Discovery

Discovery Global Multi-Asset Fund

30 September 2024

Market background

Despite significant volatility at the start of August, the third quarter of 2024 proved to be a strong one for global markets, across both equities and fixed income. This was driven by several central banks, including the US Federal Reserve (Fed) and the European Central Bank (ECB), cutting interest rates, while US economic data proved to be more resilient than feared. An exception to the trend was oil markets, which saw prices fall over the period.

Emerging markets outperformed developed market as China unveiled its most substantial stimulus package since the pandemic to boost its ailing economy. This helped the country's equity market post its best quarterly performance since 2009. US, European and UK equities also advanced. Japanese equities, however, were the exception as they fell back for a second quarter following the Bank of Japan's rate hike.

Q3 was notable for its rotation away from tech stocks. Real estate and utilities were the top-performing sectors within the MSCI ACWI, while industrials and financials also outperformed. By contrast, IT and communication services lagged after some disappointing earnings numbers called into question the elevated valuations. Energy was the weakest performer amid the sluggish economic growth outlook. Developed market sovereign bonds had a strong quarter as investors priced in more aggressive cuts.

South African equities had a strong run, closing Q3 firmly in positive territory. Key was the prospect — and subsequent realisation — of policy easing in both the US and South Africa, as well as progress towards the implementation of market-friendly reforms in South Africa. Further tailwinds came towards the end of September after China unveiled stimulus measures to support its ailing economy, prompting renewed impetus towards risk assets globally.

On the currency front, the rand continued its momentum over the quarter, supported by a combination of a weaker US dollar and a positive shift in sentiment towards the South African economy. Gold prices continued to rise.

Performance review

Over the quarter the Fund produced a positive absolute return in US dollars, gross of fees[1], but underperformed its benchmark (60% MSCI ACWI / 40% WGBI).

The largest detractor from relative performance, was equity security selection, which was particularly evident in July. This stemmed primarily from a market rotation away from technology, which negatively impacted the portfolio's overweight positions in cyclical technology. Later, positive performance from the overweight allocation to Asia ex-Japan, which benefitted from the announcement of additional stimulus measures in China, was offset by losses from broad equity index exposure in the US as investors rotated away from mega-cap tech into more interest-rate-sensitive areas of the market. The portfolio's fixed income allocation performed broadly in-line with the benchmark.

The portfolio's gold allocation contributed positively.

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[1] Based on gross-of-fee composite returns of various managed accounts and pooled funds. Net returns will be lower and relative returns may differ according to share class held and applicable fee level.

In Q3, global economies experienced bouts of volatility driven by softening macroeconomic data, recessionary concerns and evolving central bank policy. During the quarter, portfolio positioning was adjusted to adapt to these factors, with net equity exposure increased, fixed income duration reduced, and currency allocation repositioned.

In equities, the net allocation rose by 3% to approximately 67% (excluding option delta), 7% overweight relative to the benchmark. This increase mainly reflects the addition of two equity index futures: one in U.S. small-cap equities, positioned for potential upside if the U.S. market broadens with a soft landing, and the other in a U.S. semiconductor index, added to capture an attractive entry point amid late-July volatility. The semiconductor sector remains a key focus, given its expected benefit from long-term structural growth trends.

In fixed income, the portfolio overall duration exposure was stable, with positions in UK and US government bonds maintained, and new positions in Australian and European government bonds added over the quarter. We continue to believe these positions will benefit as the central banks of these economies embark on material easing cycles over the next 12 months.

Outlook and strategy

In the US, monetary policy remains tight as economic activity moderates. Consequently, the Fed has begun cutting interest rates and has indicated limited tolerance for further labour market deterioration. Financial markets remain volatile, with investors weighing the risks of a sharper slowdown and concerns over the Fed being ‘behind the curve’ against the potential for a soft landing supported by rate cuts and easing conditions. Fiscal policy remains loose, bolstering growth, while the upcoming November election is likely to heighten uncertainty and market volatility. Although we see an elevated risk of a more significant slowdown, ongoing monetary easing, fiscal support, and a relatively resilient growth outlook lead us to expect a soft landing as the central scenario for the US.

In Europe, we believe policy remains tight, with shorter lags than in the US due to lower pandemic stimulus, higher floating-rate debt, and limited fiscal support. Growth indicators have been weak, trending below expectations and nearing recession in some countries, while shorter-term inflation measures are now in line with the ECB’s target. We expect eurozone growth to stay subdued and inflation to ease as energy pressures decline. Given structural headwinds in the eurozone compared to US tailwinds, we anticipate the ECB’s easing cycle will be more pronounced than the Fed’s.

In China, policy appears loose, though material easing has yet to occur. However, easing measures are becoming more assertive, with new initiatives announced over the past month, sparking a rally in Chinese and Hong Kong equity markets. We expect policymakers to take further action to support a recovery, although the path to recovery is likely to be uneven. While inflation is still weak, base effects should offer more forward-looking support. We believe the Chinese economy will fare better than the bearish consensus suggests.

Our central investment roadmap, as outlined above, leaves us somewhat more optimistic about the prospects for risk assets, particularly in Asia and the US. In fixed income, we maintain a solid allocation to defensive government bonds, as recession risks remain elevated. This positioning also provides dry powder to deploy during episodes of volatility in the coming six months. In currencies, we retain a preference for the US dollar over European and Asian currencies as a diversifying portfolio position, given positive carry dynamics and our expectation that easing will be more pronounced in these regions than in the US.