Discovery Flexible Property Fund

30 September 2024

Market context

The third quarter (Q3) of 2024 proved to be a strong one for global equity markets. This was primarily driven by several central banks, including the US Federal Reserve (Fed) and the European Central Bank, cutting interest rates, while US economic data proved to be more resilient than initially feared.

Emerging markets outperformed developed markets, supported by China unveiling its most substantial stimulus package since the pandemic to boost its ailing economy. This helped the country post its best quarterly equity performance since 2009. US, European and UK equities also advanced.

South African equities also had a strong run, closing Q3 firmly in positive territory. Key drivers included the prospect — and subsequent realisation — of policy easing in both the US and South Africa, as well as progress towards the implementation of market-friendly reforms in South Africa. Further tailwinds came towards the end of September in the form of China's stimulus programme, prompting renewed impetus towards risk assets globally.

On the currency front, the rand continued its momentum over the quarter, supported by a combination of a weaker US dollar and a positive shift in sentiment towards the South African economy.

Performance

For the quarter, the fund underperformed the benchmark.

Overweight exposure to higher-yielding counters such as Redefine Properties and Burstone Group contributed positively to performance over the quarter, with Burstone Group announcing a transformative deal and partnership with Blackstone regarding their European property platform.

The portfolio's international exposure weighed on relative returns over the quarter, where performance paled in comparison to the exuberant reaction to South Africa's recently formed Government of National Unity (GNU). The relative underperformance of international names was fairly agnostic of sector and geography. Positions in names such as Segro, a UK logistics REIT, Merlin Properties, a European logistics and warehousing name, and Prologis with the US as its hub, all detracted from performance.

Outlook

The sharp increase in interest rates over 2022 and into 2023 resulted in a steep derating of the listed property sector, both locally and abroad. However, as increased rhetoric regarding monetary policy easing entered the fray in late 2023, property globally benefitted as interest rate sensitive instruments rerated.

The property market has been further supported by the US Federal Reserve (Fed) initiating its rate cutting cycle, together with soft but not collapsing economic data out of the US.

In our view, the improving fundamentals support current valuations. However, the total return outlook depends heavily on ratings remaining stable on the back of a loosely predictable cutting cycle without massive geopolitical surprises. Looking forward, total returns will be underpinned by income yield and growth, with the sector having enjoyed significant rerating in the second half of the year.

We believe the sector offers attractive value over a medium- to long-term time horizon, primarily underpinned by a more sustainable cash-covered yield, together with a supportive valuation that reflects near-term operational and balance sheet concerns.

In the current environment, we continue to assess the portfolio risks and actively screen for opportunities that market dynamics such as these are likely to offer. Ultimately, we aim to provide our clients with the best risk-adjusted medium- and long-term outcomes.