Discovery Global Multi-Asset Fund

Market background

The third quarter of the year was extremely volatile, and effectively one of two halves as the market flip flopped over what central banks might do next. Risk assets were in positive territory up until mid-August, driven by the belief that 'peak inflation' had been reached and would lead to a dovish pivot in monetary policy. Instead, inflation kept rising and strong US labour data signalled that an expectation of looser policy was premature. The Fed indicated it would stick to its restrictive policy stance, leading to a sharp sell-off across a broad array of assets in the latter half. This hawkish tone was echoed by other central banks, also facing inflationary pressures, although the BoJ and PBoC remain the outliers with the former keeping its accommodative policy in place.

Europe was a key reason behind high inflation given this year's energy shock, which refuses to settle, partly due to the suspension of the Nord Stream gas pipelines to Europe. The UK faced market turmoil following a 'mini-budget' towards the end of the quarter which included the largest package of tax cuts since the 1970s; the BoE promptly announced it would delay the start of quantitative tightening and instead engage in asset purchases to restore market liquidity. Geopolitical risks did not help sentiment either, with continued concern over Russia's war games and China's intentions regarding Taiwan.

Against this backdrop, global equity indices lost ground for a third consecutive quarter – for the first time since the financial crisis, with emerging markets underperforming developed markets. Within emerging markets, the declines were led by Asia and in particular China where COVID-19 lockdowns, growth concerns, and renewed scrutiny on tech shares saw indices fall by double digits. US equities fell by mid-single digits following the realisation that the Fed would continue to tighten policy even if growth were to slow.

Elsewhere within Growth assets, high yield corporate bonds also fell in value with Europe underperforming the US as the worsening economic outlook triggered rising angst about companies' ability to pay their debts. Emerging market debt also fell by mid-single digits as hawkish action by central banks and a strong US dollar continued to act as headwinds. The US dollar reached its strongest level in over two decades; conversely, the Japanese yen slid to a fresh 24-year low due to the widening rate

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differential, and the GBP at one point reached its weakest level versus the US dollar since 1985. Commodities also struggled – not helped by further COVID lockdowns in China which have in turn raised questions about the strength of global demand.

Persistent inflation and more hawkish central banks saw Defensive assets lose ground too. Sovereign bonds had another poor quarter with Gilts faring the worst given the market turmoil in the UK. Long end gilts are typically the least price sensitive due to the meaningful regulatory asset and liability buying. As such, the extraordinary sight of the 30-year gilt yield surpassing 5% in trading for the first time since 2002 highlighted investor jitters. US Treasuries and European sovereigns also lost ground. Investment grade corporate bonds sold off as they were negatively impacted by rising rates.

The gold price fell during the quarter, ending below $1,700/oz; expectations for aggressive action by the Fed, together with sustained US dollar strength, diminished the precious metal's lustre.

Performance review

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

The largest contributor to relative returns was asset allocation, driven by underweights in both equity and fixed income.

Portfolio activity

Over the period, we selectively added to Asian equities given attractive valuations and increasing policy support. We also reduced the portfolio's underweight to fixed income, primarily through developed market sovereign bonds, notably a new position in Australia. Although we believe it's too early to go overweight government bonds in the portfolio, a recent decline in the Australian housing market furthers our conviction that the economy is less likely to accommodate rates as high as the US and that we will see policy divergence which should support yields.

Outlook and strategy

Central banks, and the Federal Reserve in particular, have sighted that lowering the rate of inflation is their primary objective at present. They have highlighted that this will likely come at the expense of economic growth. After reacting positively to what appears to be a peaking of inflation in the US, evidence that growth is slowing and resulting speculation that the Fed had pivoted, financial markets have weakened as faith in the latter has diminished. We continue to believe that tightness in the US labour market and the level of wage growth is inconsistent with the Fed being able to return inflation to target without a weaker economy and labour market. Our central case heading towards 2023 is that the Fed

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will have to maintain tight policy while both growth and earnings weaken. The level of valuations in the US remains elevated against a backdrop of tighter liquidity conditions and a now moderating growth and earnings impulse. We remain cautious on equities in the developed world 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 moving back towards easing policy with a clear pivot having taken place coming into 2022. Although covid remains a challenge in China, we remain encouraged by the prospect of further 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 going forward and this should provide some support to asset markets in the region.

Our central scenario for financial markets continues to be that volatility will remain high in the near future. As we look six to twelve months out, we believe investors should continue to focus on tightening liquidity dynamics in the developed world and the weakening of growth and earnings, while valuations in the US remain at a premium when factoring in likely earnings downgrades. In Asia, Chinese growth is likely to begin bottoming out and then strengthening heading into 2023 with Chinese policy makers having moved decisively towards easing and asset valuations are more attractive. The Strategy 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 corporate earnings, believing that these are the primary forces driving financial markets from here.

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