

Asset class indicators Autumn 2021

FROM THE DISCOVERY BALANCED FUND RANGE MANAGERS AT



At a glance – asset views

Domestic asset allocation	-	0	+
Equities			●
Government bonds			●
Credit	●		
Inflation-linked bonds	●		
Listed property	●		
Cash	●		

International asset allocation	-	0	+
Equities			●
Government bonds	●		
Credit	●		
Cash	●		

Views expressed are those of the management team of the Discovery Balanced Fund range. Views expressed for each asset class are subjective and are for the asset class as a whole. All views are as at 01.06.21.

Domestic equities

Positive

The outlook for equities remains positive, and we continue to tilt the portfolios towards select cyclical exposures where the earnings revisions cycle is presenting good opportunities. Our exposure to global defensive companies is limited to a few specific holdings, mainly Naspers, Prosus and Bid Corp, where earnings expectations remain relatively robust, while valuations are reasonable. These stocks should also provide some protection should the rand's recent trend of good fortunes come to an end.

However, our core exposure within domestic equities is our allocation to global cyclical stocks which include diversified miners, platinum group metals miners, Sappi, Sasol and luxury goods maker, Richemont. These companies are geared to the global economic cycle and continue to exhibit favourable earnings revisions profiles. Most of the exposures in this bucket are benefitting from tight commodity markets and low inventory levels in our view.

We have also increased our exposure to local cyclical companies over recent quarters. We have a growing exposure to the South African banks where earnings revisions have started to turn and valuations are attractive alongside our exposure to apparel retailers and Motus Holdings which have good earnings revisions profiles, trading at reasonable valuations. While our exposure to local defensive businesses is limited as earnings revisions and valuations are still not as compelling in this space, we have found select opportunities in MTN Group, Pick 'n Pay Stores and Bidvest and have been building up a position in Life Healthcare.

Offshore equities

Positive

The offshore allocation remains favourably disposed to equities, with our tilt towards cyclical companies where earnings have troughed and are recovering and valuations are reasonable. Our allocations to US banks, semi-conductor and capital goods companies 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.

In Japan, as the global capex cycle is starting to turn and global PMIs continue to improve, we expect Japanese industrials to continue rebound. Both the Chinese and Japanese equity markets also offer significant diversification benefits given their low correlations with the domestic equity market, thus exhibiting attractive risk and return attributes from a portfolio construction perspective.

Domestic fixed interest

GOVERNMENT BONDS

Positive

We have maintained the material allocation to local sovereign bonds especially within the context of the global fixed income universe. The South African Reserve Bank (SARB) is facing less pressure than other emerging market central bankers and are currently on hold.

The continued willingness to exercise fiscal prudence and the further reduced supply will provide some support to bonds. We continue to like the buffer provided by the income profile of local bonds and think bonds are supported by attractive valuations versus their own history as well as against emerging market peers (the domestic 10-year government bond has one of the highest real yields versus its counterparts, particularly those with a similar risk profile).

We recognise that global bond markets will weigh on the domestic market and will selectively take profit on selected parts of the curve as it reaches fair value, whilst continuing to be positive on the medium-term total risk-adjusted return profile for domestic bonds.

CREDIT

Negative

The asset class remains susceptible, in our view, to a sell-off should the pace of economic activity fail to reflate sufficiently, and sovereign credit quality continues to deteriorate. This, alongside constrained liquidity in the secondary market, restricts our allocation, hence it remains moderate. Our favourable dispensation towards the current upswing in domestic economic activity is expressed rather through our higher allocation to cyclical domestic equities.

The allocation within domestic credit is skewed towards assets with defensive credit qualities. We therefore have minimal exposure to cyclical sectors of the economy, instead favouring an allocation to higher quality issuers, namely; banks, insurers, government-guaranteed state-owned enterprises and large blue-chip corporates with strong balance sheets.

INFLATION-LINKED BONDS

Negative

We continue to prefer local nominal debt over inflation-linked bonds (ILBs). While ILBs could be considered attractive at the short-end of the maturity curve on an

inflation break-even basis, the asset class remains highly illiquid, hence our preference for nominal bonds.

LISTED PROPERTY

Negative

Our allocation to the sector remains limited. The domestic property sector has suffered from several setbacks over the last few years, including deteriorating fundamentals, governance and reporting-related concerns, rebasing of earnings and the introduction of pay-out ratios. On a sustainable earnings basis, like-for-like rental growth is forecast to be below inflation for the next two to three years, while deleveraging will likely further dampen growth prospects. Direct asset values are also likely to come under some pressure, although it is too early to estimate the magnitude thereof. That said, valuations could be considered attractive. While we are pleased with the re-rating of the sector over recent months, we believe current valuations are justified given the deteriorating growth profile of both distributions and net asset value (NAV).

Offshore fixed interest

GOVERNMENT BONDS

Negative

Developed market central bankers have demonstrated a willingness to look through this year's rise in inflation and want confirmation of a stabilized broad-based economic recovery. This easy monetary policy stance is likely to continue to anchor the short end of the curve. We expect high inflation prints over the next few months to test the longer end of yield curves, but any overshoot should be viewed as a buying opportunity.

CREDIT

Negative

Over recent years, global credit markets have been the prime beneficiaries of a low growth, low volatility and accommodative policy environment. Corporates have responded by substantially re-leveraging, i.e. taking on significant and increasing levels of debt to fund corporate action, dividend pay-outs and earnings- accretive share buybacks. While credit should outperform government bonds as trends in economic growth globally accelerates, we continue to prefer global equities as the primary asset class to capture this trend to the benefit of our investors.

Cash

Even though cash does not protect investors against inflation, it provides the safety of capital preservation – at least in nominal terms – while also providing us with liquidity to invest when opportunities arise. When the risk of capital loss on other assets rises substantially, cash serves as an appropriate temporary investment. At present, we hold minimal cash both locally and offshore.

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