

Discovery Global Multi-Asset Fund

Market background

The second quarter of the year was strong for most markets overall, supported by continued progress on the global vaccination rollout and a reduction in new global COVID-19 cases, although the Delta variant started to be a cause for concern towards the end of the period. US inflation significantly beat market expectations for two consecutive months, rising by +4.2% and +5.0% respectively on a year-on-year basis. This fuelled concerns of the US overheating as a result of significant fiscal support, supply bottlenecks and increased consumer spending as economies continued to reopen. However, having reiterated their dovish stance for a number of months, the Fed made a perceived hawkish pivot in the final month of the quarter, bringing forward expectations of the first rate hike to 2023. This helped to ease investor concerns regarding the tail risks surrounding inflation.

Against this backdrop, global equities generated high-single digit positive returns, although this was predominantly driven by developed markets. Whilst China still generated a solid positive return during the quarter, growing concerns around the softness in growth and the tightening of policy caused the region to lag. Conversely, US and European equities both reached fresh all-time highs over the period. In the latter half of the quarter, following the Fed's meeting, the growth over cyclical trade reasserted itself and technology stocks rebounded. Elsewhere, emerging market debt generated a positive return in part helped by US dollar weakness, whilst spreads of high yield bonds compressed further which saw prices rise with the US outperforming Europe. Within commodities, oil performed strongly during the quarter thanks to further progress with vaccinations and economies reopening. Copper also moved up in value for the fifth consecutive quarter despite a sharp pullback in June.

Sovereign bonds saw some divergent performance; in spite of inflation data showing higher pricing pressures, US treasuries and UK Gilts recovered whilst their European counterparts lost ground.

Investment grade corporate bonds generated a positive return; the US outperformed European with the spreads of US investment grade bonds having now reached the tightness of the previous cycle. The US dollar lost ground against some major currencies over the course of the quarter although saw a bounce following the June Fed meeting. Conversely, emerging market currencies saw some sizeable moves and had a positive period overall. Bitcoin declined by -41% during the quarter as it was negatively impacted by scrutiny from authoritative bodies.

Gold recovered from its poor first quarter and returned 4%, to end the period on \$1,770/oz, albeit falling sharply in June due to the Fed meeting narrative.

Performance review

For the quarter, the Fund delivered a positive absolute return ahead of the benchmark.

Equity markets continued to push higher, while credit spreads tightened, and government bond yields generally moved lower after selling off sharply through the first quarter. US equities outperformed, with Europe also performing strongly, while Asia and emerging markets gained more modestly due to some modest US dollar strength and softer-than-expected Chinese economic data releases.

Sector wise, there was a significant rotation towards the end of the quarter, away from Value and towards Growth as the reflation trade faced a setback following the US Federal Reserve indicating a quicker-than-expected move away from highly accommodative policy. The technology sector outperformed strongly, while financials and industrials rose more modestly and consolidated following a very strong first quarter.

The Fund's equity allocation outperformed marginally over the quarter, benefiting from our overall overweight allocation, although this was offset by weak stock selection as a number of Asian, diversified mining and insurance companies detracted from returns. Fixed income added to performance, as our additions to US, Australian and New Zealand government bonds performed well, while an underweight to European duration also added value. The holding in gold also added to absolute and relative returns over the quarter, as the yellow metal recovered from a weak first quarter. We exited the position at attractive levels.

Portfolio activity

There were a number of notable changes to the Strategy over the quarter. In equities, we reduced exposure towards the end of this period. This was predominantly a result of reducing or exiting cyclical and Asian exposures, due to our concerns around increasing prospects for slowing growth in China over the next 6-12 months.

In fixed income, we added to Australian and New Zealand government bonds in April, as well as US government bonds in June, post the first quarter sell off in global rates markets, taking fund duration to 2.5 years from close to 0.

In currency, we reduced EM exposure, reducing positions in Indonesia and South Africa. This was also a result of our expectations that the Federal Reserve will begin to move towards tapering in the second half of the year – likely placing upward pressure on the US dollar. We also exited a position in gold due to our belief that US real yields will likely shift higher as the Federal Reserve become progressively less accommodative over the next year.

Outlook and strategy

The successful rollout of vaccines is allowing social distancing restrictions to be eased and the recovery to continue for much of the world. Looking forward, we believe that the current pace of vaccine programmes should allow for a return to more normal social conventions for much of the developed world as we advance through the second half of this year. At the same time, the size of fiscal and monetary policy support remains significant as central banks and governments seek to support households and businesses to foster a return toward full employment. One area of divergence here is in China, where the credit cycle, a primary policy lever, has turned lower and authorities are seeking to address imbalances in local government debt. This has scope to slow the Chinese economy heading into 2022.

Our central scenario for financial markets continues to be that volatility will likely remain elevated in the coming quarters, although the drivers of this volatility are likely to shift. As we look six months out, towards the beginning of 2022, we believe investors should focus on the prospect of slowing growth in China, as a function of the current down-cycle in Chinese credit creation, at a time when the Federal Reserve are also likely tapering its quantitative easing programme. This confluence of forces has scope to add volatility across asset markets. Although we continue to see opportunities for medium-term investors, we have moderated risk and raise cash in order to be positioned to take advantage of any bouts of volatility. We continue to watch China's credit cycle, the progress in vaccine rollouts and the willingness of central banks to maintain highly accommodative policy as economies recover, believing that these are the primary forces driving financial markets from here. We will seek to continue to take advantage of opportunities as they are presented by market volatility.

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