Discovery Money Market Fund

Market background

US economic growth was noticeably weaker in Q3 amid lower household spending and surging COVID infections. Fixed investment spending and export activity also contracted over the period, but incoming indicators point to a quicker pace in expansion over Q4. Rising demand for labour, record-high job vacancies and the expiration of unemployment benefits saw unemployment moderate back to pre-pandemic levels over the quarter. The personal consumption expenditures index (the US Federal Reserve's preferred measure of inflation) soared to 5.7% in November from one year ago, marking the quickest rise in prices in nearly four decades. The minutes from the Fed's December meeting saw inflation forecasts being revised higher, while officials also confirmed the widely held view that interest rate hikes may come "sooner or at a faster pace", with a March 2022 lift-off and three hikes in 2022 now pencilled in.

In Europe, supply chain shortages induced a sharp drop off in activity in Q4. Inflation in the region also soared (up 4.9%) year on year (y/y) in November, while core inflation reached multi-decade highs. While the European Central Bank (ECB) remained more dovish than their Fed counterparts by keeping interest rates steady, they also indicated that asset purchases would continue to slow as they entered 2022. Unlike the ECB, the Bank of England (BoE) surprised markets and raised interest rates by 15 basis points (bps) as higher inflation persisted, coupled with tighter labour markets.

In recognition of the headwinds to China's economic growth from the coronavirus and the ongoing slowdown in the property market, the People's Bank of China (PBoC) revealed a more dovish stance at the start of December. The PBoC cut the Reserve Requirement Ratio (RRR) and reduced slightly the loan prime rate – the rate at which companies and households can borrow. Further signs of a shift towards a more supportive policy stance came mid-month at the conclusion of China's Central Economic Work

Conference. This saw the country's leadership recognising the increased pressure on the domestic economy and stating that stabilisation will be a key priority in 2022.

Elsewhere in emerging markets, Turkey's strong growth data was scuppered by high and rising inflation and a sell-off in the lira (following interest rate cuts, which President Recep Tayyip Erdogan encouraged) – eroding the purchasing power of household incomes and dampening both confidence in the economy and credibility in the central bank.

Back home, GDP contracted over Q3 as output fell more than expected amid the social unrest and violent protests in July. The contraction followed four consecutive quarters of expansion. The onset of the fourth wave of Omicron-led infections poses further downside risks to the pace of the economic recovery. Price pressures at the factory gate continued to intensify as producer price inflation (PPI) quickened to 9.6% y/y in November, from 7.8% in the previous month, while consumer prices (CPI) accelerated to 5.5% in November from 5.0% y/y the previous month, above consensus expectations of 5.4%, driven by transport and fuel price hikes.

Performance review

Fixed income markets endured a downbeat year, with persistent inflation and either the prospect of monetary policymakers paring back support or (in much of EM) proactive rate hiking to tackle inflation weighing on bond prices. The fourth quarter closed flat as bond investors continued to digest the evolving global monetary policy outlook, including a notably hawkish pivot by the US Federal Reserve (Fed).

Locally, Q4 got off to a rocky start as yields sold off and the JSE All Bond Index came endured external headwinds from China, intensifying inflation fears and hawkish pivots by major central banks, while local risks such as elections and power outages dampened investor sentiment toward local bonds and the currency. Non-residents were net sellers of South African Government Bonds over the quarter amid selling pressure in emerging market debt (EMD) markets. One-year fixed-rate negotiable certificates of deposit (NCD's) kicked higher over the quarter by 0.51% (from 4.92% to 5.43%), driven initially by a move higher in global short rates, with markets becoming more concerned that inflation would be more persistent and domestically, the market continuing to price in a high probability of a hike and the South African Reserve Bank (SARB) following through with a pre-emptive 25bps rate hike at the 18 November MPC meeting. Cash, as measured by the STeFI Composite Index, returned 0.34% for the month and 0.95% for the quarter. In currencies, the rand retreated against the US dollar, euro and pound sterling.

For the quarter, the Fund outperformed the benchmark.

Portfolio activity

Over the quarter, we increased duration slightly and selectively added exposure to Government Treasury Bills – which are currently attractively priced. We also increased exposure to Prime-linked NCDs as a portfolio hedge.

Outlook and strategy

Global

The transition to normalised monetary policy makes the macroeconomic outlook uncertain. Financial 'normalisation' – central banks' return to conventional monetary policy after years of abnormally accommodative stances – may be a similarly difficult transition, potentially exposing markets to significant stresses in the year ahead. However, vaccine roll-outs should help underpin growth in 2022. China's new willingness to tolerate weaker growth in the near term will weigh on regions that rely heavily on Chinese demand, like Europe. In contrast, the US is well positioned to sustain above-trend growth in 2022. In much of the emerging world, short-term interest rates have already begun to rise. We expect economic recovery to proceed at a more modest pace; the emergence of Omicron and lack of vaccinations means supply shortages will continue to weigh on economic activity, while less room for prolonged monetary and fiscal stimulation will keep the recovery in a low gear.

Local

South Africa's economy impressed with resiliency and a stronger-than-anticipated rebound in the first half of 2021 from the pandemic nadir, however, the outlook in recent months has somewhat dimmed on the back of both external and domestic risks to the downside. Recent Q3 growth data came in weaker than forecasted, and we expect softer growth over Q4 and into this year on the back of the fourth wave of COVID infections. On the fiscal front, the Medium-Term Budget Policy Statement (MTBPS) showed South Africa to be in a relatively better position in the medium term than a year ago. That said, the jury is still out on whether the National Treasury can achieve fiscal sustainability in the face of government inertia in implementing reforms and plugging the fiscal slippage from the public sector wage bill and struggling state-owned enterprises. On the monetary front, the SARB pre-emptively hiked interest rates to ensure we stay ahead of any inflation surprises. We do not foresee an accelerated hiking cycle going forward, but a more gradual and data-dependent approach to normalisation over the next 18–24 months.

Positioning

Financial markets have begun pricing in a faster pace of interest rate hikes across the developed world. The persistence of high inflation prints has seen central bank rhetoric turn more hawkish. Locally, we are poised to see inflationary pressures coming through in the next couple of months into the new year. The upward pressure on essential basket items such as food, petrol and electricity are only going to eat away at the purchasing power of household incomes.

In the final gathering of the calendar year, the SARB MPC assessed the short-term inflation risks being on the upside, owing to elevated oil and energy prices. Policymakers did, however, emphasise that despite the November rate hike, policy will remain accommodative and continue to support the recovery.

We continued to allow duration to roll-in over the quarter and remain cautious given the significant repricing to global short-end yield curves, the trajectory of interest rates and what is currently priced into our market.

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