# Discovery Balanced, Moderate Balanced, Cautious Balanced Funds

## Market background

October saw a continuation of the market weakness that was evident in August and September. Underlying the risk-off sentiment was the realisation that interest rates could remain higher for longer, which sustained the recent rise in bond yields. Overlaying this was the significant concern about rising geopolitical risk, resulting from the re-emergence of conflict in the Middle East in early October.

In the US recent inflation and growth data surprised to the upside with consumer strength showing no signs of abating after nominal spending jumped and beat expectations. This together with strong business data, including retail and industrial production numbers, indicated a resilient US economy despite interest rates now in restrictive territory. Conversely, in Europe, tight monetary policy has started to have an impact; data was much weaker in October with the first estimate of Q3 GDP in the eurozone showing a -0.1% contraction.

The risk off sentiment dominated risk assets, and global equities were down by over 2% during the month, with emerging markets underperforming developed markets. US equities declined in October, with both the S&P and Nasdaq dropping more than 10% from their July highs, entering correction territory. European equities were similarly gripped by the risk off mood during the month. Within Asia, equity markets were also weak as the sentiment around the Middle East conflict spilled over together with the additional negative news that the US has planned tighter curbs on China's access to advance semiconductor chips.

South African equities continued the trend set in August and September, following international markets lower, with the FTE/JSE All Share Index (ALSI) ending the month down 2.2%, taking the ALSI into negative territory for the year.

Elsewhere within growth assets, performance was mixed. Global high yield corporate bonds generated a negative return impacted by poor risk sentiment and rising yields, with the US underperforming Europe. Emerging market debt also generated a negative return with local currency marginally outperforming. Following a very strong third quarter, oil prices were lower over the month despite concerns over risks to supply due to the conflict in the Middle East as well as news of the US sanctioning two shipping companies for violating the price cap on Russian oil.

Within defensive assets US treasury bonds sold off, losing ground for the sixth month running. European government bonds outperformed as the flash CPI release for the eurozone in October fell to a 2-year low and data weakened. A rare ray of light came from South African government bonds, which delivered positive returns in rands and dollars.

Despite risk-off sentiment and US dollar demand, the rand strengthened slightly against the US dollar in the month. This meant fewer gains for investors in rand hedge shares like Richemont, BAT or Sasol and Anglo Platinum.

With the geopolitical backdrop increasingly fragile, the demand for safe havens saw the price of gold rise by c.7%, moving by more since the banking stress in March, and at one point surpassing the $2,000/oz mark.

To read more, please click here or visit the Insights section of www.ninetyone.com.

## Performance review

In the month the portfolio delivered a negative absolute return.

Sentiment soured after it became evident that global rates would remain higher for longer, causing bond yields to spike across developed and developing markets, and spilling into equity markets – leaving few places for investors to hide. Indeed, at an asset class level, the only place to hide was in cash and South African government bonds.

In the second half of the year, we lightened some of the portfolio's exposure to global bonds and SA bonds, keeping some of the proceeds in cash. Some of this cash has been deployed, topping up existing holdings – for instance in diversified miners - on price weakness. We also added new positions, for instance in selected SA retail holdings, also on price weakness.

## Key negative contributions:

In a sea of red in local and global risk assets, some notable detractors were:

- China: Naspers, Prosus, Richemont and our offshore China equity holdings detracted on China negativity, as did Anglo American and Impala
- Energy: ExxonMobil and BP gave up recent gains

## Key positive contributions:

- Gold mining stocks: our domestic positions in Gold Fields and Anglo Gold Ashanti, and offshore positions in Barrick Gold and Agnico Eagle delivered positive returns – decoupling from global bonds which sold off
- Woolworths and The Foschini Group delivered positive absolute returns
- SA bonds: these were positive on an absolute basis and outperformed every other global asset class, largely due to the yield underpin
- Select offshore equity: this includes Elevance Health and UnitedHealthcare where performance is attracting attention; Microsoft also performed well after a strong set of results.

## Outlook and strategy

For the remainder of the year, we expect the uncertainty and volatility to continue, with market swings dictated by the narrative of the moment rather than changes in underlying fundamentals. The current risk-off sentiment drove October's sell-off in global bonds and leveraged assets, China equities being a notable example. This will only settle once the market has certainty on interest rate policy in the US. The US Federal Reserve has made it clear that it will only cut rates on evidence of slowing growth. The only other driver would be a credit event or evidence that liquidity is drying up that causes an issue in the financial plumbing.

The local market continues to be impacted by global market developments. Sentiment is now decidedly risk off as markets recognise that higher rates for longer will dampen global demand. We remain cautiously positioned and outline some of the factors that are potentially at play over the final months of the year and that could test the asset class:

- Evidence is building, especially outside of the **US,** that growth is slowing. This is becoming increasingly apparent in the Eurozone, where data points to a recession sooner rather than later.
- In the **US,** delinquencies are rising, and retailers are reporting anxiety over top line growth as fiscal support for consumers is dwindling. Recent results have remained robust, but many companies have downgraded earnings expectations for Q4 results.
- We will monitor economic data releases in the coming months to confirm our thesis of a recession in 2024. In addition, while inflation is coming down, the base effects in the coming months may create volatility in the data.
- The massive shakeout in **global bonds**, coupled with US dollar strength (which reduces global liquidity), tight policy and slowing global growth creates a potent risk-off cocktail. This means volatility and uncertainty will remain.
- We are monitoring **China** closely. After months of negative data releases there are some early signs that the bottom may have been reached. The policy dynamic is highly supportive; local government debt problems are being resolved; extra bond issuance is injecting liquidity into the system, and the iron ore price is holding up, suggesting ongoing investment in infrastructure.
- Chinese equities have not held up over the month, likely driven by global risk-off sentiment. On the positive side, the recent earnings season saw Chinese companies deliver positive results, on balance.
- **Liquidity** is tightening and will likely impact risk assets in the months ahead.

Given this backdrop, we remain cautious. Our **overall equity exposure remains neutral,** with our equity mix still tilted towards companies with strong earnings fundamentals, which can manage through the slowdown. We have deployed some of our cash into SA Inc stocks, those with attractive entry points. These include Truworths International, Woolworths, Shoprite and Sanlam. On the global side we added to our position in the London Stock Exchange.
We trimmed our exposure to Richemont and MTN, and sold out of Reinet after a period of strong performance. Similarly, globally we took profits on Universal Music, selling our holding down to zero.

We believe our position in **European bonds** will add value in time. We also maintain a healthy **allocation to SA bonds which have an attractive yield underpin.** The portfolio has a healthy cash balance, which continues to yield an attractive risk-free return. This dry powder in cash puts us in a better position to take advantage of future opportunities.

## DISCLAIMER:

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

Collective Investment Schemes (Unit Trusts) are generally medium to long-term investments. The value of participatory interests (units) or the investment may go down as well as up. Past performance is not necessarily a guide to future performance. Collective investment schemes are traded at ruling prices and can engage in borrowing and scrip lending (i.e. borrowing and lending of assets). The manager does not provide any guarantee, either with respect to the capital or the return of a portfolio. Any forecasts and/or commentary in this document are not guaranteed to occur. Different classes of participatory interests apply to these portfolios and are subject to different fees and charges. A schedule of all fees and charges, inclusive of VAT and maximum commissions, is available on request from us or from your financial adviser. Forward pricing is used.

For the full CIS disclosure and risk statement, go to:
CIS disclosure:
http://www.discovery.co.za/assets/discoverycoza/corporate/cis-disclosure.pdf
Risk disclosure:
http://www.discovery.co.za/assets/discoverycoza/corporate/risk-disclosure.pdf