cogence

Q4 2024

THE COGENT QUARTERLY

MARKET BACKDROP

Overview of the last quarter's market movements

FUND HIGHLIGHTS

Update on portfolio performance and current positioning

SCOOP OF THE DAY

Spotlight on an exciting investment opportunity

CHARTING THE FUTURE

Insights on market outlook and future opportunities

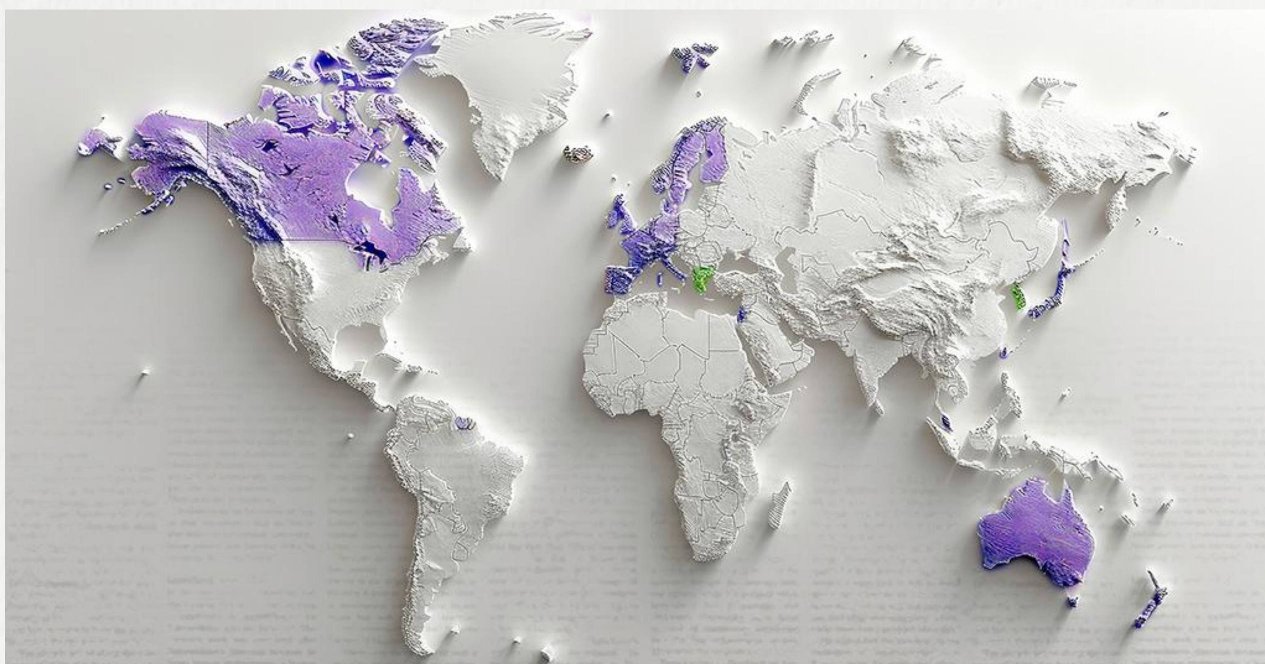
Market **backdrop**

THE QUARTER IN SUMMARY:

Dollar strength, the US election and policy uncertainty took centre stage in Q4, driving developed market equities higher, while emerging market equities lagged.

Global bond returns were mixed, with continued economic data leading to riskier areas outperforming, and the SA bond market gained.

Oil rebounded, while gold and broad commodities were largely muted.



Q4 proved to be a challenging end to the year for financial markets, with the US election and policy uncertainty acting as primary drivers of asset class returns. Positive returns over the quarter included US equities, led again by the US tech sector, Japanese equities and German equities, while emerging market equities delivered negative returns in the context of a stronger US dollar. High-yield credit was positive over the quarter whereas sovereign bond yields broadly detracted. Precious metals also gave up some of their strong year-to-date returns.

The quarter got off to a shaky start, with both global equities and bonds providing negative returns in October. The combination of stickier inflation and a resilient labour market in the US led to expectations for fewer interest rate cuts from the Federal Reserve. This spurred a sell-off in US equities and a rise in US government bond yields over the month, though policy uncertainty remained a theme throughout the quarter, keeping sovereign bond yields elevated. Notably, while both the Federal Reserve and the European Central Bank cut rates in December, a less-dovish-than-expected tone regarding the prospect of future rate cuts pushed yields higher across both regions. UK gilt yields were also negatively impacted over the period by the UK budget announcement, which contained more government spending than anticipated, and French government bond yields moved higher as the successful vote of no confidence added to political uncertainty.

Market performance over the quarter was also heavily influenced by the outcome of the US election. Trump's victory and the Republican party's majority win across both chambers of Congress supported the view that "US exceptionalism" can continue. Expectations for corporate tax cuts, expansionary fiscal policy, and a nationalist trade policy drove US equity markets and the US dollar higher over November. US equities hence finished the quarter in positive territory as the rally over November was enough to offset the losses experienced by the asset class in October and December.

Source: BlackRock, 31 December 2024.

Equity markets outside the US did not, however, receive the election outcome as positively, with European and emerging markets selling off. The prospect of trade tariffs impacted both regions and the surge in US dollar proved to be particularly painful for emerging markets. In addition, waning views that the Chinese government support measures will be enough to boost the domestic economy also worked to spur further weakness in Chinese equities.

In South Africa (SA), the equity market posted declines over the quarter. With the rand weakening, factors such as uncertainty over South Africa's status in the AGOA trade program (which was under review) and concerns about U.S. monetary policy contributed to investor unease. Despite a tougher Q4, annual returns are strong and the outlook for South Africa is positive. In the fourth quarter, South African listed property experienced a modest decline. Despite this, the sector achieved remarkable annual gains driven by lower bond yields, healthier balance sheets and improved growth prospects amid declining interest rates.

SA bonds also delivered subdued results, as investors moderated their initial bullish interest rates and inflation expectations. Inflation-linked bonds outperformed nominal bonds over the period.

Elsewhere, commodity returns were mixed, with precious metals retracing some of their strong gains year-to-date primarily due to rise in the US dollar, whereas growing concerns about gas supply and the prospect of a cold winter pushed gas prices higher over the quarter.

Source: BlackRock, 31 December 2024.

Fund **highlights**

PERFORMANCE

Cogence Discovery Dynamic Asset Optimiser (DAO) Solutions – click here to view factsheets

Cogence was appointed as the investment manager of the DAOs in April 2024. Cogence transitioned the portfolios during May and June to the new strategic asset allocations (SAA). The portfolios now feed into the Cogence Global Growth Portfolio (USD) for its global exposure (see factsheet here)

		3-month return (ZAR)			1-year return (ZAR)			2-year return (ZAR) (p.a.)		
		Fund	Peer Group	Relative	Fund	Peer Group	Relative	Fund	Peer Group	Relative
DAO portfolios	Cogence Discovery Cautious Dynamic Asset Optimiser Fund of Fund	2.23%	1.68%	0.55%	14.62%	12.25%	2.37%	13.29%	11.65%	1.64%
	Cogence Discovery Moderate Dynamic Asset Optimiser Fund of Fund	2.08%	1.60%	0.48%	14.82%	12.80%	2.02%	14.15%	12.04%	2.11%
	Cogence Discovery Balanced Dynamic Asset Optimiser Fund of Fund	1.95%	1.46%	0.49%	14.36%	13.45%	0.91%	13.39%	12.85%	0.54%

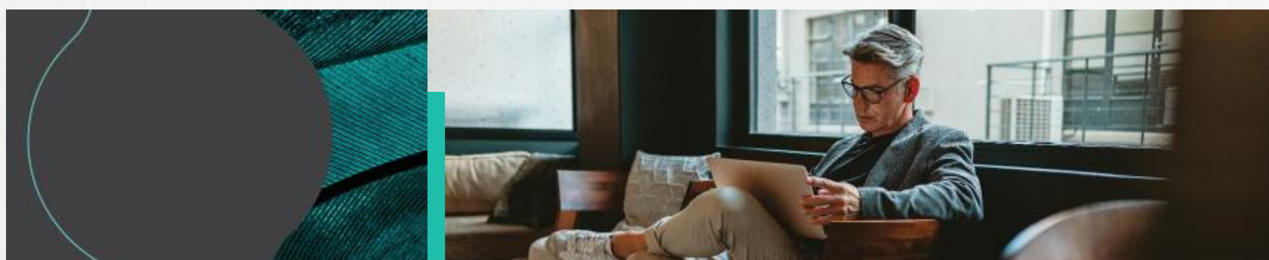
Source: Morningstar, 31 December 2024.
Note: Past performance is not necessarily an indication of future performance. Returns are quoted net of fees, in ZAR. Peer group category by risk profile: Cautious - ASISA SA Multi-Asset Low Equity, Moderate - ASISA SA Multi-Asset Medium Equity, Balanced – ASISA SA Multi-Asset High Equity.

The Cogence Discovery Dynamic Asset Optimiser (DAO) portfolio range performed ahead of peers over the quarter, delivering positive performance across the three risk profiles. Strong performance over the last three months has contributed positively to the strong relative outperformance over the 12-month period to end December 2024.

On the asset allocation side, the overweight to global assets was a positive contributor over the quarter. More specifically, global equities outperformed SA equity in local currency terms. The contributions were further enhanced by ZAR losing ground relative to the dollar. With the rand weakening, factors such as uncertainty surrounding South Africa's status in the AGOA trade programme (which was under review) and concerns about US monetary policy – fuelled by perceptions of inflationary pressure linked to Trump's "America First" policies – added to investor unease. Local equities declined and local bonds posted subdued results following notable fluctuations as investors moderated their initial bullish interest rates and inflation expectations.

Locally, our preference for SA bonds also made positive contributions, as local bonds delivered strong performance, outperforming local equities and global assets. While local equities benefitted in the immediate aftermath of the election, local bonds have continued to benefit from the fiscal discipline. Inflation-linked bonds struggled to keep pace with nominal bonds during the same period. As a result, the decision to maintain an underweight position in inflation-linked bonds contributed positively to the fund's overall relative performance. This strategic positioning allowed the portfolio to capitalise on stronger nominal bond returns, reflecting a favourable market environment for bond investments during the quarter. Finally, global assets have been largely led by dollar and US tech names. While there are multiple factors driving the dollar, incoming administration and potential for tariffs have been positive for the dollar.

From a manager selection perspective, key detractors to performance in the global sleeve were Dodge & Cox global equity, followed by BlackRock Global Unconstrained Equity (GLUE). Across the SA asset classes, Ninety One Active Quants Fund was a key contributor, mostly driven by its overweight positions in Mr Price Group and Momentum Group. Additionally, the Ninety One SA Equity Fund outperformed, driven by its position in Naspers, which offset the drag from Gold Fields, which faced challenges during the quarter. In the fourth quarter, South African-listed property experienced a modest decline. However, the sector achieved impressive annual gains of nearly 30%, driven by lower bond yields, healthier balance sheets and improved growth prospects as interest rates declined. The Discovery Flexible Property Fund lagged its benchmark during the quarter, but having the specialist property allocation in the portfolio added to its performance. More negatively, the Discovery Strategic Bond Fund underperformed, which weighed on the portfolio's overall relative performance. However, for the 12-month period, South African bonds had a remarkable rally adding value to the portfolio.



POSITIONING

Cogence Discovery DAO Solutions

The Cogence Discovery Dynamic Asset Optimiser Fund of Funds are constructed as diversified portfolios of funds spanning various asset classes, and across both active and passive strategies. Asset allocation and global manager selection advice is provided by BlackRock, while RisCura advise Cogence on local manager selection.

Current asset allocation of the various investment solutions represents the combined exposure from the long-term strategic asset allocation (SAA) and the short-term dynamic asset allocation (DAA) taken over the three-month period to the latest quarter end.

Chart 1: Strategic asset allocation

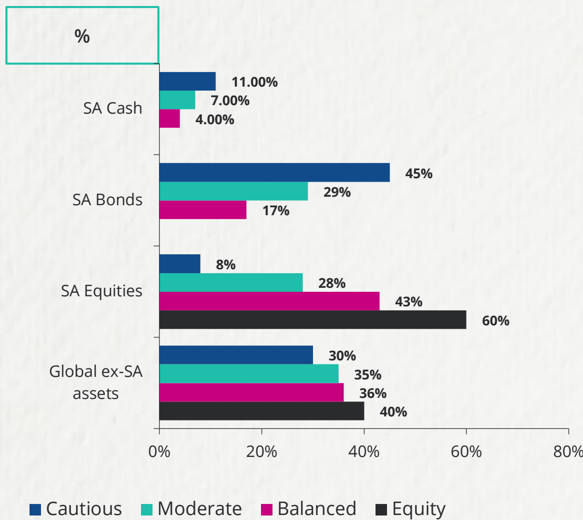


Chart 2: Dynamic asset allocation

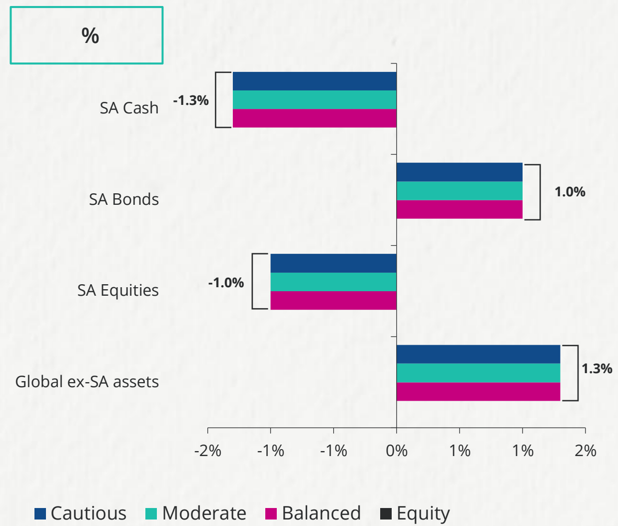


Chart 1: Strategic asset allocation

Strategic asset allocation changes

- There have been no material changes made to the SAA over the quarter.

Dynamic asset allocation changes

- During Q4, we continue to have an overweight to global assets (1.3%) (via the Cogence Global Growth Portfolio), which is invested in a combination of global equity and bond assets. We are bullish on global equities in particular, and believe that they provide a stronger growth momentum as a well as access to secular themes.
- We are overweight to South African bonds (1.0%), as we see the asset class providing attractive income for the portfolios and prefer local bonds over local equity and cash.
- We use the cash position (-1.3%) and SA equity (-1.0%) underweight to fund the overweight to global assets and to SA bonds.
- While we did not make any changes to the overall asset allocations in the portfolios over the quarter, on a look-through basis, please note below the dynamic asset allocation changes over the quarter in the Cogence Global Growth Portfolio, which the local solutions feed into for the global component.
- **In October**, we reduced our overweight to equities by reducing our exposure to US and emerging markets. Within bonds, we reduced our underweight exposure to US duration by buying US government bonds, which is funded out of equities and cash. Overall, the portfolio remained moderately short duration, driven largely by a small short, mostly in the US.
- **In November,** we added to US equities by reducing our exposure to Europe ex-UK and Japanese equities. The clear outcome of the US elections is expected to extend the period of US exceptionalism, supported by potential deregulation, an AI-related investment boom, and corporate-friendly fiscal policies. We reduced our allocation to gold by 1%. We continue to see gold being supported by structural diversification of emerging-market central banks' foreign reserves, which is why we continue to maintain a position as an intermediate view.
- **In December**, we did not make any dynamic asset allocation changes. Instead, we traded the portfolio at the start of January with the following dynamic changes. We made changes within equities, adjusting our regional weightings in line with the continuing exceptionalism within the US, which we tilt further towards. In turn, we made reductions in Europe ex-UK and emerging market equities. Within bonds, our positioning remains unchanged.

Scoop of the day

Staying pro-risk into 2025

The BlackRock Investment Institute recently shared some insights supporting their risk-on stance entering 2025.

2024 reinforced that we are not in a typical business cycle. Instead, mega forces – big structural shifts like the rise of artificial intelligence (AI) – are transforming economies and altering their long-term trajectories. Financial markets themselves are also being reshaped as some sectors grow and others fade, changing the makeup of benchmark indexes. That calls for a new way of investing: Being more dynamic and putting more focus on themes and less on broad asset classes

Ever-bigger share

"Magnifient 7" market cap as a share of the S&P 500, 1995-2024

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We think investors should no longer think in terms of business cycles, with short-term fluctuations in activity leading to expansion or recession. Instead, mega forces are driving an economic transformation that could keep shifting the long-term trend, making a wide range of very different outcomes possible – on the upside and downside. Markets are starting to reflect these shifts: The "magnificent 7" of mostly mega-cap tech shares now make up almost a third of the S&P 500's market capitalisation. See the chart. We think this calls for rethinking investing, and challenges investment strategies based on valuations converging back to historical trends.

We follow that playbook as we stay pro-risk headed into 2025. We increase our overweight to US stocks as we expect AI beneficiaries to broaden out beyond tech. We're also confident US equities can keep outpacing global peers given the ability to better capitalise on mega forces, a favourable growth outlook, potential tax cuts and regulatory easing. Signposts for changing our view include any surge in long-term bond yields or an escalation in trade protectionism.

More broadly, we think investors can find opportunities by tapping into the transformation we expect in the real economy. AI and the low-carbon transition require investment potentially on par with the Industrial Revolution. Major tech companies are starting to rival the US government on research and development spending. Plus, meeting growing energy demand will generate US$3.5 trillion of investment per year this decade, according to the BlackRock Investment Institute Transition Scenario. Big spending on AI and the low-carbon transition, plus rising geopolitical fragmentation is likely to cause persistent US inflation pressures. And an aging workforce could start to bite as immigration slows, likely keeping wage growth too high for inflation to return to the Fed's 2% target. We think that means the Fed will keep rates well above pre-pandemic levels even after cutting some in 2025.

Bottom line: Mega forces are reshaping economies and markets. That requires a new playbook challenging old investment rules. We stay pro-risk to kick off 2025, but stand ready to dial down risk as catalysts emerge.

Source: BlackRock Investment Institute, 09 December 2024.

Charting **the future**

LOOKING AHEAD

01 **Rethinking Investing | Markets view today's data through the lens of a business cycle:** We think heightened sensitivity of long-term assets to short-term surprises reflects markets viewing new information through the lens of a typical business cycle rather than in the context of a transformation reshaping the outlook.

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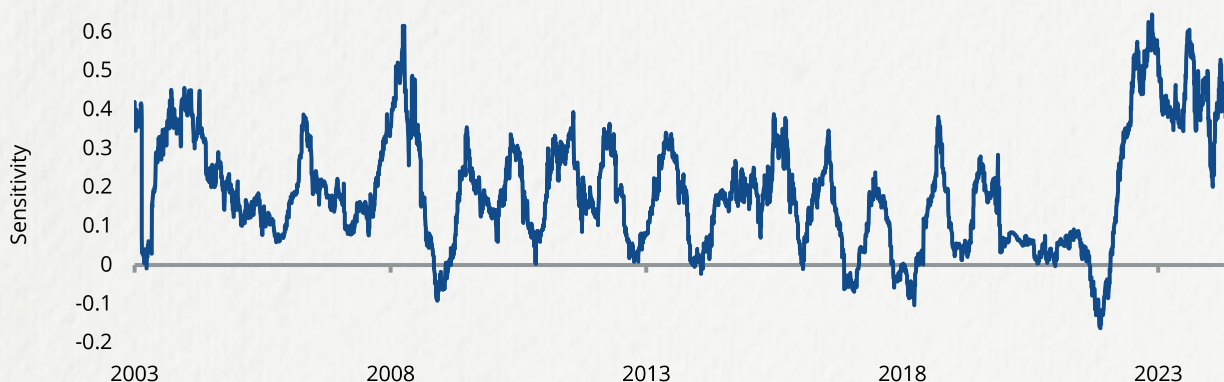
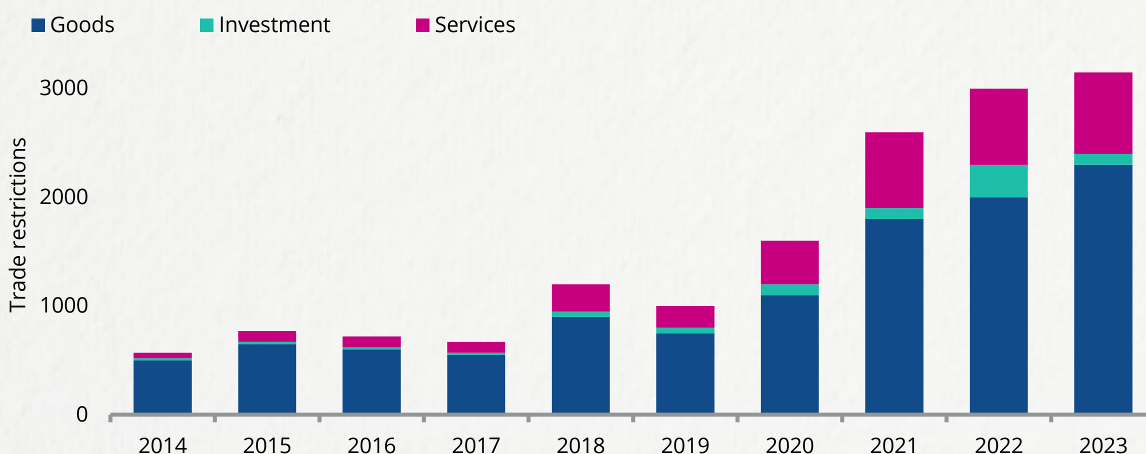


Past performance is no guarantee of future results. *Source: BlackRock Investment Institute, with data from LSEG Datastream, December 2024. Notes: The line shows how sensitive the U.S. 10-year Treasury yield is to economic surprises, using regression analysis to estimate the relationship between U.S. 10-year Treasury yields and the Citi Economics Surprise Index over a rolling six-month window. This is only an estimate of the relationship between the 10-year Treasury yield and economic surprises.*

02 **The investment environment | Macro policy could be more disruptive and less of a stabiliser:** We see macro policy becoming a potential source of disruption going forward – as s seen in the rising trade restrictions around the globe. That could put the onus on markets to enforce discipline, such as a with fiscal policy.

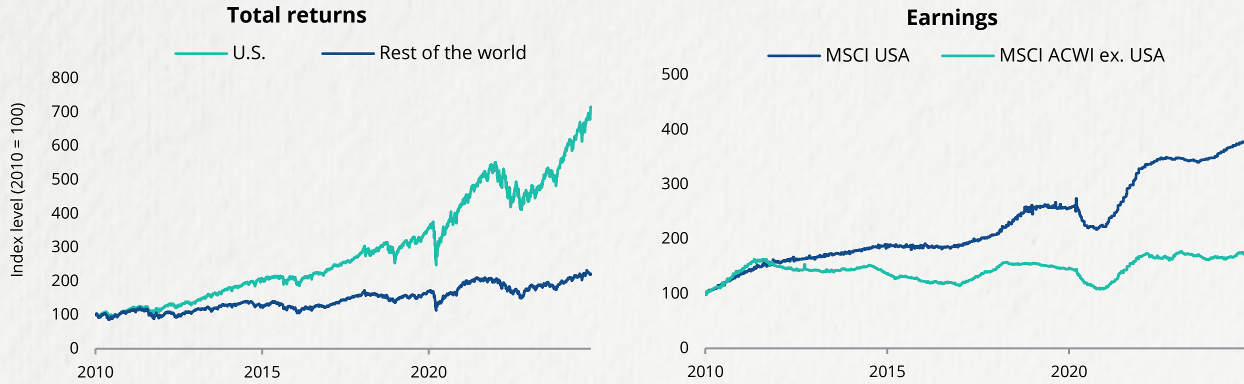
Trade restrictions, 2014-2023



Source: BlackRock Investment Institute, IMF, globaltradealert.org (or with the data from globaltradealert.org), December 2024. Notes: The chart shows the number of unilateral non-liberalizing trade interventions (as classified by globaltradealert.org) taken by countries around the world.

03 | **Staying pro-risk | We think US equities can keep outperforming:** US equities have outperformed the rest of the world, fuelled by robust corporate earnings. We see divergence across regional markets staying wide as mega forces reshape economies and sectors – creating opportunities.

U.S. equity performance vs. the rest of the world, 2010-2024



Past performance is not a reliable indicator of future results. It is not possible to invest directly in an index. Indexes are unmanaged and performance does not account for fees. *Source: BlackRock Investment Institute, with data from LSEG Datastream, December 2024. Notes: The charts show the indexed performance of U.S. equities compared to the rest of the world. Index proxies used: MSCI USA, MSCI ACWI ex. USA.*

04 | **Staying pro-risk | Signposts for changing our risk-on stance:** Growing trade protectionism or a spike in long-term bond yields could challenge our pro-risk stance. Equities have pushed higher even with the renewed pricing of higher-for-longer-rates. We see gold as a potential diversifier.

Gold prices and U.S. real yields, 2004-2024

Source: LSEG Datastream and BlackRock Investment Institute. Jan 27, 2025. Note: The real price is calculated by using U.S. consumer price inflation index.

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