Discovery Balanced, Moderate Balanced, Cautious Balanced Funds

Market background

Financial market returns were broadly negative in May, as investors kept a close eye on the debt ceiling negotiations in the US, while weighing up the likelihood of the world's largest economy defaulting on its debt obligations. Against this backdrop, central banks continued to raise interest rates, including the US Federal Reserve (Fed) and the European Central Bank (ECB) whose 25 basis points (bps) hike left interest rates at levels last seen during the Global Financial Crisis. Meanwhile, the People's Bank of China (PBoC) elected to keep rates on hold and add more liquidity to support China's economic recovery, continuing its policy divergence from developed markets. Turning to South Africa, a string of negative data and newsflow, including accusations that the government had supplied weapons to Russia, saw the local bourse close deep in negative territory.

For May, global equities as measured by the MSCI All Country World Index returned -1.0%. Developed markets outperformed emerging markets, with the MSCI World Index returning -0.9%, while the MSCI Emerging Markets Index ended the month down by -1.7%.
All returns are quoted in US dollars.

Local equities closed the month firmly in the red, with the Capped SWIX falling 5.8%. Resources lost 2.2%. Industrials closed 3.3% lower, led by declines from Naspers (-8.7%) and Prosus (-5.4%), with positive gains from Richemont (3.8%) offsetting some of the losses. Financials posted the largest decline among the super sectors, falling 7.5% for the month. The FTSE/JSE All Property Index fell 5.8% for the month, while the JSE All Bond Index declined by 4.8%. Cash, as measured by the STeFI Composite Index, delivered +0.7%. In currencies, the rand closed the month weaker against the US dollar, euro and pound sterling.

Discovery Life Investment Services Pty (Ltd): Registration number 2007/005969/07, branded as Discovery Invest, is an authorised financial services provider.

Performance review

For the month, the portfolio delivered a negative absolute return.

Key positive contributions:

- Within the weak backdrop for SA and global equities over the month, notable positions that detracted from returns are:
  - Naspers/Prosus detracted from returns for the month in the local equity component as well as our exposure to ABSA Group, FirstRand and MTN Group.
  - The offshore equity's allocation to China-listed shares, Barrick Gold and oil companies (ExxonMobil and BP) detracted from returns over the month.
- Global bonds detracted from absolute returns for the month in US dollar terms, but these declines were offset by rand weakness.

Key negative contributions:

- In a tough backdrop for local and global equities:
  - Within the SA equity component, AngloGold Ashanti contributed the most to returns over the month. Exposure to Richemont and Gold Fields also added to returns.
  - The offshore equity component notably benefitted from holdings in Bank Rakyat and Technology shares (i.e., Microsoft, Samsung, ASML, TSMC and Apple).
- The rand weakness over the month impacted the offshore exposure of the Fund positively.

Outlook and strategy

With the debt ceiling dispute being settled in the US, the next step is how liquidity withdrawals in the coming months impacts risk assets as the US treasury has to refill their coffers after running down the Treasury General account (which supplied the market with liquidity in the past 6 months). In addition, credit growth is slowing in line with consumer loan surveys. This is likely to pressure growth in the months ahead in the US and confirm our base case for a weaker growth outlook in the second half of the year. Furthermore, China's reopening is proving to be an uneven recovery given bottlenecks and no further strong stimulus measures by authorities. This is resulting in a slower recovery than seen in other economies post their COVID reopening, as recent data releases have come through weaker than expected, with sentiment towards China being very negative. There is a need for China to stimulate the economy more in the coming months to support the recovery and rumours have been circulating recently that policy measures should be forthcoming, albeit at the time of writing, we have seen some measures taken, but nothing meaningful announced.

The market has also downgraded growth expectations for the SA economy due to our electricity issues, which we are carefully monitoring as we navigate through a tricky winter period. While we still maintain a healthy allocation to SA bonds, we do have dry powder in SA cash at attractive yields that we can use

Discovery Life Investment Services (Pty) Ltd, branded as Discovery Invest, is an authorised financial services provider. Company registration number 2007/005969/07.

to allocate to opportunities as they present themselves. We will continue to look for opportunities to rotate into shorter-duration SA bond assets.

The mixed backdrop will likely continue to result in volatility in risk assets in the period ahead and we continue to have a lighter overall equity exposure with a preference for, albeit reduced position in 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 supportive earnings revisions profiles across our holdings, has tilted the portfolio to the domestic market. In previous months, our earnings revisions work steered us to increase positions in more defensive names at the expense of SA cyclicals within the local equity component and with recent company updates, earnings downgrades are starting to materialise. We are paying close attention to this, as the market tends to overshoot to the downside, and this could create opportunities to buy these companies in the months ahead. We are still of the view that developed market equities do not yet reflect the high likelihood of earnings downside risk due to record margins and sales levels in the goods side of the economy declining towards trend. The offshore stock selection continues to favour a position in Asia ex-Japan equities to benefit from the expected consumption tailwinds from China, while Developed Market 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.

As we near the end of the global hiking cycle, our position in defensive government bonds focused on high grade nations with leverage and housing imbalances (Australia, New Zealand, South Korea, Canada and Sweden) should enhance returns of the overall portfolio.

Discovery Life Investment Services (Pty) Ltd, branded as Discovery Invest, is an authorised financial services provider. Company registration number 2007/005969/07.