Discovery Global Equity Feeder Fund

Market background

Over the summer there was mounting evidence that a more restrictive monetary policy was taking its toll on economic activity, with credit conditions tightening and manufacturing activity slowing around the world, even though labour markets remained relatively robust. However, oil prices rose as Saudi Arabia and Russia restricted supply, and inflation remained stickier than central banks were happy with. Consequently, interest rates were increased in the US, the UK and Europe. The prospect of rates remaining higher for longer than had been expected resulted in investors taking a more cautious attitude, and both equities and bonds sold off. Real rates have risen significantly, and the quarter ended with US Treasuries at their highest yields since 2007.

Japan, the one market where higher inflation was welcome, outperformed despite the weakness of the yen. Emerging markets also outperformed, helped by a positive performance from India and outperformance from China where a targeted policy response gave some hope that recent economic weakness could be halted. The property sector there remains challenged, but currency weakness seems to be helping the export sector even as domestic demand remains under pressure. The weakness of the technology sector over the period impacted markets such as Taiwan and South Korea, but the strength of the energy sector boosted markets including the UK and Brazil.

Energy stocks significantly outperformed other sectors as oil prices rose. The steepening of the yield curve proved of some help to financial stocks, but higher yields acted as a serious headwind for utilities and real estate stocks. Technology stocks gave up some of their previous outperformance, and cyclically sensitive sectors such as industrials and consumer discretionary stocks lagged as economic activity slowed.

Performance review

For the quarter, the Fund delivered a negative absolute return and underperformed the benchmark.

Stock selection in the consumer discretionary sector proved most challenging, not helped by US luxury goods holding company Tapestry which reacted poorly to an all-cash merger with Capri Holdings. Stock selection in industrials also proved unhelpful. South Korean EV battery producer LG Energy Solution came under pressure as competition from China intensified. We remain comfortable with its status as the largest EV player outside of China and its top-class economics.

In communication services, TKO Group, the result of the merger of World Wrestling Entertainment and Ultimate Fighting Championship, gave back some of its prior gains, not helped by disappointment with recent contents rights negotiations. In a period when a number of technology stocks gave back some of their previous gains, German semiconductor company Infineon underperformed after disappointing results. Cybersecurity company Fortinet reported disappointing results and guidance due to contracts being pushed out as a result of macroeconomic uncertainty combined with inventory digestion. However, in a challenging period for the sector, Nvidia remained one of the top contributors over the period, despite profit-taking in September. Positively, having an underweight position in Apple also contributed to relative performance.

In financials, insurer AIA Group was weak on poor sentiment towards China, despite continued improvement in life insurance sales. However, at a time when less economically sensitive stocks held up relatively well, Chinese beverage producer Kweichow Moutai was among the top contributors to performance. Elsewhere, US engineering business Jacob Solutions was boosted by plans to spin off its nuclear business. A strong oil price lifted oil major Exxon Mobil and US energy business Hess.

Outlook and strategy

As we move into the final quarter of 2023, investors and global equity markets are navigating a complex economic landscape. Consumer spending has remained robust thus far, with higher savings ratios, stronger household balance sheets, longer term fixed rate mortgages, record low unemployment, reasonable wage inflation and still pent-up demand following the end of COVID lockdowns. It has surprised many market participants as to how slowly interest rate rises are actually impacting economy-wide consumption, with strong US household and corporate balance sheets. The chief influence on markets in the coming months remains the shift in monetary policies around the world. As central banks in developed economies have continued tightening monetary policy to curb inflationary pressures rate rises - which have historically worked with a roughly 15-18 month lag – have begun to cause a pullback in equities and a rotation into more defensive companies as the market begins pricing in more recessionary conditions.

Consensus forecasts tend to incorporate expectation of a slowdown or mild recession later in the year. Market leadership to this point has been continuing in the US tech sector reflecting the global economy and corporate earnings staying stronger for longer. Sectors like renewable energy and electric vehicles have de-rated as governments pause for thought over future policies and supply has overtaken demand in some sectors.

Positive structural growth drivers in many industries we are exposed to persist, and the re-opening of the Chinese economy, whilst proving slower than expected, if boosted by some well-targeted stimulus could provide useful cyclical tailwinds as we move forward. As always, the market outlook is unclear and we are retaining a diversified portfolio, with a broad range of stocks, that can withstand different macroeconomic scenarios. We continue to focus on companies with either disruptive growth potential, the ability to compound high returns or companies successfully restructuring, all of which are undervalued and where a positive change in sentiment is delivering the opportunity to outperform. We have continued to add high-conviction stocks whilst taking some profits in our most overbought names or where operating momentum is deteriorating.

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