Discovery Flexible Property

31 October 2024

Market background

October was a volatile month for global markets, primarily driven by geopolitical tensions in the Middle East and uncertainty surrounding the upcoming US election. Sentiment towards risk assets turned more cautious as a result, with further headwinds coming in the form of a relatively subdued earnings season. October was also a much quieter month for Asian markets, where investors are still waiting for clarity following China's policy announcements last month. In South Africa, October marked the first month of negative performance for domestic equities since the formation of the Government of National Unity (GNU), with global dynamics contributing to investor caution.

Performance review

For the month, the portfolio underperformed its benchmark.

Among the largest detractors from relative performance was the portfolio's overweight exposure to Hammerson. The British retail landlord's share price fell on the back of elevated yields and increased pressure on the UK property market following the UK government's Autumn budget. The general trend of rising bond yields globally made for a challenging macro environment, leading to a broad-based negative impact on our offshore positions. Our overweights in Prologis and American Tower weighed on performance as a result, despite both companies having reported results that were in line with expectations. At the same time, underweight exposure to the likes of Nepi Rockcastle and Resilient added value given the more subdued global backdrop. Staying with contributors, local names Vukile and Redefine were among the largest contributors to performance over the month, with both companies benefitting from a more favourable outlook towards the domestic economy and a potential uptick in consumer activity.

Outlook and strategy

The sharp increase in interest rates over 2022 and into 2023 resulted in a steep derating of the listed property sector, both locally and abroad. However, as increased rhetoric regarding monetary policy easing entered the fray in late 2023, property globally benefitted as interest rate sensitive instruments rerated. The property market has been further supported by the US Federal Reserve (Fed) initiating its rate cutting cycle, together with soft but not collapsing economic data out of the US.

In our view, the improving fundamentals support current valuations. However, the total return outlook depends heavily on ratings remaining stable on the back of a loosely predictable cutting cycle without massive geopolitical surprises. Looking forward, total returns will be underpinned by income yield and growth, with the sector having enjoyed significant rerating in the second half of the year. We believe the sector offers attractive value over a medium- to long-term time horizon, primarily underpinned by a more sustainable cash-covered yield, together with a supportive valuation that reflects near-term operational and balance sheet concerns.

In the current environment, we continue to assess the portfolio risks and actively screen for opportunities that market dynamics such as these are likely to offer. Ultimately, we aim to provide our clients with the best risk-adjusted medium- and long-term outcomes.