Discovery Flexible Property

31 July 2024

Market background

July started on a positive note but lost some momentum towards the end of the month. Sentiment towards risk assets gained traction on the back of growing expectations that the US Federal Reserve (Fed) could begin cutting interest rates in September. However, investor optimism began to wane midway through the month, weighed down by underwhelming earnings from certain mega-cap tech stocks and weaker economic data coming out of China. In South Africa, domestic assets continued their upward trajectory, buoyed by the prospect of positive economic reforms under President Ramaphosa's newly formed Government of National Unity.

Performance review

For the month, the portfolio underperformed the benchmark.

Following an exceptionally strong month for local names, July saw the portfolio's overweight exposure to select offshore counters contribute positively to relative performance. Among the largest contributors were the likes of Prologis (a global leader in logistics real estate), Hammerson (a major British property development and investment company), and American Tower Corporation (a US-based REIT that owns, develops and operates wireless and broadcast communications infrastructure).

Weighing on performance was the portfolio's underweight exposure to certain counters poised to benefit more immediately from changes to the interest rate regime. Examples include solely retail-focused names, such as Resilient and Vukile Property Fund, which were among the main detractors from relative performance over the month.

Outlook and strategy

The sharp increase in interest rates over 2022 and into 2023 resulted in a steep derating of the listed property sector, both locally and abroad. However, as increased rhetoric regarding a pivot on rate decisions entered the fray in late 2023, property globally benefitted as interest rate sensitive instruments re-rated. More recently, a dovish-sounding Fed, together with soft economic data out of the US, further buoyed this sentiment and provided support for the property market.

Locally, SA property benefited from lower bond yields and a market-friendly outcome following the national elections. We continue to believe that we are at the peak of the interest rate cycle and that any potential rate cuts will be beneficial to earnings and ratings for both local and global companies.

In our view, the improving fundamentals are supported by reasonable valuations; total returns being underpinned by income yield rather significant than re-rating potential within the year. The sector trades on a forward distributable income yield of c.10.2% and a c.30% discount to net asset value.

We believe the sector offers attractive value over a medium- to long-term time horizon, primarily underpinned by a more sustainable cash-covered yield, together with a supportive valuation that reflects near-term operational and balance sheet concerns. In the current environment, we continue to assess the portfolio risks and actively screen for opportunities that market dynamics such as these are likely to offer. Ultimately, we aim to provide our clients with the best risk-adjusted medium- and long-term outcomes.