Discovery Balanced, Moderate Balanced, Cautious Balanced Funds

31 January 2025

Market background

It was a dramatic start to the year as Donald Trump's inauguration was swiftly followed by a record number of executive orders reinforcing his "America First" agenda. Despite rising trade tensions—underscored by Trump's tariff proposals—interest rate uncertainty, and the DeepSeek AI shock, financial markets navigated a volatile month to end broadly higher, with gains across gold, government bonds and global equities.

Global equities started strong, though leadership shifted, with Europe outperforming the US. However, the month was punctuated by three distinct bouts of volatility, reflecting the caution that tempers optimism. Inflation concerns resurfaced early on, casting doubt on the number of rate cuts the US Federal Reserve (Fed) will deliver this year. Sector performance was largely positive, with communication services and health care leading gains, while technology lagged.

Fixed income markets saw volatility, with bond yields generally rising across developed economies amid persistent inflation pressures, resilient economic data, and shifting central bank expectations. The Bank of Japan diverged from the broader trend, while European and US bond markets adjusted to evolving rate-cut outlooks.

In South Africa, the FTSE/JSE ALSI delivered a positive return, driven by a significantly stronger resources sector. Gold benefitted from heightened geopolitical uncertainty, while China's latest economic stimulus provided additional support for commodities, lifting South Africa's resources sector to an impressive 16.1% return. The South African Reserve Bank continued its rate-cutting cycle, lowering the repo rate to 7.50%.

On the economic front, growth forecasts for 2025 improved.

Performance review

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

Key contributors:

- Local and global gold stocks, including Agnico Eagle and AngloGold, as well as platinum-group metals (PGMs) firms and gold exchange-traded funds (ETFs)
- Compagnie Financière Richemont SA, following a strong trading update
- Stocks in the communication services and tech hardware sectors

Key detractors:

- 'SA Inc.' stocks, particularly retailers, banks, insurers
- SA-listed property
- Tech stocks: Nvidia, Broadcom and Apple, following the news from Chinese firm DeepSeek that it has built a new AI model; Microsoft was also a detractor, with recent results indicating a short-term slowing growth trajectory in its cloud business.

January was a busy month, with several changes made to the portfolio. We took profits on some of our US names, deploying some of the proceeds into a gold ETF, with the remainder held in cash as we waited for the volatility to settle after the US presidential inauguration and earnings season. We reduced our exposure to Nvidia while we seek greater clarity on the capital expenditure plans of companies purchasing its chips, particularly in light of the DeepSeek announcement and its potential impact on AI infrastructure investment. We began building positions in several new software names based on specific idiosyncratic drivers and will provide further details in due course. In South Africa, we took some profits on Discovery and Clicks and topped up our investment in MTN.

Outlook and strategy

In January, we built a cash buffer to maintain flexibility as market dynamics evolve. We remain focused on key policy developments in the US, particularly distinguishing between market noise and fundamental shifts. Markets have traded sideways following the mid-January highs, with dip-buying still prevalent. We are assessing whether moves by the Trump administration meaningfully impact growth and inflation and are also looking to February's earnings season to provide clarity on fundamental drivers.

We are also watching the developments around AI-related names, where the DeepSeek announcement has raised questions about demand sustainability. The key focus is whether we are transitioning from AI 1.0—driven by infrastructure buildout and data centre expansion—toward AI 2.0, centred on monetisation and implementation. If so, opportunities will emerge across different fronts, from device replacement cycles (e.g., laptops and iPhones) to enterprise adoption for efficiency gains or new product launches. Identifying the winners and losers in this shift remains a key challenge but provides a significant opportunity.

Overall, we remain constructive on risk assets but expect a more measured market environment after two years of strong gains. Future returns will rely more on earnings delivery than valuation rerating. Higher starting valuations demand strong execution from companies, making stock selection increasingly critical.

In South Africa, we maintain exposure to '**SA Inc.'** names, where improving earnings fundamentals—supported by lower interest rates, better consumer activity, and potential structural reforms are positive tailwinds. Retailers and financials stand to benefit, though job creation remains a factor to watch.

In fixed income, we hold no global bonds due to limited value, particularly as market expectations of terminal rates have adjusted higher. However, South African government bonds continue to offer attractive yields, and we maintain exposure to this asset class.

On policy dynamics, we continue to monitor how far central banks will go in cutting interest rates. The prevailing view is that the next US rate cut this year will come in June or later, with subsequent moves dependent on incoming data. Inflation remains sticky, but early signs of job market softening—particularly in leading indicators like construction job openings—suggest rate cuts should not be ruled out entirely. Our base case assumes a rational policy approach, with measured easing to sustain economic momentum.

In Europe, a key risk is political: could populist parties gain power in Germany, leading to a shift away from fiscal conservatism? A new government with a pro-stimulus stance could provide a much-needed growth boost, as the US has experienced.

The US dollar appears to have peaked, now trading in a more range-bound manner. This removes a key pressure point on emerging markets, including South Africa, where macroeconomic conditions remain challenging but may improve as interest rates decline.

We remain nimble amid ongoing uncertainty, closely watching US policy shifts, the global rate-cutting cycle, and evolving AI investment trends. Volatility will create opportunities, and our focus remains on fundamentals, ensuring the portfolio is well-positioned for a shifting macroeconomic and investment landscape.