

Discovery Equity Fund

Market background

Emerging markets (EM) underperformed Global markets in February. The MSCI EM Index declined by 3.0% while the MSCI World Index declined by 2.5%. On a year-to-date (YTD) basis, EM are outperforming their developed markets (DM) peers with the MSCI EM index down 4.8% compared to the MSCI World which closed down 7.7%.

The key event in the month was Russia's invasion of Ukraine. As expected, global markets did not react well to this development, as we saw the S&P 500 Index down 3.0%. Volatility surged in global equities with the VIX closing in February at 30.15 which is 74.3% higher from where it finished at the end of December 2021. Russia and Ukraine play a key role in global commodity markets as both are key exporters of wheat (and account for c.28% of global exports). Russia is also a key producer of commodities, including but not limited to; platinum-group metals (PGMs), aluminium, and iron ore. The biggest impact was seen in the oil market, with Brent Crude rising past the US\$100/bbl mark, and up 30% YTD at the end of February. The oil price surged to just above US\$130/bbl in early March before easing. Russia is a key exporter of natural gas to Europe, supplying Germany with c.40% of its requirements. The US 10-Year Treasury Bond yield hit a high of 2.05% before retracing to 1.83%. Investors retreating to 'safe haven' assets amid the ensuing conflict was reflected by falling 10-year government bond yields and a rising gold price. All returns are quoted in US dollars.

Locally, the equity market had a strong month, with the FTSE/JSE All Share Index and the Capped SWIX rising by 3.0% and 2.7%, respectively. This was very different to what occurred in global markets, largely due to two factors that supported the South African market: 1) The commodity price surge proved a big positive for miners and the economy as it will continue to support the fiscus for much longer than initially expected, and 2) Russia had a decent weighting in the MSCI EM Index. As the situation deteriorated for Russian equities, South Africa and Brazil benefitted from increased flows as these countries became favoured EM destinations. In macroeconomic news, Finance Minister Enoch Godongwana delivered his maiden February budget speech which delayed fiscal tightening by a year, leaving the FY22/23 fiscal deficit unchanged from the October Medium-Term Budget Policy Statement projections at 6% of GDP. Disappointingly, it seems the National Treasury is set to spend the windfalls from the higher commodity markets, instead of using the extra revenue to invest and reduce debt.

Performance review

For the month, the portfolio outperformed the benchmark.



The local equity component generated positive returns for the portfolio. Notable contributors to relative performance came from underweight positions in the Naspers-Prosus stable as Chinese tech companies remained under pressure amid regulatory headwinds. The overweight allocation to Exxaro Resources contributed positively to performance, as the commodity price boom included other commodities such as copper and iron ore.

Offsetting some of these gains was an underweight position in Impala Platinum, as the surge in palladium and platinum prices amid the ensuing conflict in Ukraine benefitted the South African miners. The large underweight in diversified miner, Anglo American, was the largest detractor from relative performance within the local equity component.

The offshore equity allocation was the biggest drag on performance overall, amid broad-based weakness in global equity markets over the period.

Significant purchases over the period included Capitec Bank Holdings and Shoprite Holdings, while significant sales included Exxaro Resources and Anglo American Platinum.

Outlook and strategy

The portfolio's investment philosophy and process aim to deliver consistent returns for investors. We follow a multi-style investment approach which is dynamically adjusted to ensure that relative risk is actively managed throughout the business cycle. We prefer shares that are trading at a discount relative to the market.

Some of the portfolio's largest overweight positions include Clicks Group and BHP Group, while its significant underweight holdings include Anglo American and FirstRand Bank. Both Clicks and BHP display strong relative quality attributes, while both Anglo American and FirstRand display weak relative value.