Discovery Balanced, Moderate Balanced, Cautious Balanced Funds

Market background

The final quarter of an eventful year saw most financial markets rally significantly. Earlier in the quarter, the Middle East conflict returned geopolitical risk to the foreground. While the situation remains uncertain, the impact on energy and financial markets has been limited. Elsewhere, data was weaker across the board, providing evidence that the US economy is cooling. This together with declining inflation on both sides of the Atlantic, led to growing investor confidence that the next move for central banks would be a dovish pivot. This gained momentum in December after the US Federal Reserve (Fed) signalled rate cuts in 2024. Similarly, the narrative from the European Central Bank (ECB) was that the inflation path justified halting the sequence of further rate hikes.

The South African Reserve Bank (SARB) maintained its repo rate at 8.25% in November, aiming 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, downward revisions were made to the forecast for 2024.

As expectations for a soft landing and dovish central bank pivot gathered pace, global equities rallied, delivering low double-digit returns. Developed markets outperformed emerging markets as US equities led the charge, also delivering double-digit returns. Chinese equity markets were lower, driven by continued weakness in the region's property stocks and negative sentiment in gaming-related stocks due to the prospect of further regulation.

Commodities declined during the month, but there was notable divergence. For example, the oil price was weak during December as supply remained strong. Conversely, the price of copper rose amid fears of a supply shortage as decarbonisation goals supported demand for copper-rich electrification technologies.

The demand for 'safe havens' together with investor expectations of rate cuts in 2024, saw the gold price rise, ending the year at an all-time high in US dollar terms.

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Performance review

In December and over the quarter, the portfolio delivered a positive absolute return.

Sentiment switched from risk-off in September and October to risk-on in November and December as the higher-for-longer interest rate narrative ended and the Fed started talking about rate cuts. As a result, global bonds, which were the worst performers in September and October, delivered the best return for the portfolio in November and December – supported by our long duration position. Equity selection also paid dividends as laggards such as SA property, global property and utilities reversed position, delivering strong returns by the end of the quarter.

Key positive contributions:

In a strong backdrop for risk assets, notable movers were:

- Gold mining stocks: our domestic positions in Gold Fields and AngloGold Ashanti, and offshore positions in Barrick Gold and Agnico Eagle continued their run and delivered positive returns
- Industrials: strong performances from the likes of Schneider Electric and Trane Technologies
- Software and semi-conductors: Amazon and Microsoft maintained their upward momentum, as did the semi-conductor holdings
- Defensive holdings: Global property, SA property, utilities such as Iberdrola, Enel Spa and NextEra Energy
- SA banks: Capitec, FirstRand, Investec ad Standard Bank
- SA and global bonds: these were strongly positive

Key negative contributions:

- Energy: ExxonMobil, BP and small holding Sasol
- Resources: Anglo American: sold off following a weak production and guidance update while Impala Platinum shares fell following an accident on site
- Selected SA Inc: Woolworths took a breather following strong performance; Bidvest fell following a negative trading update; Absa fell on a weaker than expected trading update
- Rand strength: offshore returns were diluted by a stronger rand
- Naspers and Prosus: share prices fell after Chinese regulators announced plans to regulate the online gaming sector which also hurt sentiment in China impacting our China equity holdings

Outlook and strategy

Given the late-cycle environment, volatility will continue, with market swings dictated by the narrative of the moment. The market sentiment shift in November from 'higher for longer' to anticipating rate cuts in the first half of 2024 was confirmed in December came as the Fed changed its stance and agreed with the market on potential rate cuts in 2024, no longer holding its stance of being data dependant and on inflation, no longer waiting for inflation to fall to 2% before lowering rates, as long as the direction of travel is downwards. We expect volatility will likely remain until there is clarity on the timing and quantum of the cuts.

The local market continues to be impacted by global market developments. We do not expect that the upswing in markets seen in the last quarter will be sustained and remain cautiously positioned as the market needs a period of consolidation. We outline some of the factors that are potentially at play over the first quarter of the year which could test risk assets:

- Evidence continues to build, in the **US and outside,** that growth is slowing. This is more apparent in the euro zone, which is on the brink of a recession.

- In the **US,** valuations are full following the sharp move upwards in Q4 and current positive sentiment; risk assets could be vulnerable in the face of a possible market consolidation or pullback.
- We will take advantage of the dips to add to our equity portfolio in the coming year and are aware of the importance of a solid earnings base given that earnings risks are elevated.
- We will monitor economic data releases in the coming months, but the direction of travel is clear – inflation will reduce through the year. What is less clear is the timing of cuts and the severity of the recession.
- We are monitoring **China** closely. China continued to stimulate through Q4, which should reflect in the first quarter of 2024 in stocks such as diversified miners and our offshore equity holdings. The policy dynamic remains supportive.
- **Liquidity** will meaningfully tighten in the months ahead, given that the US has used up available reserves, creating opportunities in risk assets.

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. However, opportunities are presenting themselves and we will use our dry powder in cash to increase our **overall equity exposure** during the year. 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.

On the global side we are taking advantage of volatility and sold Partners Group and Universal Music to zero, following strong performance. We added new positions in **Dolby Laboratories** and **Jacobs Solutions**, on more attractive entry points.

On the SA equity side, we sold British American Tobacco and MTN over questions about the resilience of their earnings. We topped up where we have a higher conviction on earnings, including Mondi, Truworths International, Woolworths and SA banks.

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 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.

DISCLAIMER: