Discovery Balanced, Moderate Balanced, Cautious Balanced Funds

Market background

Risk assets and commodities were set to have another decent month for November, until fears over a new fast-spreading variant Omicron sparked a global market sell-off and a dash to 'safe haven' assets. Notably, comments made by US Federal Reserve (Fed) Chair Jerome Powell in a Senate hearing signalled a more hawkish pivot, highlighting more pressing worries from inflation, and a recognition that labour markets were stronger than data suggested, and thus heralding an acceleration in tapering and the start of rate hikes.

Developed market (DM) equities (MSCI World Index) got off to a good start but in the end closed 2.2% lower for the month, while their emerging market (EM) peers (MSCI Emerging Markets Index) suffered bigger losses, down 4.1% over the same period. US equities (S&P 500 Index) fell -0.7%, while European equities (Euro Stoxx 600, -2.5%) faltered under stress induced by renewed government curbs and rising COVID cases heading into the winter months. Asian stock returns tracked the global equity sell-off lower with Japan's Topix down 3.2% and mainland China's blue chip CSI 300 Index weathering the storm slightly better with a -1.0% return for the month.

In fixed income, sovereign bonds reinstated their role as a hedge in a risk-off environment and the yield on the US 10-year Treasury fell the most since March 2020 (yields fall as prices rise). Across the Atlantic, UK gilts, the European benchmark German bunds and Italian BTPs all posted gains over the month. Meanwhile, the risk-off mood drove emerging market debt lower. The Bloomberg Barclays Global Aggregate Bond Index ended the month down 0.3%.
All returns above are quoted in US dollars.

South African equities bucked the trend in November, with the benchmark FTSE/JSE All Share Index (ALSI) posting gains of +4.4% for the month. At a super-sector level, resources (+6.8%) and industrials (+6.4%) did the heavy lifting once again, while financials endured another month of weakness, down 2.6% over the same period. The JSE All Bond Index (+0.7%) managed to eke out a positive return, despite selling pressure in EM local debt markets. The listed property (JSE All Property Index) recouped some of its prior losses with a 2.2% return for the month. Cash, as measured by the STeFI Composite Index, remained broadly stable at 0.3% for the month. In currencies, the rand sold off against the greenback, euro and pound sterling.

At the sector level, basic materials had another positive month, with precious metals miners led higher by the gold counters (AngloGold Ashanti and Harmony Gold Mining Co.). Despite weakness in platinum and palladium prices, the platinum-group metals miners managed to end the month firmer on the back of corporate action. Notably, Royal Bafokeng Platinum was the top performing stock on the bourse in November, as a bidding war for the miner sent its stock price to record highs. In consumer goods, index bellwether Richemont continued to drive performance as its earnings release beat analyst forecasts, while the weaker rand provided a further tailwind for the luxury giant. More negatively, consumer services sustained pressure, with the travel and leisure sub-sector buffeted by Omicron news, which has upended the recovery seen in in the second half of this year. Financials had another poor showing in November, as the weaker rand booked one of its weakest spells since the start of the pandemic.

Performance review

For the month, the portfolio delivered positive absolute returns.

Key positive contributions:

- Performance was underpinned by holdings in MTN Group and Richemont over the month. Gains were further enhanced by the mining sector, which followed October with another decent month of performance. This includes our platinum-group metals (PGMs) holdings (Impala Platinum and Anglo-American Platinum), diversified miners (Anglo American, BHP Group and Glencore).

- In a sea of red in global equity markets, our exposure to the semi-conductor sector added to returns in the offshore equity component over the month.

- The offshore allocation added to performance overall, owing to the weaker rand over the month.

Key negative contributions:

- Performance was underpinned by holdings in MTN Group and Richemont over the month. Gains were further enhanced by the mining sector, which followed October with another decent month of performance. This includes our platinum-group metals (PGMs) holdings (Impala Platinum and Anglo-American Platinum), diversified miners (Anglo American, BHP Group and Glencore).

- In a sea of red in global equity markets, our exposure to the semi-conductor sector added to returns in the offshore equity component over the month.

- The offshore allocation added to performance overall, owing to the weaker rand over the month.

Portfolio activity

Within the local equity component, we took profits by trimming our holdings in Capitec Bank, Pepkor and Old Mutual to top up existing holdings and taking advantage of attractive levels in Nedbank Group and FirstRand. After a strong run, we also trimmed exposure to Richemont and Aspen Pharmacare and used the proceeds to add to our holdings in Impala Platinum, Anglo American and Northam Platinum.

Within the offshore equity component, we took profits in European oils and added to our existing exposures in General Motors and Lear. We expect auto production to ramp up off depressed levels into 2022 as the chip shortages continue to ease. We also topped up our existing holdings in State Street and Moncler at attractive entry points.

Outlook and strategy

While growth has peaked, we continue to see strong growth from the US, and still high purchasing managers' indices (PMIs) from most countries. China remains a headwind as they transition towards a lower but higher quality growth model that we believe is more sustainable. Global inventory levels continue to be at very low levels given supply chain bottlenecks over the course of the year. We are monitoring these developments closely given the easing of these constraints will be further supportive of growth as inventory needs to be restocked across global supply chains in addition to fulfilling normal demand. It will also have implications for inflation expectations, which is another key area of focus as it can impact policy actions by the Fed and the speed of when the punch bowl is taken away.

To navigate through this, we continue to have a balanced and diversified exposure across asset classes, geographies, sectors and individual assets. In assessing the environment and making asset allocation decisions, we continue to tilt the portfolio to those asset classes (and underlying assets) that score well in terms of our compelling forces framework: fundamentals, valuations and market price behaviour.

The offshore allocation remains favourably disposed to equities, with our tilt continuing to be towards cyclical companies where earnings have troughed and are recovering and valuations are reasonable. Our allocations to semi-conductor, consumer discretionary and financials continue to see upgrades to forecasts as the economic recovery takes hold. We also have exposure to high quality, attractively valued companies with improving operating performance. This includes quality compounders with pricing power or structural winners in healthcare and tech-related sectors. We believe these companies exhibit a long runway for strong, sustainable earnings growth that the market appears to be underestimating.

Regionally, we continue to have a positive skew towards Asia, as Chinese markets continue to exhibit reasonable valuations, while earnings have substantial upside over the medium term, in our view. China's consumer industries have great growth potential given the low penetration levels in many consumer sectors, while increasing household wealth is driving consumption upgrades and industry leaders are seeing market growth, potential market share expansion and higher margins over time. The recent regulation crackdown in China has impacted sentiment negatively and increased the risk premium across the whole market and therefore impacting the companies we own. However, we are comfortable that the earnings potential and trajectory of these companies remains intact and that once the dust settles, these firms are poised to deliver on their investment theses.

Bond markets globally continue to see curves bear-flatten across the board as central bankers around the world are increasingly hawkish against a backdrop of persistently strong inflation. We expect bonds to weaken from here as yields rise across the curve but expect real yields will rise as inflation starts to moderate next year.

The local equity composition is well diversified, and the portfolio remains tilted towards select cyclical exposures at the expense of more defensive holdings. We continue to build up exposure to global defensive companies, Naspers and Prosus, where earnings revisions are expected to trough and the valuation is reasonable and continue to hold Aspen Pharmacare (but at a reduced weight after the strong performance) where there is still further scope for positive earnings revisions. These stocks also provide additional protection against any potential rand weakness. This sits alongside our allocation to global cyclical stocks (diversified miners, platinum miners, Sappi, Sasol and luxury goods maker, Richemont) geared to the global economic cycle. Most of the exposures in this bucket are benefitting from tight commodity markets and low inventory levels in our view. The South African consumer and corporates continue to be more resilient than the market initially feared, and we therefore continue to have a healthy, growing allocation to South African banks, where earnings revisions are positive, and valuations are attractive. This sits alongside our exposure to our reduced and now select allocation to apparel retailers (Pepkor and Truworths International) and Motus Holdings, which have good earnings revisions profiles, trading at reasonable valuations. Our exposure to local defensive businesses has continued to be through MTN Group and Bidvest Group, and further complimented by our holdings in Life Healthcare and Netcare, as the earnings revisions profiles appear to have troughed on the back of an improving occupancy profile into 2022 that results in strong positive operating leverage that the market appears to be under-estimating, in our view. We also built a position in Shoprite, as the management team continue to deliver on strategy and gaining strong momentum in taking market share through their Checkers brand in the middle and upper income consumer brackets – which is also at higher margins, while also improving cash flow and returns with better capital allocation.

We have maintained the material allocation to local sovereign bonds, especially within the context of the global fixed income universe. We still expect inflation to peak towards the end of the year and to remain contained into next year. Risk-adjusted valuations remain attractive relative to other sovereign debt, and the high running yield should support the asset class from here. It remains our preferred fixed income exposure.

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