Discovery Balanced, Moderate Balanced, Cautious Balanced Funds

Market background

The second quarter (Q2) began on a positive note as risks facing the global banking sector began to dissipate. Subsequently, the political debate around raising the US debt ceiling drove uncertainty, but the deal eventually passed, much to the relief of market participants. Investors' focus then shifted to global growth dynamics and signals of further rate hikes from key central banks.

In the US, the Federal Reserve hiked its key interest rate in May and then paused in June, later signalling that two further hikes are likely to be needed this year. This, combined with data evidencing US economic resilience, caused yields to rise meaningfully across the US Treasury curve. Within the equity market, the big focus on Artificial Intelligence (AI) and its productivity-boosting potential drove gains in tech sector stocks. Elsewhere, economic data suggested a tailing off China's recovery momentum from the first quarter, ultimately prompting the People's Bank of China (PBoC) to cut two key interest rates. In South Africa, loadshedding continued to mire the economic outlook, although growth indicators surprised to the upside later in the quarter. Geopolitical tensions weighed on the rand and a combination of this, and stubborn inflation saw a hawkish shift at the South African Reserve Bank. To read more, please click here or visit the Insights section of www.ninetyone.com.

Performance review

For the quarter, the portfolio delivered positive absolute returns.

Key positive contributions:

- Within the SA equity component, Richemont, FirstRand and Woolworths contributed the most to returns over the quarter.
- In a strong backdrop for global equities, the offshore equity component notably benefitted from holdings in technology shares (Microsoft, Samsung, ASML, TSMC and Apple), Bank Rakyat and Mastercard.
- Rand weakness over the quarter impacted the offshore exposure of the fund positively.

Key negative contributions:

- In the local equity component, Impala Platinum, Anheuser-Busch InBev and diversified miner South32, detracted from returns for the quarter.
- The offshore equity's allocation to China-listed shares, Barrick Gold, and oil companies (ExxonMobil and BP) weighed on absolute performance.
- Our allocation to SA and global bonds detracted from absolute returns over the period.

Outlook and strategy

It was a buoyant start for global equities in the first half of 2023, even with the banking crisis that occurred in the midst of it all. However, these are some of the factors that are potentially at play over the course of the second half of the year that will test the asset class:

- There is a growing market consensus for a "softer or no landing scenario" to play out, underpinned by the tight labour market and stabilising housing market data. We are monitoring economic data releases in the coming months to confirm our thesis of a high probability of an acceleration in slowing growth in developed markets (due to many of our indicators pointing to this). In addition, while inflation is coming down, the base effects in the coming months may create volatility in the data.
- Liquidity has been a supportive driver over the first half of the year. Our view is that liquidity is becoming less supportive in the coming months and will likely impact risk assets.
- China's reopening recovery remains slow and uneven, given bottlenecks and no strong stimulus measures by authorities, but rather a continuation of a more targeted and measured approach. This contrasts the recoveries seen in other economies following the lift-off in COVID restrictions. As a result, sentiment towards China is now trending more negative. In the absence of a stronger stimulus drive, slower growth out of China will have a broader impact on global growth dynamics.
- While South Africa-focused risk assets have underperformed global markets due mainly to our own goals from electricity shortages. The key question of whether the worst is behind us will be answered after the winter – a period when maintenance and weather-related factors that are supportive in energy availability start to reverse.

Given this backdrop, we continue to have a lighter overall equity exposure. Within the local equity component, our company earnings analysis has steered us to increase positions in more defensive exposures, at the expense of SA cyclicals, since earlier in the year. We are paying close attention to this, as the market forecasts and the resultant share price reactions tends to overshoot to the downside, and this will create opportunities to buy these companies back in the months ahead. Developed market

(DM) equities remain fully valued and do not yet reflect the high likelihood of earnings downside risk due to; record margins and sales levels in the goods side of the economy continuing to decline towards trend, and exacerbated by the slowing growth trajectory, as well as less supportive inflationary underpins to toplines in the months ahead. The offshore stock selection continues to favour a position in Asia ex-Japan equities to benefit from the expected consumption tailwinds from China, while DM exposures are tilted to areas of relative earnings resilience (e.g.: Iberdrola, Rentokil, PepsiCo, Intact Financial and select healthcare names) or companies with structural earnings tailwinds (e.g.: Microsoft, Mastercard, Universal Music Group) given the heightened earnings risk from the slowing growth backdrop.

As we are nearing the end of the global hiking cycle, our position in defensive government bonds, focused on high-grade nations with leverage and housing imbalances (Australia, New Zealand, South Korea, Canada, and Sweden) should enhance returns of the overall portfolio going forward. The market has also downgraded growth expectations for the SA economy due to the idiosyncratic issues mentioned above. While we maintain a healthy allocation to SA Bonds, we do have dry powder in SA cash, at attractive yields, which we can allocate to opportunities as they present themselves. We continue to look for opportunities to rotate into shorter-duration SA bond assets in the months ahead.

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