Discovery Target Retirement Date Fund

31 July 2024

Market background

July was a month of contrasts, with a strong first half offset by a weak second. The narratives remained familiar, with markets initially buoyed by the lowest US inflation print since March 2021. This led to growing anticipation that the US Federal Reserve (Fed) would cut interest rates by its September meeting. However, sentiment towards risk assets began to turn at the midway point of the month. A combination of weak economic data from China, including missed GDP forecasts and slowing retail sales, combined with underwhelming earnings from some of the mega-cap tech stocks, brought about some sharp downward moves.

Emerging markets lagged their developed peers on the back of the Chinese data, and concerns around demand led to commodity prices losing ground, with declines among energy prices, industrial metals and agricultural goods. The UK proved a bright spot, despite the weakness in commodities. At a sector level, the prospect of rate cuts lifted real estate and utilities stocks, while IT and communication services – the year's standout performers – found themselves at the bottom.

Most bond markets posted gains in July, thanks to the rising prospect of interest-rate cuts in the US and Europe. Gold rose by more than 5% in July, ending the month at roughly US$2,448 per ounce.

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Performance review

Over the month the portfolio delivered a positive absolute return.

Key contributors:

- SA listed property led gains
- Precious-metal stocks, including gold and platinum-group metals (PGMs)
- 'SA Inc.' stocks including SA banks and retailers. Aspen Pharmacare was also a standout performer
- Bonds – both global and SA bonds
- Defensive global equities, including financials such as Intact Financial and within healthcare – UnitedHealth Group
- Apple was positive over the month, in contrast to the other 'Magnificent 7' names

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Key detractors:

- A stronger rand took the lustre off global bond and equity returns
- Semiconductor holdings and big tech holdings retreated

We took advantage of the strong returns over the year to take profits on some of our global equities in mid-July. We cut some of our exposure to semiconductor stocks and trimmed our exposure to big tech, including Microsoft and Amazon. We also sold out of Trane Technologies and Intercontinental Exchange. Given the strong run in South African markets, we took the same opportunity, rotating the portfolio into our higher conviction stocks within 'SA Inc'. We also took profits on Prosus and added opportunistically to British American Tobacco and gold stock holdings on weakness.

Outlook and strategy

While central banks continue to balance inflation and economic growth, the rate-cutting cycle is most likely upon us. The Bank of England cut rates by 0.25% in July, following earlier moves by the European Central Bank and the Bank of Canada, and the US Federal Reserve is widely expected to cut rates in September.

The onset of rate cuts is just one factor likely to drive increased volatility in the second half of the year. Markets have shifted their concerns from a no landing vs. soft landing scenario to a soft landing vs. recession scenario. This shift dampens the prospects for market growth, while the uncertainty ahead of the US election in November is also likely to constrain growth and amplify volatility. Additionally, the macroeconomic landscape remains dynamic. This month we saw the unwind of the yen carry trade, following the Bank of Japan's interest rate hike at the end of July, which saw the yen rebound from near a multi-decade low.

In China, 2H GDP and June retail sales both missed expectations, and property activity remained depressed. This resulted in weak market performance in the consumer sectors. The Third Plenum conference took place in July and provided no positive policy surprises.

As a small emerging market, South Africa is often buffeted by these global forces. After a strong run in July, the rand weakened slightly on risk-off sentiment. Locally sentiment is more positive as inflation begins to slow, supported by a dip in the fuel price. While keeping an eye on the Government of National Unity, investors are focused on the upcoming earnings season and the possibility of a rate cut in South Africa.

The portfolio has restored its cash balance, which continues to yield an attractive risk-free return. Our equity mix remains tilted towards companies with strong earnings fundamentals at a reasonable valuation and is presently tilted towards South African equities. However global equities remain on our radar; the expected volatility in the US may present buying opportunities among our favoured stocks which we will take advantage of as they arise. China's recovery continues to stutter, and we are cautious about rebuilding our positions in Chinese stocks until we have more conviction in growth opportunities. We have increased duration on SA bonds to marginally overweight and continue to hold some exposure to global bonds that provide a hedge to the portfolio in the event of a more material slowdown, including European, Australian and New Zealand bonds.