Discovery Target Retirement Date Funds

Market background

August proved to be a challenging and volatile month with negative headlines outpacing the positive. Financial markets grappled with rising risks from the Chinese property sector, as well as US data that fanned concerns over persistent inflationary pressures. This led to the growing realisation for investors that interest rates could remain higher for longer, with consensus rate cuts now not expected until Q2 2024. An additional catalyst for difficult markets was Fitch Ratings decision to downgrade the US credit rating from AAA to AA+.

In the UK the Bank of England (BoE) raised its key interest rate by 25bps in August, warning that rates could remain higher for longer if inflationary pressures persist. Expectations for further policy tightening grew on the back of better-than-expected GDP numbers for the second quarter (Q2), placing pressure on equity markets. Meanwhile in the Eurozone, retail sales contracted well below expectations, services PMI contracted for the first time this year, manufacturing activity continued to fall, and business confidence fell to its lowest levels in nearly two years. This prompted markets to believe the region is too fragile to absorb another interest rate hike without tilting the economy into recession.

In China, more data emerged that the economy is faltering, pushing the government to step in with measures to lift investor confidence and boost economic growth. The PBoC lowered its one-year medium-term lending facility by just 15 basis points (bps) while keeping its five-year loan prime rate unchanged. This was not enough for investors who were anticipating stronger support to boost economic growth. Policymakers later announced the reduction in stamp duty on stock trading, along with planned measures to reduce the pace of initial public offerings and restrict large shareholders from substantial share reductions. The news provided equities with a short-term lift, but not enough to offset losses for the month. By the end of August, the Shanghai Composite (-5.1%) and Hang Seng (-8.2%) were in the red, while the yield on China's 10-year government bond rose to around 2.6%.

South African equities followed international markets lower, with rand weakness further weighing on performance. While headline inflation eased closer to the South African Reserve Bank's (SARB's) 3-6% target range, retail sales fell below consensus forecasts, a sign of consumer pressure. The month was also tough for miners as lower commodity prices and concerns over slower growth in China weighed on the sector. The yield on the 10-year government bond rose to around 11.69% broadly in line with

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global bond markets, while risk-off sentiment and US dollar demand saw the rand decline against major currencies.

Overall, developed markets outperformed emerging markets, with the MSCI All Countries World Index delivering -2.8% and the MSCI Emerging Markets Index producing -5.6%. Gold depreciated in value by 1%, with a strong US dollar and the prospect of further rate hikes acting as headwinds.

Performance review

In August the portfolio delivered a negative absolute return as market sentiment reverted to risk-off from the risk-on sentiment of July, unwinding some of the previous gains. We made few changes to the portfolio in the month, selecting opportunities as they presented themselves.

Key positive contributions:

- In a sea of red, Exxon Mobil and BP outperformed on supply concerns given Opec's commitment to tighter production for longer. Russian oil cuts contributed to price strength, while on the demand side, China is mopping up supplies.
- Google and Amazon were also positive over the month.
- Locally, Shoprite, Bidvest and Outsurance continued their strong run, providing relief in a sea of red.
- In the local fixed income component, SA bonds were marginally positive over the month.
- A weaker rand provided support to our offshore holdings.

Key negative contributions:

- Dollar strength hurt precious metals producers Impala, Anglogold and Northam, which all detracted from performance. Impala and Northam led the fall, following the bearish outlooks communicated by recent results in the PGM sector.
- Hopes that the Chinese economy would rally fizzled in the month, dragging down China-exposed stocks in our offshore holdings as well as luxury goods maker Richemont, Naspers/Prosus and diversified mining exposure.
- Our position in global bonds also detracted from returns

Outlook and strategy

While global equity markets have remained relatively buoyant this year, they are now range-bound, moving in tune with sentiment rather than in a determined direction. We remain defensively positioned and outline some of the factors that are potentially at play over the course of the last few months of the year and could test the asset class:

- Evidence is building 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 China signs of a steepening downturn in the property market provided no relief to investors. As a result, sentiment towards China was trending more negative, but there have been quite a few stimulus announcements recently and the more recent one of easing mortgage restrictions is seeing early signs of improving property activity. We are monitoring whether this, coupled with the increased local government bond issuance underpins growth in the coming months.
- In the US the jury is out on the "softer or no landing scenario" which had prompted positive market sentiment in July. In the last week of August, weaker-than-expected data reports suggested that economic growth in the US was beginning to ease. We are monitoring economic data releases in the coming months to confirm our thesis of a high probability of an acceleration in slowing growth in

developed markets (due to many of our indicators pointing to this). In addition, while inflation is coming down, the base effects in the coming months may create volatility in the data.

- Liquidity has been a supportive driver over the first half of the year. Our view is that liquidity is becoming less supportive in the coming months and will likely impact risk assets.
- While South Africa-focused risk assets have underperformed global markets due mainly to our own goals from electricity shortages. Recent warnings from National Treasury about a looming fiscal deficit have dampened the mood further.

Given this backdrop, we continue to have a lighter overall equity exposure. Our company earnings analysis has steered us to increase positions in more defensive exposures, at the expense of domestic cyclicals, since earlier in the year. We are paying close attention to this, as the market forecasts and the resultant share price reactions tends to overshoot to the downside, and this will create opportunities to buy these companies back in the months ahead. We have increased our exposure to European bonds, a holding we believe will add value in time.

The market has also downgraded growth expectations for the local economy. While we maintain an allocation to SA Bonds, we still have dry powder in high yielding cash that puts us in a better position to take advantage of future opportunities. We continue to look for opportunities to rotate into shorter-duration SA bond assets in the months ahead.

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