Discovery Global Multi-Asset Fund

30 June 2024

Market background

The second quarter was mixed for capital markets. In the US, another strong run for AI-related tech stocks helped lift equity indices higher. In Europe the European Central Bank (ECB) joined the growing list of G10 banks to start cutting rates, but the announcement of a snap election in France weighed on sentiment towards the end of the period. Similarly, in the UK, the FTSE 100 performed strongly over the quarter, but lost ground in June amid election concerns.

In Asia, Hong Kong and Chinese mainland stocks fell for the second consecutive month in June, with markets lethargic ahead of a July meeting of China's top leaders. However, stocks delivered a positive performance over the quarter. In Japan, the Nikkei rallied on a weakening yen, but was unable to sustain the forward momentum of Q1, over the second quarter.

South African equities closed the second quarter in positive territory, supported by optimism over corporate earnings and the prospect of a market-friendly outcome following the national elections. The economy contracted by 0.1% quarter-on-quarter (q/q) in Q1 2024, missing market expectations and falling below the 0.3% posted in the previous quarter. Main detractors included manufacturing, mining, and construction, as loadshedding continued to weigh on economic growth.

Gold was flat in June, ending the month at US$2,327 per ounce, leaving the precious metal up by about 4% over Q2.

Performance review

Over the quarter the Fund produced a positive absolute return in US dollars, gross of fees[1], and outperformed its benchmark (60% MSCI ACWI / 40% WGBI).

The largest contributor to the portfolio's positive relative performance was security selection in equities. In April, the portfolio's overweight position towards China drove positive performance, as the Chinese equity market continued to rally from January lows due to positive policy initiatives and improved growth data. Following this, May and June's outperformance was driven by the portfolio's utilities and technology stocks, which were buoyed by growing optimism surrounding AI adoption and the anticipated increase in electricity demand.

Fixed income positions were flat on a relative basis, with positive asset allocation performance largely offset by security selection, notably a preference for government bonds with longer maturities. Currency was also flat over the quarter, with the portfolio's main position, an overweight in the US dollar, witnessing rangebound performance.

[1] Based on gross-of-fee composite returns of various managed accounts and pooled funds. Net returns will be lower and relative returns may differ according to share class held and applicable fee level.

There were several changes to the Fund over the quarter, primarily driven by stronger economic data in Europe and an assessment of increased upside risks to growth as central banks approach the start of cutting cycles. At a headline level, relative equity exposure was increased from a c.5% overweight to a 9.5% overweight position. Additionally, duration exposure was adjusted from 2 years overweight to 0.5 years overweight relative to the benchmark exposure.

In equities, the portfolio’s underweight position to Europe was reduced. This was via the closure of the remaining short European equity hedging positions due to stronger growth data which increased the probability of a cyclical recovery. Conversely, the portfolio’s overweight allocation to Asia ex-Japan was reduced. This was primarily driven by decreasing Chinese equity exposure via profit-taking on strong performers and exiting the lower conviction cyclical companies which continue to be inhibited by weak growth momentum. We maintain a positive bias towards risk assets in China given the ongoing support from policy easing and underlying supportive structural growth trends.

In fixed income, portfolio duration was reduced through a reduction in German government bonds as a result of stronger macro data. This was partly offset by a new position in UK fixed income, given attractive valuations and a view that rate cuts were likely to be implemented in the next six months given moderating inflation and slow growth.

Outlook and strategy

In the US, we believe monetary policy is tight and will continue to progressively impact the economy as companies and households refinance their debts at higher interest rates. Recent evidence shows a broad-based moderation of economic activity. While the US Federal Reserve (Fed) has backed away from rate cuts in recent quarters, we expect data trends will permit cuts later this year. Meanwhile, loose fiscal policy continues to support economic growth, which provides some risk to the US inflation outlook.

This combination of prospective monetary policy loosening, ongoing fiscal support, and improvement in some of the more rate sensitive areas of the economy leads us to expect a soft landing for the US. In saying this, the risk of a recession remains elevated as present as past policy tightening continues to feed through.

In Europe, we believe policy is tight and the lags are shorter than in the US due to less pandemic stimulus, higher levels of floating rate debt and notably less fiscal support. Growth indicators remain weak despite some modest signs of improvement from a low base. We expect eurozone inflation to continue to moderate as energy price pressures continue to abate. We see an elevated risk of a deflationary period in the eurozone and believe that the ECB’s easing cycle will be more pronounced than that of the Fed.

In China, policy appears loose albeit without material easing taking place. However, easing measures are becoming progressively more forceful, with additional fiscal stimulus and strong efforts being made to clear excess housing inventory through the People’s Bank of China funding of social housing. We expect policy makers to do what it takes to ensure that a sustained recovery takes hold. Growth metrics are mixed and the recovery will remain bumpy. Inflation is weak, but base effects should offer more support going forward. We continue to believe that the Chinese economy will experience a more benign outcome than the bearish consensus suggests.

Our central investment roadmap, as discussed above, leaves us somewhat more positive on the prospect for risk assets, particularly in Asia and the US. In fixed income, portfolio duration declined through the first half of this year post a strong rally in government bonds at the end of last year and due to an increase in the probability of a US soft landing. We maintain an overweight to defensive duration, however, particularly in Europe. In currency we maintain a preference for the US dollar versus European and Asian currencies, as a diversifying portfolio position, given positive carry dynamics and our expectation that easing in these regions will be more pronounced than in the US.