

Discovery Global Multi-Asset Fund

Market background

During the first quarter of the year, mixed performance amongst assets could be attributed to the ongoing tug-of-war between, on the one side, the continued commitment to ultra-loose monetary policy and the announcement of significant new fiscal stimulus, and on the other, fears that a forthcoming resurgence in activity and consumer demand would drive up inflation therefore forcing policy makers to row back.

Against this backdrop, the majority of equity markets generated positive returns albeit with value significantly outperforming growth, and developed markets outperforming emerging markets. European equities in particular performed strongly despite concerns regarding the vaccine rollout and further restrictions, benefiting from a higher weighting to cyclical stocks and the reflation theme. US equities reached a fresh record high while Japan also performed strongly on the back of better-than-expected data. China was the exception, generating a small negative return due to a conservative growth target for 2021 and Western sanctions. Emerging market debt generated a negative return during the month, as concerns over higher Treasury yields, US dollar strength and country specific issues proved to be a headwind, while high yield bonds detracted in sympathy with the yield sell-off. Oil was the top performing asset, thanks to tight supply and a strong recovery in global economic demand.

Sovereign bonds, particularly in the US, experienced a material negative performance with US Treasury 10-year yields rising over 80bps, the largest rise in absolute terms since Q4 16. The rise in yields saw the price of US sovereign bonds decline in value. Investment grade bonds suffered as a result too. In contrast, the US Dollar enjoyed its best quarterly performance since Q2 18 as investors moved to price-in potential hikes from the US Federal Reserve due to the prospect of inflation. The Japanese yen – often held for its defensive attributes – lost significant ground versus the US dollar.

Gold saw a run of nine successive quarterly increases come to an end, with its price falling by -10%. Recent similarly sized falls also coincided with a sharp rise in Treasury yields.

Performance review

For the quarter, the Fund outperformed the benchmark.

Equity markets gained as developed markets rallied due to an increasingly bullish outlook for growth as vaccine programmes continued to advance and social distancing measures were dialled back. European markets outperformed, aided by a weaker euro, while Asian and emerging market equities underperformed due to some strengthening in the US dollar but also because of Chinese authorities raising financial stability concerns linked to asset valuations, which investors took as a signal that Chinese policy will be tightened. Within equity markets, technology and broader “growth” equities struggled as US government bond yields rose, while financials and industrials outperformed.

The Fund’s equity allocation was mixed but added to returns overall. Exposure to semiconductor, banks, insurance and mining businesses all gained strongly, while a number of Asian equity positions weighed on returns.

In fixed income, the fund has maintained very little exposure to developed market government bonds, which sold off through the quarter. A number of small positions in EM local currency bonds did detract, however, as US Treasury yields continued to rise.

The Fund’s currency exposure detracted from returns as the Turkish lira sold off following the head of Turkey’s Central Bank being fired.

The Fund’s position in gold also detracted from returns as its price fell in response to higher US Treasury yields and a stronger US dollar.

Portfolio activity

In equities, we added exposure to US Large Cap banks early on in the quarter given their strong balance sheets, high levels of provisions and our expectation for higher US Treasury yields. Over the quarter we also added to stocks exposed to the semiconductor cycle as a result of very tight supply alongside strong structural demand as result of broadening usage of semiconductors.

In fixed income and currency, we added to a position in Mexican local currency bonds and the Mexican peso where valuations had improved post the selloff in global government bonds yields and closed our short-dated holdings in Turkish government bonds and the currency after the investment case was undermined by the sudden replacement of the Central Bank Governor by a candidate who is closely aligned with Erdogan's unorthodox belief that higher rates leads to higher inflation. Hence it is likely going forward that as inflation continues to surprise to the upside the central bank will fall behind the curve and fail to use policy effectively to control inflation.

Outlook and strategy

The global recovery moderated somewhat in recent months due to increased restrictions on movement in Europe and the United States in particular, but also in other countries around the world. The rollout of vaccines is now well underway and expected to continue to accelerate in the coming months, while social distancing restrictions are beginning to be eased. Looking forward, we believe that the current pace of vaccine programmes should allow for a return to more normal social distancing in the second half of this year for much of the developed world. 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 through this period of economic weakness and foster a return toward full employment.

Our central scenario for financial markets continues to be that volatility will likely remain elevated in the coming quarters, although we believe that the near-term adjustment in government bond yields is close to complete and yields will likely consolidate through the summer months as shorter-term inflation pressures dissipate. Risk premia have compressed considerably from the extreme levels reached a year ago but remain elevated relative to history in a number of areas and developed market real yields remain negative, which is supportive of asset markets. We continue to see opportunities for medium-term investors as a result, although these have become far more specific rather than broad based. 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 and inflation rises, 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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