Discovery Flexible Property Fund

31 August 2024

Market background

South African equities rallied in August, with the FTSE/JSE ALSI closing marginally off its all-time high recorded earlier in the month. Sentiment towards risk assets improved after the US Federal Reserve (Fed) signalled the possibility of an interest rate cut in September, while the growing likelihood of a ‘soft landing’ for the world’s largest economy gained traction on the back of more supportive economic data. Global capital markets closed the month broadly firmer, with further support coming in the form of robust corporate earnings for the second quarter of the year.

Performance review

For the month, the portfolio marginally underperformed its benchmark.

Among the main detractors from relative performance were overweight positions in global counters, Prologis, Segro and Tritax Big Box.

Despite offshore property having a fairly strong month in August, domestic counters continued to outperform on the back of growing expectations of interest rate cuts and improved sentiment towards the local economy. This benefitted the portfolio’s overweight positions in SA-centric names, such as Hyprop, Redefine and Growthpoint Properties, while underweight exposure to the likes of Resilient and Fortress weighed on relative performance.

As the outlook for the SA economy continues to improve, we reduced our offshore exposure in favour of certain domestic counters, while maintaining overweight positions in select offshore names where fundamentals remain attractive.

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 re-rated. More recently, a dovish-sounding Fed, together with soft economic data out of the US, further buoyed this sentiment and provided support for the property market.

Locally, SA property benefitted from lower bond yields and a market-friendly outcome following the national elections. We continue to believe that we are at the peak of the interest rate cycle and that any potential rate cuts will be beneficial to earnings and ratings for both local and global companies. In our view, the improving fundamentals are supported by reasonable valuations; total returns being underpinned by income yield rather than re-rating potential within the year. The sector trades on a forward distributable income yield of c.10.2% and a c.30% discount to net asset value.

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.