Discovery Diversified Income

May 2024

Market background

The Fast View

- After a strong start, stickier-than-expected global inflation data tempered fixed income markets
- Emerging Market Fixed Income benefitted from the increasingly dovish outlook for US monetary policy
- In South Africa, government bonds and the local currency experienced bouts of underperformance amid concerns surrounding elections. In the end, the bonds managed to ride out the storm, as the risk premium dissipated on positive pre-election polling

To read more, please click here.

Performance review

For the month, the Fund performed broadly in line with the benchmark.

Fixed income markets performed well in the first half of the month. Macroeconomic data, including weaker-than-expected US non-farm payrolls and US CPI inflation — that was in line with expectations — combined with central bank rhetoric, supported a more dovish outlook for monetary policy. This reversed later in the month as the combination of renewed signs of stubborn inflation in the UK and Europe, hawkish comments from the Fed, and a series of weak US Treasury auctions promoted a sell-off across global fixed income markets.

For much of the month, emerging market debt benefitted from the increasingly dovish outlook for US monetary policy. Locally, the JSE All Bond Index (ALBI) posted a return of 0.75%. Initially, concerns about a potentially unfavourable outcome in the national elections led to significant downside risk and volatility. However, as pre-election polls indicated a more favourable result, the risk premium began to fade towards the end of the month. This positive shift was further supported by encouraging economic indicators and improved commodity prices, which helped stabilize the local currency. Positive performance was observed across all segments of the yield curve, and our strategic positioning contributed positively to returns.

We saw the inflation-linked bond (ILB) curve bear-flatten during the month; and we have sold down our exposure in the asset class, as inflation continues to ease back inside the target band.

SA-listed property performance saw an improvement over the month, as the risk premium priced into the market eased off. We booked profits earlier in the month, which supported returns.

The yield-enhancing allocation to investment-grade credit continued to add value.

The FX component of the portfolio, the bulk of which is in the US dollar, weighed on returns, as the greenback continued to struggle against a basket of its major trade partners.

Outlook and strategy

Amid the intricate tapestry of global economies, resilient growth continues to weave a diverse range of perspectives. Inflation expectations have moderated, with divergence in growth across individual economies, the US and EMs look more resilient, the latter further boosted by an upside surprise in Q1 GDP growth in China. South Africa's growth dynamics are showing signs of improvement on the back of reduced power outages and logistical improvements at the ports. The rand continues to find support in gold prices, while at the same time wrestling with the volatility surrounding coalition scenarios following elections results, while delayed Fed cuts also pose a risk to the exchange rate. We expect the SARB's easing cycle to commence late in the fourth quarter or early in the first quarter of 2025.

From a positioning perspective, South African Government Bonds remain attractive on valuation grounds. In the initial rally heading into elections, we reduced some risk, as we believed prudent to participate and protect capital in the portfolio. We have shifted some of our curve positioning from the long and belly segments, and more towards the front end of the yield curve on the back of a more benign outlook from the SARB's MPC meeting. We believe performance will return as the benefit of income is realised and volatility subsides. We have sold down our ILB holdings, reallocating to nominals instead. We sold down some of the local listed property exposure earlier in the month on strength and have switched out some of the local exposure to offshore names. Locally we continue to tactically seize on select opportunities in high-quality counters. Investment-grade credit remains a neutral allocation in our portfolios. In FX, we have added to our FX exposure, the bulk of which resides in the US dollar, on the back of increased volatility.