Discovery Target Retirement Date Fund

31 December 2024

Market context

Robust US economic data and rising inflation created volatility across markets as the year ended, driving up yields and strengthening the US dollar. A more hawkish tone from the US Federal Reserve (Fed) dampened optimism about the pace of future interest rate cuts, contributing to a subdued end to what had been a strong year for overall market performance.

Global equities ended the quarter in negative territory overall, with significant regional divergence. US equities reached another all-time high in November before softening in December, though they still posted gains for the quarter. Japanese equities also delivered positive returns, buoyed by a weaker yen. However, markets exposed to potential US tariffs, including China and Mexico, saw declines over the quarter.

At the sector level, consumer discretionary, communication services, and technology were notable outperformers, while materials and healthcare lagged. Healthcare stocks were hit particularly hard following the nomination of vaccine sceptic Robert Kennedy Jr. to lead the US health department.

Global bond markets struggled as rising yields and persistent inflation concerns weighed on performance. Despite earlier expectations of rate cuts, central banks largely maintained a cautious stance, limiting investor optimism in fixed-income assets.

South African financial markets came under pressure in Q4, with December marking a third consecutive month of equity declines. Global headwinds, including US monetary policy uncertainty and the risk of a Federal Government shutdown, drove risk-off sentiment. Additionally, concerns arose about South Africa's participation in the AGOA trade program after reports suggested its inclusion could come under review. Domestically, October's Medium-Term Budget Policy Statement signalled a shift toward greater private sector involvement in infrastructure projects. However, warnings from Finance Minister Enoch Godongwana about rising fiscal deficits and national debt tempered investor optimism, contributing to a weaker rand.

The South African Reserve Bank (SARB) continued its rate-cutting cycle, lowering the repo rate by 25 basis points (bps) to 7.75%. Meanwhile, Q3 GDP unexpectedly contracted by 0.3% quarter-on-quarter, with four of ten industries reporting declines.

After a strong run in 2024 (+27%), gold ended the year on a muted note, declining to US$2,625 per troy ounce.

Performance

Over the quarter and the month, the portfolio delivered a positive absolute return.

Key contributors:

- Standout performers over the quarter include:
  - Big tech exposure, including Google, Amazon, Nvidia and Tesla
  - Semiconductor holdings: TSMC, MediaTek and Broadcom given supportive fundamentals
  - US-centric stocks: Tapestry, General Motors, TKO Group
  - Mr Price, Discovery, The Foschini Group (TFG), Capitec and Absa
- Gaming stocks: Take-Two Interactive as well as the recently added Nintendo performed well
- Japanese insurer and financial holdings group, Sompo on good results
- A weaker rand was a tailwind for offshore earnings

Key detractors:

- 'SA Inc.' stocks
- SA-listed property
- Interest rate sensitive holdings in the real estate and utilities sectors
- Diversified Miners, platinum-group metals (PGMs) and gold stocks: dollar dominance drove a retreat in these companies
- China stocks held back on market sentiment rather than fundamentals

Several changes were made to the portfolio over the quarter. In the fixed income component of the portfolio, we increased bond duration by allocating to South African bonds while exiting our remaining global bonds (German holdings), to take profits early in the quarter. In the equity component, we reallocated cash into US-centric names, while also increasing exposure to stocks like Nintendo ahead of its anticipated console launch. We also topped up positions in the London Stock Exchange and Discovery, and initiated a position in Anheuser-Busch InBev, taking advantage of price weakness and the bottoming of the negative earnings expectations cycle, we believe. In terms of sales, we trimmed our positions in Gold Fields, and Harmony Gold, and exited Barrick Gold, locking in profits. Similarly, Shoprite and Bidvest were sold as earnings expectations were no longer ahead of market expectations. We also exited Zalando following a strong performance after its trading update that led to earnings upgrades ahead of our expectations. Additionally, we trimmed positions in Richemont and South 32 due to diminished growth expectations.

Outlook and strategy

Markets remain constructive on risk assets, but after two years of strong returns—over 20% in the US—we expect a more measured environment in 2025. Returns can still be achieved, but the focus must shift from valuation rerating to earnings delivery. With higher valuations now embedded, the ability of companies to meet or exceed earnings expectations will be critical, placing greater emphasis on stock selection and rigorous analysis.

Our base case remains slowing growth leading to a soft landing for the US economy, but this outlook is increasingly uncertain. The sequencing and magnitude of policy changes under the new Trump administration will be critical. Trade tariffs and fiscal policy shifts could inject volatility, particularly in the first half of the year. At the same time, the Fed faces a challenging path, with markets expecting only two rate cuts in 2025. Given emerging cracks in the US economy, such as in the housing market, we believe more aggressive cuts may be required to sustain growth. This could lead to a "growth scare" rather than a full recession, with volatility driven by the timing and scale of monetary easing.

Equities continue to represent the largest asset class in the portfolio, with selective additions driven by opportunities arising from market volatility.

Our equity portfolio is positioned around companies with strong earnings fundamentals and reasonable valuations.
In South Africa, we remain optimistic about 'SA Inc.' names, which are supported by improving earnings fundamentals. The rate of change in the local economy is turning positive, with factors like lower interest rates, improved consumer activity, and structural reforms such as the two-pot retirement system creating tailwinds. Retailers and financials are well-positioned to benefit, and we expect these sectors to continue delivering in 2025. However, the labour market remains a critical area to watch, as job creation will shape the sustainability of these trends.
Globally, stock picking will be increasingly critical in 2025, and our focus remains on deeply understanding our portfolio companies to navigate potential challenges effectively. Outside of the government policy uncertainty, the further understanding of how Artificial Intelligence is impacting business models (positively and negatively) will become clearer.
In China, stimulus continued into December, but recent economic data does not yet reflect a meaningful pickup in activity. Equities remain mixed, and we are cautious about increasing exposure until there is more clarity on growth and trade dynamics.
In fixed income, we hold no global bonds given the limited value in international markets, where terminal rates are now expected to settle higher than anticipated, reflecting a changed post-pandemic world. However, South African government bonds offer significant value, supported by robust yields and we maintain a healthy allocation to this asset class.
We will stay nimble as uncertainty continues to dominate, particularly around US policy shifts and the global rate-cutting cycle. Volatility presents opportunities, and we will focus on understanding the impact of policy changes on fundamentals while maintaining our long-term commitment to value creation.

