Discovery Balanced, Moderate Balanced, Cautious Balanced Funds

Market background

The month of October was a tale of two parts. The first half saw most asset classes continue to weaken from second quarter (Q2) lows, before staging a rebound in the second half as investors' hopes began to rise that central banks might begin to pivot away from their aggressive interest-rate hiking cycles.

Developed market (DM) stocks (MSCI World Index, +7.2%) delivered strong returns, while emerging markets (MSCI Emerging Markets Index) remained pressured, falling 3.1% over the same period as weakness in the heavily weighted MSCI China (-16.8%) overshadowed solid gains in Brazil and India.

In fixed income, US Treasuries fell 1.7% over the month, with the yield on 10-year sovereign bonds in the US rising to 4.05%, while 10-year yields across several European countries and the UK fell after the September spikes. The Bloomberg Barclays Global Aggregate Bond Index ended the month down 0.7%. All returns are quoted in US dollars.

In tandem with global markets, South African (SA) equities rose strongly, with the Capped SWIX up 5.3% for the month. At a super-sector level, financials (+12.9%) did most of the heavy lifting, supported by resources (+3.7%), while industrials chipped in with a 1.7% return. Banks led at the sector level, inspired by Investec and Standard Bank announcements, alongside listed property, while technology (-15.6%) saw weakness over the month due to developments in China (as mentioned above) impacting the Naspers-Prosus stable via its association to Tencent. The JSE All Bond Index was less buoyant, returning +1.1% for the month. Cash, as measured by the STeFI Composite Index, delivered a 0.51% return over the same period. The rand remained volatile and on the backfoot over the month, weakening against the greenback, euro and pound sterling, but holding firm against the renminbi.

Performance review

For the month, the portfolio delivered positive absolute returns.

Key positive contributions:

- There was broad-based strength in SA and global equity over the month that added to returns, in particular:
    - Within the SA equity component, banks and listed property contributed strongly to returns. Sappi, Impala Platinum and Anglo American Platinum added positively.
    - The offshore equity component benefitted from our exposure to Mastercard, healthcare (i.e., UnitedHealth & Elevance Health), Oil (i.e., ExxonMobil and BP) and consumer staples (i.e., Philip Morris International and PepsiCo).
- The allocation to SA bonds added to absolute returns.
- The offshore component of the also benefited from the rand weakness over the period.

Key negative contributions:

- Naspers and Prosus, BHP Group and South32 detracted from returns within the local equity component.
- The offshore equity allocations to Chinese equities, American Tower, NextEra Energy and Waste Management held back returns over the month.
- Our exposure to South Korean bonds also weighed on returns.

Portfolio activity

We took advantage of the correction in equity markets and dollar strength by adding to global equities from the middle of the month, using cash, while also taking profits on some of our long USD/short USD block economies (sold all New Zealand and half of the Australian position).

Within the local equity component, we trimmed our position in Gold Fields and The Foschini Group, as the earnings revisions are no longer supportive, while also trimming the Naspers-Prosus exposure earlier in the month to right-size the position. We used some of the proceeds to top up our position in SA Banks (Capitec Bank and Standard Bank Group) where the earnings revisions profiles are supportive over the next 12 months. In the offshore equity component, we topped up existing ideas on weakness, where we believe the earnings resilience are intact given the current macro headwinds.

In local fixed Income, we trimmed half of our inflation-linked bond position, choosing to take profit on a tactical trade.

Outlook and strategy

The ongoing liquidity withdrawal and higher interest rates are likely to impact growth in the coming months and continue to result in higher volatility in risk assets. To navigate through this, we are actively taking advantage of this volatility by adding to existing positions with stronger earnings conviction on weakness, while taking profits in various areas on strength.

While recently adding some equity exposure on weakness, we have maintained a lighter overall equity exposure and the equity selection has a balance of more defensive and select cyclical exposure. Our preference for SA Equity over offshore equity remains as we believe the valuation support (SA did not enjoy the multiple expansion seen in developed markets), coupled with strong earnings revisions profiles across our holdings, has tilted the portfolio to the domestic market. The offshore stock selection has favoured a larger position in more defensive sectors (healthcare, utilities and real estate) given the earnings risk in cyclical sectors such as consumer discretionary and industrials.

The local equity composition is well diversified with our defensive exposures in our holdings of Naspers and Prosus, British American Tobacco and Bid Corp, where we believe earnings revisions are likely to inflect positively in the coming year. This sits alongside a reduced, but still healthy allocation to global cyclical stocks (diversified miners, platinum-group metals miners and Richemont) continuing to exhibit favourable earnings revisions profiles. We continue to have a healthy allocation to South African banks (with a preference for ABSA, Nedbank and FirstRand) where earnings revisions remain positive, and valuations are attractive. This sits alongside our exposure to select apparel retailers (Pepkor, Woolworths and Mr Price Group) that display good earnings revisions profiles. Our exposure to local defensive businesses is mainly through Life Healthcare and Shoprite and a reduced exposure to MTN Group.

The valuation argument for local sovereign bonds still holds and we maintain a large allocation overall. With headline inflation rates peaking, the next few months are critical for global rates.

