Discovery Global Value 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 but outperformed the benchmark.

The biggest positive contributors to performance over the quarter included two energy-focused businesses, oil services company NOV and engineering and consultancy business John Wood Group, which rallied alongside a nearly 30% rise in oil prices. More specifically, John Wood's half-year results demonstrated solid progress on the strategy laid out at last year's capital markets day, with revenue and profits ahead of expectations. Some of the travel-related stocks, namely engine supplier Rolls-Royce and Turkish airport operator TAV, also performed strongly. Rolls-Royce rallied by 46% in the third quarter alone, taking this year's rise to over 130%, with the firm's half-yearly results released in August displaying more encouraging signs of the turnaround underway under the recently appointed CEO. TAV also delivered solid results, helped by positive trends in the number of passengers using its airports.

On the negative side, several of our airline holdings (SouthWest Airlines, easyJet and Jet2) detracted from relative performance, on both disappointing earnings releases – partly due to the impacts of higher fuel and labour costs – and worries about softening pricing in the sector. Digital automotive marketplace Cars.com and dental equipment provider Dentsply Sirona also detracted, after releasing quarterly results that were negatively received by the market.

Outlook and strategy

It is worth noting that the outperformance of our Fund in the year to date has been delivered despite the fact that the index's performance has been heavily skewed by the continued stock-market dominance of the largest (primarily technology) companies in the US, which we mostly do not hold. Remove this effect by looking at an equal-weighted index, and the average US stock was in fact flat over the first three quarters of 2023.

This underlines that this is not necessarily an easy backdrop for active portfolio managers, but we continue to see a broad, deep, and exciting opportunity set for those with a value orientation. Value companies continue to trade at a historically wide discount relative to growth companies, and we are seeing attractive potential value investments across industry sectors. By region, UK and European stocks are still significantly cheaper than US stocks, a fact reflected in our current allocations, with North America our biggest underweight, and Europe and the UK are our two biggest overweights. While regional weightings are an output of our bottom-up stock selection process, they do tend to reflect where we are seeing the highest concentrations of value opportunity. As a result of all of the above, our estimated potential upside is well above the median of the last eight or so years, and our portfolio remains well diversified by sector, region and type of value opportunity.

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