Discovery Flexible Property

Market background

Global financial market performance was broadly positive in March, supported by a resurgence in growth assets after a turbulent period in the middle of the month. News headlines were dominated by the prospect of a global banking crisis, starting in the US with the collapse of Silicon Valley Bank and culminating in Switzerland with the acquisition of Credit Suisse by UBS. These events led to a sharp sell-off in financial sector assets across the US and Europe. In response, central banks and other authorities stepped in to reassure investors of the sector's resilience and overall stability, and calm was restored. China's economy continued to show signs of recovery, supporting metal prices. While in South Africa, a bigger-than-expected interest rate hike and a string of negative economic data releases weighed on the local bourse.

Looking back at the first quarter of the year (Q1), January saw global equity and fixed income markets close firmer, as declining inflationary pressures across key economies fuelled optimism that central banks were approaching the end of their rate-hiking cycles. Sentiment reversed somewhat in February, with 'stickier' inflation prints and a more resilient labour market in the US sparking concerns that rates would remain higher for longer. In March, after the initial wobble around financial sector concerns, growth stocks rallied on the back of falling bond yields, which helped global financial markets close Q1 firmer. The MSCI All Country World Index returned +6.8% for the quarter. Developed markets outperformed emerging markets, with the MSCI World Index returning +7.9% and the MSCI Emerging Markets Index +3.5%.

Locally, the South African Reserve Bank (SARB) hiked its benchmark repo rate by 50bps in March, above market expectations of a 25bps increase. Annual inflation increased above market expectations to 7% in February, while GDP growth for Q4 2022 contracted by 1.3% q/q, below market forecasts of a 0.4% fall. South Africa's energy crisis continued to weigh on economic activity and growth forecasts, with Standard & Poor's downgrading the country's sovereign credit rating outlook from 'positive' to 'stable', and the IMF projecting a sharp deterioration in the country's near-term growth outlook.

For Q1 2023, the FTSE/JSE All Share Index and Capped SWIX gained 5.2% and 2.4% respectively. Industrials surged 13.6%, while financials lost 0.3% and resources closed 4.7% lower. The JSE All Bond Index gained 3.4%, listed property lost 4.8% and cash, as measured by the STeFI Composite Index, delivered +1.7%.

Performance review

The Fund outperformed the benchmark over the quarter.

Allocations to off-benchmark international counters were among the largest contributors to outperformance over the quarter. Exposure to industrial players, Prologis and Tritax Big Box REIT, each of which has differentiation in geographical exposures, contributed positively to performance. Similarly, adding to performance over the period were overweight positions in retail names with a range of geographical focus: in the UK, Hammerson and newly merged entity Shaftesbury Capital, and in Eastern Europe, Nepi Rockcastle.

Portfolio activity

Over the quarter we increased the Fund's exposure to local names that offer a combination of highly attractive and sustainable yields, coupled with moderate growth outlooks and improving balance sheets. This included the likes of Redefine Properties and SA Corporate, both of whom are offering earnings yields in excess of 12%.

We also further reduced the Fund's position in Equites Property Fund as the company continues to face headwinds from rising interest rates in the UK, which is likely to negatively impact its UK property valuations.

Outlook and strategy

The sharp increase in interest rates over 2022 resulted in a steep derating of the listed property sector, both locally and abroad. These negative impacts, however, were offset by a significant recovery of earnings from its COVID lows. Although the quarterly returns for the listed property sector were lacklustre, the expected stabilisation in the rates outlook, along with improving sector fundamentals, proven by company results released over the quarter, bodes well for the remainder of the year and beyond. Retail, in particular, continues to show robust data with continued improvement in fundamental metrics, such as vacancy statistics and rental reversions. Industrial too remains robust.

In our view, the improving fundamentals are further supported by relatively attractive valuations. The sector trades on a forward yield of c.10.5% (c.11% for SA only) and a c.30% discount to net asset value. Due to payout ratios, introduced to follow international best practice supporting liquidity and the health of balance sheets, dividend yields are slightly muted on a relative basis, but far more sustainable and dependable.

The sector offers attractive value over the medium- to long-term time horizon, primarily underpinned by a more sustainable cash-covered yield, together with a supportive valuation. Over the medium term, we remain constructive of a return to earnings and distribution growth off a sustainable income base as the economy recovers.

In the current environment, we continue to assess the portfolio’s 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 investment outcomes.