Discovery Invest

The formula for successful investing

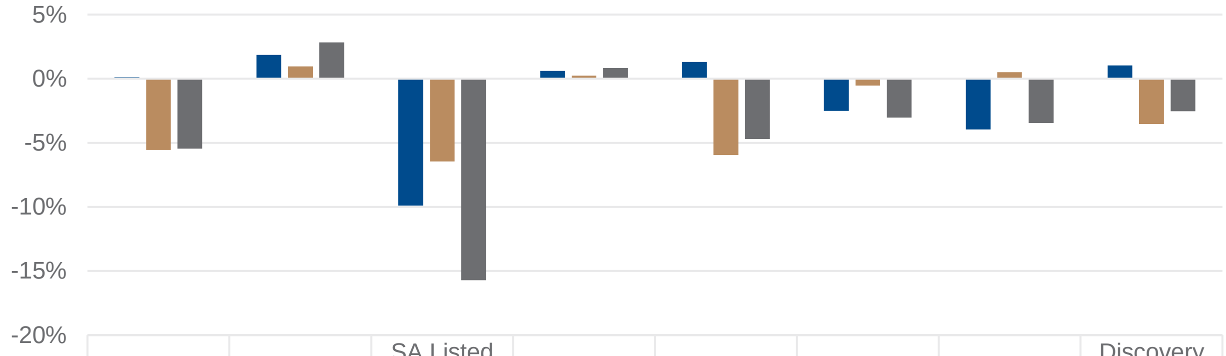
Discovery Balanced Funds

Volatility awakens in February

Following a protracted period of low volatility, which created a high level of complacency among investors, a spike of volatility reared its head in February. The Chicago Board Options Exchange Volatility Index (VIX) – which measures implied volatility – shot up to its highest level since 2011 and, in the process, precipitated a sell-off in global equity markets. In somewhat ironic fashion, positive newsflow – in the form of robust US economic data (and labour market data in particular) – was, at least in part, the catalyst for this skittish behaviour among investors. The release of the US employment report pointed towards further strengthening of the US labour market, but much attention was paid to the wage growth figure which was the highest recorded in three years and marked the third consecutive month of increases. As a result, this ignited concerns that inflation could rise faster than initially anticipated, the knock-on effect of which could be a more rapid rise in US interest rates.

The fallout from this has, to date, been contained to equity markets, the impact of which can be seen in the below chart where local and global stock markets have retreated sharply this month. Meanwhile, local listed property has suffered as a result of negative newsflow attached to some of the sector heavyweights, resulting in meaningful drawdowns. On other hand, bonds have continued to ride the wave of positive sentiment following the outcome of the ANC elective conference. Global bonds and cash have yielded negative returns in rand terms on the back of the stronger local currency. The Discovery Balanced Fund has been impacted given its exposure to both local and global equities. However, its drawdown has been more muted than equity markets as it has benefited from its diversification given that it has exposure to different regions and asset classes — here its material allocation to local bonds has been helpful, while its small exposure to local listed property has meant that the sector sell-off has only had a limited impact on performance.

Asset class returns



	ALSI	ALBI	SA Listed Property Index	STEFI	MSCI ACWI (ZAR)	WGBI (ZAR)	LIBOR (USD) ZAR	Discovery Balanced Fund
Jan-18	0.1%	1.9%	-9.9%	0.6%	1.3%	-2.5%	-4.0%	1.0%
MTD	-5.5%	1.0%	-6.5%	0.2%	-6.0%	-0.5%	0.5%	-3.5%
YTD	-5.5%	2.8%	-15.7%	0.8%	-4.7%	-3.0%	-3.5%	-2.5%

Jan-18 MTD YTD

Source: Morningstar, Investec Asset Management, 13.02.2018

Going forward, we do not hold the view that we are faced with the advent of a bear market in the short term. We believe the current momentum is in favour of a continuation in the improvement of global growth dynamics as underlying global economic fundamentals remain strong — global growth has accelerated, is synchronised and self-sustaining in our view. Although we believe we are at the mature stage of the business cycle, some countries have not achieved growth for sustained periods, thus suggesting further upside. But, we believe a modicum of caution is warranted. In our view, the recent market fall is not enough to mitigate valuation risk given that equity markets remain at lofty levels. However, we do not believe that valuations alone will trigger a bear market (another catalyst is required in our view, such as a global recession). Global bond yields remain low, but are now rising in line with growth, while financial conditions are still supportive, but should be less so going forward. Current late cycle economic indicators are generally not 'hot enough' for us to shun risk assets, but we do agree that we need to closely monitor the situation. In our view, strong earnings growth has driven markets in recent times. Typically, corporate profit margins usually begin to fall before recessions strike, and, at this point, there is generally no real anxiety yet about the quality of corporate balance sheets. In our view, the recent setback could be a healthy correction from an overbought market.

Therefore, we continue to hold our view of a continued improvement in global growth. Against this backdrop, we maintain our exposure to risk assets. Although global stocks have generally performed well in the last year, regions such as Europe and Japan (our preferred exposures) are still playing catch up. These two are cyclical in nature and accelerating economic activity is leading to strong profit recoveries (and positive earnings revisions), valuations remain attractive (lower multiples on lower earnings base) and sentiment is improving.

Given domestic growth is forecast to improve in 2018, inflation is expected to remain within the South African Reserve Bank's (SARB) target band of 3-6% and optimism around new ANC leadership is elevated for now, South Africa could be poised to benefit from an improving investment environment for equities. However, we believe the optimism expressed by the market should be tempered. Policy changes are typically slow to implement, while the expected improvement in the business and consumer environment could be protracted. Therefore, we believe it is critical to remain consistent to our bottom-up, fundamental investment process which drives our investment decisions on the back of company-specific reasons. Some of our significant positions include Barloworld, Old Mutual, Sasol and Standard Bank Group.

Global fixed income markets have been slow to reflect the positive global growth dynamics. We remain wary of the asset class. In our view, should inflation and global monetary policy normalise, it is difficult to argue that negative or low real yields in global bond markets should persist.

In terms of local government bonds, although we recognise the premium yield they offer (albeit, somewhat reduced after the recent rally), we are cognisant of the uncertainty surrounding the downside to long-term fundamentals. We also view any exposure to government debt in the context of other assets held in the portfolio.

While the portfolio will always reflect our highest conviction investment ideas, we are cognisant of risk when constructing the portfolio. We believe that diversification is the best tool to manage risk and is an integral part of our decision-making process. We consider how a particular investment fits into the broader opportunity set which is reviewed regularly so as to create a consistent framework to assess new positions. Therefore, the correlations between different assets are considered when constructing the portfolio and evaluating any new investment ideas in order to enhance risk-adjusted returns.

Overall, we believe asset selection should trump asset allocation in the current environment, where we expect substantial dispersion in asset returns without them necessarily driving the overall direction of markets. We believe our investment process and philosophy should ensure consistency in our portfolio construction and help us navigate the uncertain terrain.

Disclaimer

Nothing contained herein should be construed as financial advice and is meant for information purposes only.

What to know before investing in collective investment schemes (unit trusts)
Before you invest in a collective investment scheme, there is important information you should know. This includes how we calculate the value of your investment, what affects the value of your investment, and

investment charges you may have to pay. This notice sets out the information in detail. Speak to your financial adviser if you have any questions about this information or about your investment.

What the investment is
This Fund is a Collective Investment Scheme (also known as a unit trust fund) regulated by the Collective Investment Schemes Control Act, 45 of 2002 (CISCA). Collective investment schemes in securities are generally medium- to long-term investments (around three to five years).

Who manages the investment
Discovery Life Collective Investments (Pty) Ltd, branded as Discovery Invest, is the manager of the Fund. Discovery Invest is a member of the Association of Savings and Investment South Africa (ASISA).

You decide about the suitability of this investment for your needs
By investing in this Fund, you confirm that:
• We did not provide you with any financial and investment advice about this investment
• You have taken particular care to consider whether this investment is suitable for your own needs, personal investment objectives and financial situation.

You understand that your investment may go up or down
1. The value of units (known as participatory interests) may go down as well as up.
2. Past performance is not necessarily an indication of future performance.
3. Exchange rates may fluctuate, causing the value of investments with international exposure to go up or down.
4. The capital value and investment returns of your portfolio may go up or down. We do not provide any guarantees about the capital or the returns of a portfolio.

How we calculate the unit prices and value the portfolios
1. We calculate unit trust prices on a net-asset value basis. (The net asset value is defined as the total market value of all assets in the unit portfolio, including any income accrued and less any allowable deductions from the portfolio, divided by the number of units in issue.)
2. The securities in collective investment schemes are traded at ruling prices using forward pricing. (Forward pricing means pricing all buy and sell orders of units according to the next net-asset value).
3. We value all portfolios every business day at 16:00, except on the last business day of the month when we value the portfolios at 17:00.
4. For the money market portfolio, the price of each unit is aimed at a constant value. This means that all returns are provided in the form of a distribution and that a change in the capital value will be an exception and only due to abnormal losses.

5. Buy and sell orders will receive the same price for that day if we receive them before 11:00 for the money market portfolio and before 14:00for the other portfolios.
6. We publish fund prices every business day, with a three-day lag, on www.discovery.co.za

About managing the portfolio
1. The portfolio manager may borrow up to 10% of the portfolio's market value from any appropriate financial institution in order to bridge insufficient liquidity.
2. The portfolio manager can borrow and lend scrip.
3. The portfolio may be closed in order to be managed according to the mandate (if applicable).

Fees and charges for this investment
There are fees and other charges for this investment.

The fees and charges that apply to this investment are included in the net asset value of the units and you do not have to pay any extra amounts. These fees and charges may include:
- *The initial fund management fee*
- *Commission*
- *Incentives (if applicable)*
- *Brokerage fees*
- *Market securities tax*
- *Auditor fees*
- *Bank charges*
- *Trustee fees*
- *Custodian fees*

You can ask us for a schedule of fees, charges and maximum commissions.

The total expense ratio

1. *"Total Expense Ratio" means a measure of a portfolio's assets that have been expended as payment for services rendered in the management of the portfolio or collective investment scheme, expressed as a percentage of the average daily value of the portfolio or collective investment scheme calculated over a period of a financial year by the manager of the portfolio or collective investment scheme.*
2. *A percentage of the net asset value of the portfolio is for fees and other charges relating to managing the portfolio. The percentage is referred to as the total expense ratio (TER).*
3. *A higher TER does not necessarily imply poor return, nor does a low TER imply good return.*
4. *The current TER is not an indication of any future TERs. If fees go up, the TER is also expected to increase.*
5. *During any phase-in period, the TERs do not include information gathered over a full year.*

Transaction costs (TC)
1. Investors and advisers can use transaction cost (TC) as a measure to work out the costs they will incur in buying and selling the underlying assets of a portfolio.
2. The transaction cost is expressed as a percentage of the daily net asset value of the portfolio calculated over three years on an annualised basis. (This means the amount of interest an investment earns each year on average over three years, expressed as a percentage.)
3. Transaction cost is a necessary costs in administering the Fund. It affects the Fund's returns. It should not be considered in isolation as returns may also be affected by many other factors over time, including:
- *Market returns*
- *The type of fund*
- *The investment decisions of the investment manager*
- *The TER.*

4. Where a fund is less than one year old, the TER and transaction cost cannot be calculated accurately. This is because:
- *The life span of the fund is short*
- *Calculations are based on actual data where possible and best estimates where actual data is not available.*

5. The TER and the TC shown on the fund sheet are the latest available figures.