Discovery Balanced, Moderate Balanced, Cautious Balanced Funds

Market background

January was a mixed month with several factors contributing to the diverging performance of financial assets. In the US, positive economic data led to growing investor confidence that a soft landing could be achieved. For example, Q4 GDP numbers beat expectations while inflation data appeared to be on a declining, if bumpy, path. But there was also growing scepticism of near-term rate cuts by the US Federal Reserve (Fed), while the People's Bank of China (PBoC) defied market expectations and left its medium-term policy loans rate unchanged. Conversely, the European Central Bank (ECB) struck a more dovish tone than expected, leading markets to price in earlier cuts in Europe. In SA, the South African Reserve Bank (SARB) kept its key interest rate unchanged at 8.25% in January, stating that future rate decisions would be based on incoming data.

Market sentiment was also dampened by the growing prospect of conflict spreading in the Middle East. This was compounded by the related attacks on ships in the Red Sea, and the impact on supply chains. The positive momentum helped global equities for the most part, with developed markets outperforming emerging markets.

Within defensive assets, developed market sovereign bonds lost ground as investors dialled back the prospect of rate cuts in the first quarter.

In SA, the correlation between movements in the Chinese economy and South African share markets became increasingly evident throughout the month, with resource companies in SA racking lower on the back of weaker Chinese data. The rand weakened against the dollar during the month, as uncertainty surrounding the timing of rate cuts pushed the exchange rate through the R19/$ barrier. The International Monetary Fund (IMF) downgraded its growth forecast for the South African economy in 2024 to 1%, warning that disruptions in the energy sector and logistics are drags on growth. This is significantly lower than the forecast of 1.8% made in October 2023.

On a positive note, manufacturing PMI rose to 50.9 in January, marking the first expansion in factory activity in eight months, supported by a steadier supply of electricity. Mining production surged to 6.8% year-on-year in November, significantly outpacing market expectations of a 3% rise.

In commodities, oil prices moved higher, helped by the broader risk rally as well as the latest data on US crude inventories, which fell to their lowest levels since October, and additional shipping diversions in the Red Sea.

The price of gold declined during January in US dollar terms, with a strengthening US dollar and rising bond yields acting as headwind for the precious metal.

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Performance review

In January the portfolio delivered a small negative absolute return.

Sentiment became more muted in January as the market reacted to more hawkish comments from the Fed regarding the timing of rate cuts as well as weak China sentiment. This fed through to the local equity market, which is dominated by cyclical stocks, and lacks the benefit of growth stocks, which propped up the US market.

Key negative contributions:

- SA equity in general
- Offshore bonds
- Defensive holdings: utilities such as Iberdrola, Enel Spa and NextEra Energy pared back gains as bonds weakened
- Diversified miners: investors remain cautious about the economic recovery in China

Key positive contributions:

In a more muted backdrop for risk assets, we note the following contributors to performance:

- SA-listed property carried good performance into the new year
- SA bonds had a small positive gain, supported by the yield underpin
- Software and semi-conductors: Amazon and Microsoft maintained their upward momentum, as did semi-conductor holdings such as TSMC, KLA and ASML
- Payment companies: Mastercard and Visa, following good results
- Selected ‘SA Inc.’: Truworths International, The Foschini Group
- Richemont and BidCorp also added to returns

Outlook and strategy

Given the late-cycle environment, volatility will continue, with market swings dictated by the narrative of the moment. This trend was evident in January, where the risk-on sentiment of December waned as the Fed tempered expectations of rate cuts in the first half of 2024. We expect volatility to remain until there is clarity on the timing and quantum of the cuts.

The local market continues to be impacted by global market developments. While global markets were broadly positive, this was in a narrow band.

We outline some of the factors that are potentially at play over the first quarter of the year which could test risk assets:

- **EU data** is weakening across the board and recession appears inevitable. This provides market visibility and supports our euro bond position.
- In the **US**, data is mixed as services is still growing but at a slower rate while the manufacturing data is starting to show early signs of green shoots after 18 months of contractionary conditions. **Volatility** will remain until there is certainty around the timing and quantum of rate cuts. This volatility creates opportunities to top up existing ideas or initiate new ideas that are currently on our buy list.
- We will monitor economic data releases in the coming months, but the direction of travel is clear – inflation will reduce through the first half of the year.
- We are monitoring **China** closely. The economy needs a step up in stimulus and all eyes are on the annual parliamentary gathering a.k.a the National Two Sessions, in early March.
- **Liquidity** will likely tighten in the months ahead, given that the US has used up available reserves and the fiscal impulse is waning, creating opportunities in risk assets.
- South Africa's upcoming **elections** may cause some volatility in markets; but more important are efforts to solve infrastructure constraints

Given this backdrop, in terms of our compelling forces framework, we still believe **global valuations** appear full, which leaves little room for error on earnings delivery. However, opportunities are presenting themselves as earnings bases reset or share prices pull back. We deployed some of our dry powder into stocks on our 'buy' list and will continue to do so, with a focus on offshore equities.

Our equity mix remains tilted towards companies with strong earnings fundamentals, which can manage through the slowdown and are able to come out stronger on the other side.

In response to market volatility, we made strategic adjustments to our equity holdings. After a strong performance, we opted to sell **Waste Management**. Conversely, we increased our positions in Google, KLA, and Samsung, capitalising on a temporary dip in their share prices while maintaining confidence in their fundamentals. Additionally, we bolstered our investments in select South African companies, such as Richemont and BidCorp, where we have strong conviction in their earnings potential. Finally, we took advantage of a pullback in gold stocks to add to our positions in this sector.

We believe our position in **European bonds** will continue to add value. The evidence of the economic slowdown in the euro zone is building and the ECB will be forced to cut rates. We decreased duration on German bunds, taking profits. We sold our South Korean bonds to zero, following a strong run.

We continue to favour 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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