Discovery Global Equity Feeder Fund

Market background

The combination of surging inflation, tightening financial conditions, the ongoing conflict in Ukraine and Chinese lockdowns has taken a significant toll on global equity markets and the MSCI ACWI declined over the second quarter. Sentiment was affected by growing fears about a global recession resulting from hawkish monetary policy as key central banks try to temper multi-decade high inflation. A brief rally at the end of May was interrupted after an unexpected surge in the latest consumer price data caused the US Federal Reserve to deliver an aggressive 75 basis points hike - its largest rate increase in 28 years. In China, towards the end of the period, investors assumed the worst of the economic shocks induced by COVID lockdowns and tech sector crackdown in the country were over. While this benefitted domestic equities, it did little to assuage sentiment on the global front. The US underperformed over the period, and emerging markets like Brazil, South Korea and Taiwan were all particularly weak.

Metal prices retreated as a result of disappointing data releases from China and increased concerns about global growth. Energy prices moderated but remain high, with a move by EU leaders for a ban on most Russian oil imports partially contributing, and agricultural product prices have been pushed higher by the invasion of Ukraine. The US dollar rose as a perceived ‘safe haven’, backed by a central bank still intent on raising interest rates. Value stocks outperformed growth stocks.

Materials, consumer discretionary and technology were the weakest performing sectors, weighed down by concerns of a global recession. While all sectors declined, healthcare, utilities and consumer staples held up best as investors sought more defensive positioning in a volatile market.

Performance review

In a difficult period for markets, the Fund outperformed the comparison index.

Overall, the value style performed best. Stock selection was responsible for outperformance in the quarter, led by consumer staples. Good Q1 results for Chinese baijiu distiller Kweichow Moutai were led by solid volume growth and margin improvements. The easing of COVID restrictions also contributed to expectations that it will benefit from the resumption of events. Coca-Cola Europacific Partners' Q1 2022 results indicated better volumes and higher than expected pricing, while input costs were flat. This has also partially removed market concerns about the company's ability to navigate the current environment.

While overall stock selection in consumer discretionary proved unhelpful, car parts manufacturer AutoZone contributed positively to performance after it reported better-than-expected comparable sales growth for the third quarter. Not holding Tesla helped relative performance as it underperformed due to a correction for growth stocks, production challenges, and other issues centred around CEO Elon Musk. In contrast, Amazon weighed on returns as it underperformed following a disappointing Q1 2022 profit report and guidance due to increasing expense pressure relating to external inflation, overstaffing, and overexpansion of distribution capacity. The position has been exited.

In materials, despite strong Q1 2022 results, miner Freeport-McMoRan declined as copper prices fell on concerns that rising interest rates would push a number of economies into recession. Fears that China's stimulus measures were not translating into significantly higher copper demand also weighed on the shares. In technology, NVIDIA was the weakest Fund holding as it underperformed on concerns about the near-term outlook for the semiconductor cycle. Its weakness was further accentuated by the high multiple and high beta nature of this stock in a falling market.

Within diversified financials, Intercontinental Exchange (ICE) underperformed following the announcement of its Black Knight acquisition. The move means that ICE doubles down on the mortgage tech sector, which has been slowing and is a source of investor concerns. However, over the longer term, it makes strategic sense as it will allow ICE to fully monetise the mortgage tech value chain.

Outlook and strategy

We are currently faced with a market environment where fear dominates. Whether it is concern over geopolitical events, inflationary pressures, the impact of lockdowns in China or weak consumer confidence, the news flow appears unceasingly negative. The broad consensus now seems to be that a recession is inevitable as central banks will have to move at an increasingly rapid pace to tighten monetary policy in order to dampen record inflation. While is an entirely legitimate view, the bottom-up evidence is more nuanced. Corporates continue to report satisfactory earnings and order books. However, they are slightly more circumspect around guidance as they continue to cite supply chain issues hampering their ability to meet demand. At the same time, inventory levels are rising with market bears pointing to this as evidence of weakening demand, while others contend that businesses are now structurally holding higher stock levels due to the logistical issues around acquiring key components and raw materials.

Whoever proves correct in the hard/soft landing debate, valuations are beginning to appear quite compelling on a long-term basis. This type of market typically presents attractive opportunities as overly pessimistic investors cut prices of corporate winners to highly attractive levels. It is these investments that we are actively seeking out for your Fund.