Discovery Flexible Property Fund

June 2024

Market background

It was a mixed second quarter (Q2) for global capital markets. In the US, the S&P 500 reached another all-time high, fuelled by big-tech euphoria and growing optimism over the possibility of a rate cut later this year. In Europe, gains for far-right parties in the European Parliamentary elections led French president Emmanuel Macron to call a snap election, putting equities under pressure. In Asia, Hong Kong and Chinese mainland stocks fell for the second consecutive month in June, with markets lethargic ahead of the July meeting of China's top leaders. Turning to South Africa, the national elections took centre stage as the prospect of a market-friendly outcome gained momentum, lifting domestic equities higher.

Performance review

For the quarter the portfolio underperformed the benchmark.

Among the largest detractors from relative performance over the period was the portfolio's overweight exposure to Hammerson, Shaftsbury Capital and Sirius Real Estate. The portfolio's exposure to global property counters came under pressure towards the end of the quarter, largely on the back of a significantly stronger domestic market. Sentiment towards South African assets improved in the wake of the country's national election, as the prospect of a market-friendly outcome gained traction. This resulted in domestic stocks rallying, which benefitted our overweight positions in the likes of Emira, Fairvest and Growthpoint Properties, with all three counters among the largest contributors to relative performance over the quarter.

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 a pivot on rate decisions entered the fray in late 2023, property globally has benefitted, as interest rate sensitive instruments rerated.

Global property has once again been volatile year-to-date and has underperformed other asset classes given the continued interest rate uncertainty while SA property has benefited from lower SA bond yields and a favourable political outcome. 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.