Discovery

Discovery Global Multi-Asset Fund

Market background

The final quarter of an eventful year saw most financial markets rally significantly. Early in the quarter, the Middle East conflict returned geopolitical risk to the foreground. While the situation remains uncertain, the impact on energy and financial markets has been limited. Elsewhere, data was weaker across the board, providing evidence that the US economy is cooling. This together with declining inflation on both sides of the Atlantic, led to growing investor confidence that the next move for central banks would be a dovish pivot. This gained further momentum in December after the US Federal Reserve (Fed) signalled rate cuts in 2024. Similarly, the narrative from the European Central Bank (ECB) was that the inflation path justified halting the sequence of further rate hikes.

As expectations for a soft landing and dovish central bank pivot gathered pace, global equities rallied, delivering low double-digit returns. Developed markets outperformed emerging markets as US equities led the charge, also delivering double-digit returns. Although the region's outperformance can largely be attributed to the 'Magnificent Seven' of technology-focused stocks, the rally broadened as the quarter progressed. UK equities lagged within developed markets, delivering a low single-digit positive return, as share price declines for oil majors caused the blue-chip index to underperform.

Chinese equity markets were lower, driven by continued weakness in the region's property stocks and negative sentiment in gaming-related stocks due to the prospect of new regulation. Elsewhere within growth assets, prices of high yield corporate debt also moved higher as spreads continued to tighten, with US high-yield spreads reaching their tightest level in over 18 months. Emerging market debt also made gains, in part benefitting from US dollar weakness which fell on anticipation of lower rates and easing of geopolitical risk. Commodities declined during the month, but there was divergence within the broader complex. For example, the oil price was weak during December as supply remained strong and there was continued scepticism over the nature of the OPEC+ voluntary cuts. Conversely, the price of copper rose amid fears of a supply shortage as decarbonisation goals supported demand for copper-rich electrification technologies.

Defensive assets also moved higher in the final quarter, with developed market sovereign bonds staging a significant year-end recovery in November and December, as bond markets priced in slowing inflation and the prospect of future rate cuts. The price of investment grade corporate bonds moved higher, with US and European bonds performing in line in local currency terms. Despite the Bank of Japan (BOJ) remaining one of the only central banks to maintain a dovish stance, continuing with its negative interest rate policy, the Japanese yen strengthened sharply in the fourth quarter following dovish signals from the US Fed and the narrowing rate gap between the two countries.

The demand for safe havens together with investor expectations of rate cuts in 2024, saw the gold price rise, ending the year at an all-time high in US dollar terms.

Performance review

The Strategy produced a positive return in US dollars, gross of fees[1], and matched its benchmark (60% MSCI ACWI / 40% WGBI).

Fixed income positions were the main driver of performance, in particular our overweight position to defensive developed market duration, as bond yields fell due to expectations that we've reached the peak in hiking cycles in the US and Europe in particular.

Cash equities delivered positive returns, as markets rallied due to the same interest rate narrative, and marginally outperformed the benchmark due to stock selection effects in Europe and the US. The European equity hedges detracted from relative performance.

Active currency positioning was additive in absolute terms due to positive returns from the long Japanese yen, which benefitted from the global move lower in interest rates during December and strengthening sentiment around the peaking policy hiking cycle in the US and euro zone.

Portfolio activity

There were no material changes to our views during the quarter. As a result, the overall asset allocation remained broadly consistent.

The Fund's exposure to equities decreased slightly to 56.3% from 60.2%. with the most significant underweight position being European equities, followed by US equities. European growth is rapidly decelerating as higher interest rates feed into the real economy. We believe that equity market pricing in Europe remains too benign for the economic risks facing the region and hence remain underweight. The portfolio remains overweight Asian equity, principally in China where valuations in the region remain depressed and present the opportunity to acquire high quality companies which benefit from structural tailwinds on highly attractive valuations.

There were no material changes to the fixed income holdings during the quarter. There is increasing evidence that the transmission of the policy tightening to date is feeding through into the real economy and inflation across developed markets. With the Fed and ECB likely having reached the peak in their hiking cycles, we expect these conditions to increasingly weigh on bond yields hence the portfolio remains overweight duration by 2 years relative to benchmark . The main contributor to the portfolio's overall duration is German government bonds, due to notably tight policy and weak fundamentals which we expect will lead to an imminent recession and interest rate cuts from the ECB. While we also continue to run a long position in US government bonds given attractive valuations and likely shift towards an easing cycle from the Fed in the next 12 months as inflation and growth continue to slow. We also continue to run a long position in the Japanese yen, which has attractive valuations and is likely to be a beneficiary as we see convergence in policy between central banks, notably we see potential for the ECB and Fed to lower interest rates at a time when the Bank of Japan is exiting its negative interest rate policy.

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[1] Based on gross-of-fee composite returns of various managed accounts and pooled funds. Net returns will be lower and relative returns may differ according to share class held and applicable fee level.

Outlook and strategy

In the US, we believe policy is tight in aggregate with rates having likely peaked, quantitative tightening ongoing, and the positive fiscal impulse that has been in place for much of 2023 now fading. This is evidenced by contracting monetary aggregates and credit impulses, increasing balance in the labour market, and ongoing disinflation. We expect growth to continue to moderate through 2024 and believe there is a higher probability of a recession than is currently being priced into financial markets. We believe that US inflation will continue to decelerate, with 3-month annualised statistics already being close to the Fed's 2% target.

In Europe, we believe policy is tight and the lags are shorter than in the US due to less pandemic stimulus, higher levels of floating rate debt and less fiscal support. Growth indicators have been deteriorating rapidly and there is still a considerable amount of prior tightening to feed through. We believe Europe is in the process of entering a recession that is likely to deepen rather than recover from here. Inflation is falling quickly, and 3-month annualised core inflation statistics are currently below the ECB's target. We see an increasing risk of a deflationary period in the euro zone and believe that the ECB is likely to be the first major central bank to ease policy.

In China, policy appears loose albeit without material easing taking place. Easing measures are however becoming more forceful. We expect policy makers to continue to ease policy through various measures as they aim to ensure that sustained recovery takes hold. Growth metrics are mixed, and the recovery is bumpy. We believe that the Chinese economy will experience a more benign outcome than the bearish consensus suggests.

Our central investment roadmap, as discussed above, leaves us relatively cautious on DM risk assets and more constructive on defensive duration – particularly in Europe. In Asia, we maintain a somewhat more constructive view on equities. In currency we maintain a preference for reserve currencies – particularly the Japanese yen vs. the euro, where we see scope for policy tightening from the BoJ at a time when the ECB is likely to be moving towards easing policy.

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