# Discovery Global Multi-Asset Fund

## Market background

The first quarter of 2024 saw strong performance for risk assets, driven primarily by global economic data exceeding expectations, as well as ongoing optimism around artificial intelligence (AI). For instance, the US economy expanded by +3.4% annually in Q4, while the European Union narrowly avoided recession. However, an unexpected rise in US inflation highlighted the US Federal Reserve's (Fed) challenge in managing price hikes. Despite this central banks generally adopted a dovish stance, with the Swiss National Bank (SNB) the first G10 bank to deliver a rate cut, citing reduced inflation pressure and a robust currency. The Bank of Japan (BoJ) announced the end to eight years of negative interest rates, marking Japan's first interest rate increase in nearly two decades. Towards the end of the quarter, the Chinese economy began to outperform expectations, buoyed by increased demand during the Lunar New Year period.

Global equities delivered high-single digit positive returns, with developed markets outperforming emerging markets, and several equity indices reaching record highs. US equities advanced by more than 10% during the first quarter, with the advance largely led by large cap tech. While UK equities also generated positive returns, they lagged developed peers, in part due to the smaller tech sector weighting. In Japan, the Nikkei Index saw its strongest performance since Q2 2009 as the BoJ's move away from negative rates hinted at policy normalisation. Despite property developers posing challenges, Chinese equities began to recover towards the end of the quarter on hopes of economic recovery and a slew of signals that authorities are strengthening their resolve to support slumping markets. Risk-on sentiment fuelled rallies in other asset classes, such as global high-yield corporate bonds. As investors pushed out the timing of future rate cuts, the US dollar strengthened versus all G10 currencies. This was a headwind for emerging market debt with local currency bonds in negative territory for the quarter, albeit hard currency debt delivered a positive return. Oil prices surged on the back of strong global economic performance, lingering inflation concerns, supply fears, and continued geopolitical risk.

Within defensive assets, developed market sovereign bonds lost ground as more persistent inflation and the strength of the economy led investors to dial back the prospect of rate cuts. US treasuries, euro sovereign bonds, and UK gilts all fell during the quarter. Within investment grade corporate debt, the price of bonds fell in value, impacted by the move in rates. Finally, although the BoJ ended its negative interest rate policy, the Japanese yen prolonged its depreciating move against the US dollar.

Meanwhile, with inflation surprising to the upside despite Fed signals of rate cuts, gold soared to a record high, delivering a positive, high single-digit return in US dollar terms.

## Performance review

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

Stock selection within equities was the largest detractor over the quarter. Our overweight to Chinese equities detracted following a significant sell-off during January. Despite recouping the losses during February and March, the allocation trailed on a relative basis, as the global equity index continued to advance strongly on the back of improving economic data and the strength of US mega-cap tech stocks. European equity hedges detracted over the quarter, as European equities rallied with investors growing more confident on European equities' growth prospects, as well as being attracted to their cheaper valuations vs US counterparts. Stock selection in the North American semiconductor supply chain was additive to returns, on the back of artificial intelligence optimism driving growth in stocks leveraged to the semiconductor cycle.

The overweight allocation to defensive government bonds, namely German bunds, was also a detractor. The overweight allocation to longer dated securities detracted, as yields rose over the quarter amid lingering US inflation concerns and the prospect of fewer Fed rate cuts. The long Japanese yen position was also a drag to performance as a result of this dynamic, namely the rise in global bond yields and US economic outperformance.

## Portfolio activity

There were a number of changes to the portfolio over the quarter, which were primarily driven by our assessment of the probabilities associated with a soft landing in the US economy versus the emergence of recessionary conditions.

Increasing evidence of improvement in cyclical sectors of the US economy, such as manufacturing and housing, coupled with the prospect of additional fiscal stimulus and the Fed's commitment to easing monetary policy, is likely to offset moderation in the service sector. As a result, we have increased the probability we place on a soft landing in the US economy.

As a result of this increase in probability attributed to soft landing, portfolio exposure to equity was increased over the quarter by around 10%. This increased equity exposure was made up of select opportunities in individual companies, whilst equity hedges were also reduced, namely European equity short positions were moderated. As well as the increase in equity exposure, infrastructure investments were also added to over the month given continued attractive valuations.

In fixed income, government bond duration was held steady, notably a long position in German government bonds, and long-dated US treasuries. Attractive valuations in South African rates meant a small position in government bonds was added over the quarter, as well as the currency.

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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.

## Outlook and strategy

Our outlook and strategy positioning has evolved over the past quarter as we have revised the probability of US recession lower and the probability of a soft landing higher due to emerging evidence.

In the US, we believe monetary policy is tight and will continue to progressively feed into the economy through corporate and household refinancings. The Fed has however signaled a desire to cut interest rates. If the Fed's growth and inflation forecasts prove correct, then three 0.25% cuts will likely take place later this year.

At the same time, fiscal policy in the US has remained loose and continues to support economic growth, while weak areas of the economy have begun to improve. This combination of prospective policy loosening, ongoing fiscal support and improvement in manufacturing and real estate has increased the probability of a soft landing in the US economy. We continue to expect growth to moderate through 2024 in aggregate, but we have revised down the probability of recession over the next 12 months.

In Europe, we believe policy is tight and the lags are shorter than in the US due to less pandemic stimulus, higher levels of floating rate debt and notably less fiscal support. Growth indicators remain weak but appear to be showing some modest signs of improvement at a low base, although there is still prior tightening to feed through. Inflation is falling quickly, and 3-month annualised core inflation statistics are currently below the ECB's target. We see an elevated risk of a deflationary period in the eurozone and believe that the ECB is likely to be one of the first major central banks to ease policy this summer.

In China, policy appears loose albeit without material easing taking place. Easing measures are however becoming progressively more forceful, with the People's Bank of China (PBoC)'s balance sheet having expanded in recent quarters, while additional fiscal measures focused on boosting consumption have been announced. We expect policy makers to continue to ease through various measures as they aim to ensure that a sustained recovery takes hold. Growth metrics remain mixed, and the recovery remains bumpy. We expect it to remain so without more forceful easing measures. Inflation remains weak but base effects should begin to provide more support on a forward-looking basis. We continue to believe that the Chinese economy will experience a more benign outcome than the bearish consensus suggests.

Our central investment roadmap, as discussed above, leaves us somewhat more constructive on the prospect for risk assets, particularly in Asia and the US. In fixed income, portfolio duration declined through the first quarter post a strong rally in government bonds at the end of last year and due to an increase in the probability of a US soft landing. We maintain an overweight to defensive duration, however, particularly in Europe. In currency we maintain a preference for reserve currencies – particularly the Japanese yen vs. the euro, where we see scope for policy tightening from the BoJ at a time when the ECB is likely to be easing policy. We also moved longer the US dollar versus Asian and European currencies over the quarter, due to the improved outlook for the US economy versus other regions.

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