Discovery

Discovery Global Multi-Asset Fund

Market background

There was significant turbulence in risk assets during the first quarter of the year. Initially driven by concerns of the more hawkish rhetoric from central banks, in particular the US Federal Reserve, markets then reacted negatively to the invasion of Ukraine by Russia and the subsequent imposition of severe sanctions. Inflation worries continued, exacerbated by the Ukraine crisis, given the sharp rise in commodity prices. For example, in the US, year-on-year-inflation rose to a 40-year high in February and included notable beats in categories such as rents. This forced central banks to follow up their rhetoric with more aggressive tightening of monetary policy than the market initially anticipated. The exception was China, where the PBoC has continued to inject further liquidity into the financial system. Economic data, including flash PMIs, however remained resilient.

The risk-off tone from geopolitics and central bank action meant that Growth assets mostly generated a negative return with losses stretched across equities and credit. Global equities returned c. -5% over the quarter despite developed markets, and in particular US equities, staging a rebound in March. Emerging markets underperformed largely due to China which was held back by the further extension of lockdowns and continued concerns around the impact of regulation. Europe ex UK was the worst performing region, falling by over 20% at one point, with this market particularly impacted by investor concerns around the Ukraine crisis. The UK was the exception, generating a small positive total return, in part thanks to the positive impact from rising commodity prices on some of the larger companies in the region. Energy, metals and agricultural goods all saw large gains; for example, oil prices rose to close to $140/bbl at one point given Russia’s position as a significant oil exporter, before ending the quarter below $110 thanks to a boost in supply from the US, albeit still an almost 50% increase. Credit also showed signs of stress, with losses suffered across the quality spectrum and in both Europe and the US. Emerging market debt was also negatively affected by the turn in risk sentiment, along with the continued tightening of central bank policy and a strong US dollar.

With markets expecting tighter monetary policy, sovereign bonds sold off across the board in the first quarter. The global bond rout in the middle of the quarter saw the yields of 10 year US treasury bonds

breach the 2% threshold for the first time since summer 2019. In Europe, as markets moved to price in a policy lift off, 5 year bund yields entered positive territory for the first time since 2015. A further cause of concern towards the end of the quarter was the flattening, and eventual inversion, of yield curves in the US – seen by many market participants as a harbinger for a recession down the line. Investment grade corporate bonds also sold off in sympathy with sovereign bonds, with Europe marginally outperforming the US.

Gold benefitted from the move into safe havens, as well as demand for inflation hedges and returned +6% during the quarter, ending the period above US$1,900/oz.

Performance review

For the quarter, the Fund delivered a negative absolute return and marginally outperformed the benchmark.

Equity markets declined over the first quarter with considerable volatility that was caused by Russia's invasion of Ukraine, increasingly hawkish major central banks and renewed lockdowns in China. The US equity market declined but fared better than other markets, given limited impact from events in China and Eastern Europe, while European markets underperformed because of these issues. Asian markets also struggled, falling sharply though the period before Chinese policy makers stepped in to provide reassurance that additional easing would be forthcoming and issued statements to address investor concerns regarding regulation and relations with the US. The Fund's equity allocation detracted, with higher quality holdings in particular detracting from returns, while holdings in resources and healthcare companies provided some counter. In fixed income, government bond yields rose notably. This was particularly evident in the US where the Federal Reserve is beginning to take more decisive steps towards fighting inflation. An underweight to duration, particularly in the US, added to returns over the period.

Portfolio activity

There were a number of changes to the mandate over the quarter. Over the period we made a number of additions to the equity allocation, taking advantage of opportunities that had emerged as a function of volatility. In early March, we also exited a short Eurostoxx 50 Futures contract that was held to hedge some of the portfolio's equity exposure. It was exited as the index entered into a bear market and rotated into an S&P 500 Futures short, where valuations remain stretched, to maintain the same equity weight.

Outlook and strategy

The invasion of Ukraine by Russia created stress across financial markets and has simultaneously placed upward pressure on inflation metrics, through supply chain disruptions and energy price increases, and downward pressure on growth. This has happened at a time when inflation globally is

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generally high and major central banks are beginning to withdraw policy accommodation. Central banks, and the Federal Reserve in particular, have sighted that lowering the rate of inflation is their primary objective at present. This presents a headwind to financial markets and investors should question the level of valuations against a backdrop of much tighter liquidity conditions and a moderating growth impulse. We see financial markets remaining volatile in the coming quarters as a result. The one area where policy dynamics are moving in the opposite direction is in China, where authorities were notably ahead in withdrawing policy accommodation through 2021 and are now in the process of moving back towards easing policy with a clear pivot having taken place coming into 2022. Although the lagged effects of prior policy tightening continue to feed through in China, and growth will likely be weak in the first half of this year, we remain more encouraged by the prospect of easing and the moving away from some of the policies that hampered Asian markets (regulation and deleveraging) over the past year. Chinese policy appears more market friendly through 2022 and this should provide some support to asset markets in the region.

Our central scenario for financial markets continues to be that volatility will likely remain high in the coming quarters. As we look six to twelve months out, we believe investors should continue to focus on the change in liquidity dynamics in the developed world, while valuations in the US remain extended and growth may moderate as a function of sharply higher energy prices. In Asia, Chinese growth is likely to continue to slow and higher energy prices also represent a headwind, but Chinese policy makers have moved decisively towards easing and asst valuations are more attractive. The Fund remains cautiously positioned, with an elevated exposure to Asian risk assets, as a function of these dynamics. We continue to watch the evolution of Chinese policy, the direction of developed market central bank policy, and the evolution of growth and inflation, believing that these are the primary forces driving financial markets from here. We will seek to take advantage of opportunities as they are presented.