Discovery

Discovery Global Multi-Asset Fund

Market background

Despite the hawkish rhetoric from central banks, Q4 marked the only quarter of 2022 where markets delivered broadly positive performance. A key driver behind the positive momentum was the October inflation data which, in the US and Europe, showed a welcome surprise to the downside. This shorter-term easing of inflationary concerns alongside some troubling growth data led to another attempt by the market to predict a dovish pivot in monetary policy. This supported major equity indices and sovereign bond markets. However, central banks' reaffirmation of their hawkish tone in the final month of the year weighed on sentiment and marked a turnaround in the performance of risk assets. Meanwhile the Bank of Japan (BoJ) surprised markets with its announcement that it would change its yield curve control policy, interpreted by the market as the first step in potential tightening. Finally, China announced it was abandoning its strict zero-COVID policy.

Against this backdrop, global equities performed positively and generated high-single digit returns. While US equities bounced back from a 22-month low, it was Asian equities and in particular China that were significantly positive, driven by the China reopening narrative aligned with supportive monetary and fiscal policy in the region. Credit also moved higher during the month, particularly European high yield which outperformed its US counterpart as well as European equities. Emerging market debt delivered high single digit returns, helped by a weak US dollar.

Overall, defensive assets also generated positive returns as yields moved lower generally despite central banks pushing back on the notion of a dovish pivot in monetary policy. Investment grade corporate debt also benefited from the move lower in rates and generated a small positive return with the US outperforming Europe. The application of more aggressive monetary policy by central banks in Europe and Japan – which recently signalled its intention to close the gap with higher US yields - helped to drive their currencies higher and the US dollar lower. Sterling also bounced back vs. the dollar driven by more political stability.

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Performance review

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

The largest contributor to relative returns was our regional allocation to Asian equity, notably China. Asset allocation detracted from returns due to an overweight in cash as equity markets rallied over the quarter. Security selection was relatively flat over the quarter as a positive contribution from equity security selection offset a detraction from fixed income security selection.

Portfolio activity

Over the period, cash equity exposure increased by 2%, through physical equity as we reduced our allocation to US equities and added Asian equities where we see better valuations. Within China we added to consumer discretionary and financials. We continue to hedge a portion of the portfolios cash equity through short positions in US and European index futures.

We have added to real estate exposure and the portfolio is now overweight the sector, focused on logistics and data tower infrastructure which we view as better insulated from the typical property cycle. We also added to materials where we see a structural tailwind driven by a rapid increase in climate investment and fossil fuel demand moderation accelerated by the Russia-Ukraine war and signature policy initiatives globally.

In fixed income, we continued to build duration exposure to government bonds, notably through longer dated US treasuries given weakening growth and peaking inflation, against a backdrop of attractive valuations given the repricing in yields that has taken place as a result of central bank tightening over the past 12 months.

Outlook and strategy

Both equities and fixed income assets have recently been buoyed by the prospect that major central banks are approaching the peak of their hiking cycles as evidence emerges that economies are slowing, and inflation is softening.

Inflation fighting remains the primary objective of central banks, and the Federal Reserve in particular. They have highlighted that the risk of doing too little is greater than the risk of doing too much and growth will likely be sacrificed to get inflation fully back under control. 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 notable slowdown in the economy. Our central case heading into 2023 is that the Fed will have to maintain tight policy while growth and earnings weaken. The level of

valuations in the US has moved back to an elevated level, 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 now firmly moving in the opposite direction is in China, where authorities have signalled an exit from their zero-COVID policy and are doubling down on stimulus to support the real estate market and the broader economy. We remain encouraged by the prospect of further easing and the moving away from policies that hampered Asian markets (regulation, deleveraging and zero-COVID) over the past two years.

Our central scenario for financial markets continues to be that volatility remains high in the short term. 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 extended when factoring in likely earnings downgrades. In Asia, Chinese growth is likely to strengthen during 2023 as Chinese policy makers have moved decisively towards easing and asset valuations are very 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 liquidity, growth, and corporate earnings, believing that these are the primary forces driving financial markets from here. We hold a large amount of dry powder and will seek to take advantage of opportunities as they are presented.

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