Discovery

Discovery Balanced, Moderate Balanced, Cautious Balanced Funds

Market background

Global financial markets have started the year strong after a bad 2022, and this is despite significant volatility (such as the bankruptcy of Silicon Valley Bank in March and UBS's takeover of Credit Suisse, despite the Swiss government providing guarantees for the latter).

The MSCI World Index rose +7.9%, while the MSCI Emerging Markets Index rose +4.0%, contributing to a global equity market gain of +6.8%. Over the past three months, European stocks gained 10.7%, US stocks gained 7.7%, and Pacific stocks gained 4.8%. Meanwhile, even with the Treasury volatility at highs of GFC, US treasuries experienced a strong quarter climbing 3.3%. After a volatile quarter, the US dollar closed the quarter 1% lower.
All returns are quoted in US dollars.

South African stocks, in line with global markets, ended the quarter higher, but weaker, with a rise (2.4%) in the Capped SWIX. The performance of resources (-4.7%) was the worst of all super sectors. While financials were flat (-0.3%), robust positive returns from industrials (+13.6%) helped offset losses. While listed property (as measured by the FTSE/JSE All Property Index) fell by 4.8% during the quarter, the FTSE/JSE All Bond Index rose by 3.4%. The STeFI Call Deposit Index was up 1.7% for the quarter. The rand fell in value relative to the rest of the world's currencies as the country's economic outlook worsened due to the energy crisis.

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

Performance review

For the month, the portfolio delivered a negative absolute return.

Key positive contributions:

- In a positive backdrop for local and global equities:
  - Within the SA equity component, Naspers & Prosus, Bidcorp, Richemont and AngloGold Ashanti were strong contributors to returns. Exposure to diversified miners (BHP Group and South32), SA hospitals (Life Healthcare and Netcare) and Anheuser-Busch InBev also enhanced returns over the quarter.
  - The offshore equity component benefitted from holdings in US big tech (Microsoft and Apple), Barrick Gold, American Express and semi-conductor companies (TSMC and KLA).
- The allocation to SA and global bonds also added positively to returns. In particular, our exposure to Australian government bonds was a standout performer.
- Rand weakness over the period impacted the offshore exposure of the Fund.

Key negative contributions:

- Within the positive backdrop for SA and global equities over the quarter, notable positions that detracted from returns are:
  - PGM miners (Northam Platinum and Impala Platinum), diversified miners (Anglo American and Glencore) and SA Banks (ABSA Group and Capitec Bank) detracted from returns within the local equity component.
  - The offshore equity's allocation to healthcare (UnitedHealth, Elevance Health and Johnson & Johnson) and NextEra Energy were notable detractors over the period.
- The weakening USD over the quarter impacted our currency positions negatively.

Portfolio activity

Within the SA equity allocation, we increased positions in defensive holdings (Prosus, Bidcorp, AngloGold Ashanti & Bidvest Group) at the expense of SA cyclicals (The Foschini Group and Mr Price Group, which we exited earlier in the quarter) where the earnings revisions profiles are at risk, while also trimming SA Banks (Capitec and Nedbank). We also took profits in British American Tobacco earlier in the quarter, as the earnings revisions had played out and topped up our holding in Richemont – where the earnings revisions profile is more supportive over the next 12 months. In the offshore equity component, after a strong run, we exited positions in Experian and American Express, while also trimming holdings in JP Morgan, Universal Music and AON into strength. We used the proceeds to top up existing holdings in China on weakness. We also initiated positions in Amadeus, where the market appears to be underestimating the travel recovery benefits in their earnings base, and Rentokil, where the benefits of their recent US acquisition of Terminix is being underestimated by the market, in addition to its defensive organic growth profile.

In local fixed income we trimmed some of our bond exposure, taking profit on what we had added in December and used some of the proceeds to buy a position in a platinum exchange-traded fund (ETF), while keeping the rest in cash as dry powder to take advantage of opportunities that we are presented with in the coming months, given expected market volatility. In global fixed income, we took advantage of the sell-off in global bonds to add duration by adding a position in US 30-year Treasuries, as well as adding a position in Swedish bonds to take advantage of the structural headwinds and deteriorating economy. We funded this from offshore cash. We also continued to top up our long exposure to the Japanese yen versus the Taiwanese dollar, as the withdrawal of ultra-loose Japanese monetary policy is becoming highly likely, leading to a convergence in Bank of Japan (BoJ) policy relative to other major central banks. The implementation of long yen vs the Taiwanese dollar is driven by the latter being a relatively USD-centric currency in how it's managed, which allows for the position to provide positive carry while providing diversifying properties for our allocation to Chinese and Hong Kong equities.

Outlook and strategy

The failure of Silicon Valley Bank last year is illustrative of the effects of tighter monetary policy during the past year, which followed a decade and a half of loose monetary policy marked by near-zero interest rates and quantitative easing. This prompted fast action from US regulators, who announced they would fully backup SVB depositors and instituted a new system-wide funding programme to guarantee that banks could honour withdrawal requests. Systemic risk should be contained for the time being, but the forecast for economic growth will deteriorate further in the coming months because of the impact on lower credit lending and appetite. This, along with the inverted yield curve and negative increase in the money supply, indicates a bleak future for economic expansion.

Given the market's ongoing struggle to make sense of growth and inflation outcomes and narratives made more nuanced by the tension between hard and soft economic data releases from various developed market economies, volatility in risk assets is likely to persist in the near future. While China's reopening is good news for regional economic prospects, it's not expected to go smoothly, and the effects won't be felt in the Rest of the World for at least another year. Meanwhile, South Africa is struggling with logistics bottlenecks because of Transnet and increased loadshedding, which is hurting the profits of many homegrown businesses.

We believe the valuation support (South Africa did not experience the multiple expansion seen in developed markets) and the strong earnings revisions profiles across our holdings have skewed the portfolio towards the domestic market, which will help us weather this storm. As a result of the quarterly earnings adjustments, we have increased our exposure to defensive stocks while decreasing our exposure to SA cyclicals within the local equity component. Even though developed market equities have derated from their highs, after the current rally they are now fully valued and do not yet represent the high chance of profits downside risk due to record margins and sales levels in the goods segment of the economy sliding towards trend. Due to the expected consumption tailwinds from China, the offshore stock selection continues to favour a position in Asia ex-Japan equities, while developed market exposures are skewed towards more defensive sectors (healthcare, utilities, and real estate) due to the earnings risk in cyclical sectors like consumer discretionary and industrials.

Discovery Life Investment Services (Pty) Ltd, branded as Discovery Invest, is an authorised financial services provider. Company registration number 2007/005969/07.

We still have a sizable (although reduced) allocation to local sovereign bonds because we believe the valuation rationale is sound. Our focus on high-quality countries like Australia, New Zealand, South Korea, Canada, and Sweden that have leverage and housing imbalances could boost portfolio returns as we approach the end of the hiking cycle.

Discovery Life Investment Services (Pty) Ltd, branded as Discovery Invest, is an authorised financial services provider. Company registration number 2007/005969/07.