Discovery Equity Fund

Market background

Markets got off to a strong start in January, as declining inflationary pressures across key economies drove speculation that central banks might be approaching the end of their rate hiking cycles. In the US, consumer inflation recorded its largest monthly decline since the beginning of the pandemic. Investor sentiment improved on the back of stronger-than-expected corporate earnings and the prospect that the Federal Reserve (Fed) could begin slowing the pace of interest rate hikes as early as February . While in Europe, falling energy prices and downside inflation boosted sentiment. The reopening of China's economy further supported risk appetite, as did signals from Chinese policymakers that they would put in place measures to help boost economic growth. In South Africa, equity markets tracked their global peers higher, buoyed by a less hawkish reserve bank.

South African equities closed the month in positive territory, with the FTSE/JSE All Share Index and Capped SWIX gaining +8.9% and +7.0 respectively, buoyed by the prospect of a less-hawkish Fed and renewed optimism over the reopening of China's borders. Other news lifting investor sentiment came in the form of a smaller-than-expected rate hike from the South African Reserve Bank (SARB). The central bank raised the benchmark repo rate by 25bps to 7.25%, below market forecasts of a 50bp increase. In its monetary policy statement, the SARB painted a sobering picture of the country's economy, highlighting rolling blackouts and other logistical constraints as key risks to economic growth. The SARB's latest GDP forecast now sees the economy expanding by just 0.3% (vs 1.1%) in 2023 and 0.7% (vs 1.4%) in 2024. While in more positive news, the reserve bank expects headline inflation to continue its trajectory towards the midpoint of its 3-6% target band over the next two years. Meanwhile, annual inflation continued to show signs of slowing after easing to 7.2% y/y in December from 7.4% in November. South Africa's retail trade surprised on the upside, rising 0.4% y/y in November following two straight months of declines, beating market forecasts of a 0.2% fall.

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Performance review

The Fund underperformed the benchmark for the month.

At a stock level, the Fund's underweight position in Richemont was the biggest detractor from relative performance. The luxury goods company rallied in January, as investors welcomed the prospect of a revival in consumer spending following the reopening of China's economy. The Fund's underweight position in Anglo American was the second-largest detractor from relative peformance, as general miners followed gains in commodity prices, particularly in copper and iron ore.

More positively, the offshore component of the Fund was a positive contributor to performance overall, with the weaker local currency providing an additional tailwind to offshore earnings.

In the local equity component, underweight positions in Northam Platinum and Impala Platinum aided relative perfomance. Platinum miners weakened on the back of softer palladium and platinum prices, compounded by concerns over production output and rising operating expenses in the wake of loadshedding constraints.

Significant purchases over the period included AngloGold Ashanti and The Foschini Group, while significant sales included FirstRand and British American Tobacco.

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 Exxaro Resources and British American Tobacco, while its significant underweight holdings include Standard Bank Group and Anglo American. Exxaro displays strong relative price momentum, while British American Tobacco exhibits strong relative quality attributes. In contrast, Standard Bank displays weak relative quality attributes, while Anglo American displays weak relative earnings revisions.

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