese dollar is driven by the latter being a relatively US dollar-centric currency in how it's managed, which allows for the position to provide positive carry while providing diversifying properties for our allocation to Chinese and Hong Kong equities.

Outlook and strategy

The market appears to be in a sweet spot at the moment with inflation declining off peak levels and growth still holding up well post the large interest rate increases over the course of 2022. In addition, China's reopening post COVID is also providing an underpin to global growth expectations. This has resulted in a strong rally in risk assets.

However, while there is firm commitment to reopen in China, this is unlikely to be a smooth ride and China's impact on the rest of the world's growth usually happens with at least a 12-month lag. Furthermore, while the markets and the Fed are on the same page with regards to the rate hikes to come, the disagreement lies with whether rates with be held higher for longer (Fed is communicating this to be the case) versus a pivot and cutting cycle (which the market has started to price in in the second half of 2023). The recent strong labour market data does seem to indicate a higher-for-longer stance as a higher probability outcome and many leading indicators are pointing to the lagged effect on growth from policy tightening to start to come through in the months ahead. All this indicated more volatility to be expected in risk assets in the months ahead.

To navigate through this, we currently have a lighter overall equity exposure with a preference for SA equity over offshore equity, as we continue to believe the valuation support (SA did not enjoy the multiple expansion seen in developed markets), coupled with strong earnings revisions profiles across our holdings, has tilted the portfolio to the domestic market. DM equity assets have derated and are now more reasonably valued but do not yet reflect the high likelihood of earnings downside and ongoing tight liquidity conditions. The offshore stock selection has favoured a position in Asia ex-Japan equities to benefit from the expected consumption tailwinds from China, while DM exposures are tilted to more defensive sectors (healthcare, utilities and real estate), given the earnings risk in cyclical sectors such as consumer discretionary and industrials.

The valuation argument for local sovereign bonds still holds and we maintain a large allocation overall. We will look to bank some of the gains and keep some dry powder for better entry points. As we near the end of the hiking cycle, we also continue to build our position in defensive government bonds, with our positioning focused on high-grade nations with leverage and housing imbalances (Australia, New Zealand, South Korea, Canada and Sweden).

