Discovery Target Retirement Date Fund

May 2024

Market background

May was a more upbeat month for capital markets, with most asset classes recovering from the losses of April. Although markets were more challenged towards the end of the month as global inflation data proved stickier than expected, overall investors grew more confident that rate cuts would still happen this year.

In emerging markets, performance was influenced by various factors, including negative economic indicators from China, which weighed on the overall performance of the EM index. Elections in key EM markets, including India, Mexico and South Africa, kept markets somewhat subdued.

South African equities closed the month broadly firmer, supported by hopes that the Fed could begin cutting rates this year, a viewpoint that subsequently lost momentum towards month-end. On the political front, sentiment turned somewhat cautious ahead of the national elections.

Commodities had a strong month in May, with energy stocks the exception as the price of crude oil weakened. Gold continued its upward march, touching new highs as investors sought perceived safe havens.

Performance review

For the month, the Fund delivered a positive absolute return.

Global equities rose, particularly driven by the semiconductor and large-cap technology sectors, with TKO Holdings emerging as a standout contributor. Additionally, global bonds supported, benefitting sectors like utilities and real estate. Gold stocks such as Agnico Eagle, Barrick Gold, and AngloGold Ashanti, along with companies like Naspers and Prosus, made notable contributions. Furthermore, commodity stocks like South 32, Glencore, and BHP also added to performance. Notable detractors included certain 'SA Inc.' stocks. Energy stocks faced pressure due to a decrease in crude oil prices, while Anglo American retreated after merger talks collapsed. Profit-taking in China-exposed stocks also weighed on performance.

We continue to add to our preferred equity names on market weakness. We added to Canadian National Railways, Zalando and ‘SA Inc.’ stocks. We initiated new positions in a Japanese insurer and Danish brewer, Carlsberg. In terms of sales, we continued reducing our position in JPMorgan Chase & Co., selling down to zero after strong performance. We also sold ExxonMobil down to zero, taking profits. We sold out of select Chinese holdings, including Haier Smart Home and Bosideng, as the stocks had run hard in the recent Chinese rally. We also trimmed our holdings in Anglo American and Bid Corp, following strong runs, recycling the profits into Mondi and other diversified miners.

We held our neutral duration position on SA bonds but took profits on longer-duration European bonds, while continuing to hold shorter-duration (10-year) bonds. The profits have been returned to SA where they are being held in cash and will be deployed as opportunities arise.

Outlook and strategy

Inflation and global interest rates are still the name of the game: US data points tell a story of inflation that is slowing in a stop-start fashion, delaying the onset of rate cuts. Investors believe the direction of travel is towards slowing growth and rate cuts with markets anticipating that the US Fed will cut at the end of 2024. In Europe and Canada, the central banks have cut rates, with the Canadian central bank likely to cut again this year, while the ECB has indicated this will be data dependent. The cuts have sent a positive signal to bond markets, but the uncertainty has kept many bond investors on the sidelines. The timing matters for equities in general, and EM risk assets in particular, as they tend to do well when the Fed is easing.

SA remains on tenterhooks following the outcome of the May election; until the outcome is known, we remain cautious.

Turning to the economy, the market has shifted into a reflation regime on the back of US and China manufacturing data pointing to a mild expansion after an extended period of contraction. In the US, we continue to see a two-speed economy: while manufacturing data is showing early signs of green shoots, the services sector is slowing. The labour market is sending mixed signals however incomes continue to grow, ensuring the economy remains resilient. In China economic data is mixed; after trending upwards over the holiday season, consumer spending unexpectedly plateaued in April and May. On the other hand, manufacturing and exports improved, but mounting trade tensions may hobble this. The government's focus on strategic sectors such as renewables, technology and infrastructure is likely to remain, and will be supportive of commodities. The property sector is not a focus area for growth, but authorities have made it clear that stabilisation of this sector is key to restoring consumer confidence.

As a result of this reflation regime, commodities have continued to rally. This is supportive of our positions in the resources sector. If this continues at the current pace, it does pose a risk to the inflation trajectory in the US in the second half of the year. This is something that we are watching closely.

The portfolio has a healthy cash balance, which continues to yield an attractive risk-free return. We deployed some cash into stocks on our 'buy' list and will continue to do so in the months ahead. Our equity mix remains tilted towards companies with strong earnings fundamentals at a reasonable valuation. Our allocation to SA bonds is supported by a strong yield underpin. We expect our already reduced global bond allocation to add value to the portfolio in the coming months as the ECB cuts interest rates. In time we expect to further reduce our exposure as we take profits.