Discovery Global Equity Feeder Fund
Quarter ending 30 June 2024

Market background

It was a mixed second quarter (Q2) for global capital markets. In the US, the S&P 500 reached another all-time high, fuelled by big-tech euphoria and growing optimism over the possibility of a rate cut later this year. In Europe, gains for far-right parties in the European Parliamentary elections led French president Emmanuel Macron to call a snap election, putting equities under pressure. In Asia, Hong Kong and Chinese mainland stocks fell for the second consecutive month in June, with markets lethargic ahead of the July meeting of China's top leaders. Turning to South Africa, the national elections took centre stage as the prospect of a market-friendly outcome gained momentum, lifting domestic equities higher.

Performance review

For the quarter, the portfolio delivered a positive absolute return and outperformed the benchmark.

Stock selection in IT, and to a lesser degree, communication services and healthcare, helped drive performance. In IT, Nvidia continued to perform strongly after reporting higher-than-expected results and an outlook showing higher-than-expected profit potential. Positive supply chain channel checks have led to an increase in revenue estimates. In particular, semiconductor packaging capacity is being revised up which has positive implications for company chip orders, indicating that demand continues to outpace supply. Other AI-related stocks continued to ride a wave of optimism, with TSMC, SK hynix and Broadcom all among the leading contributors to relative performance. The purchase of software business Autodesk proved timely as good results and a favourable resolution to an audit committee investigation helped the shares. However, our large underweight position in Apple detracted from relative returns as the stock performed well.

In communication services, TKO Group did well after reporting higher-than-expected results and giving an outlook showing that strong operating trends look set to continue. Visual social network Pinterest rose sharply on good results which showed increased user engagement and monetisation.

However, positioning in Chinese internet company Netease detracted from relative performance as its games outlook disappointed and the stock has now been sold. Broad weakness across Chinese consumer demand impacted the wholesale price of Moutai products and the shares of Kweichow Moutai de-rated alongside the sector. In healthcare, weak results dragged down China's Bio-Rad Laboratories.

Stock selection in the industrials sector proved challenging. Jacobs Solutions disappointed the market with mixed second-quarter results and no increase in guidance for the full year. French construction and concessions business Eiffage was hit by political uncertainty following the calling of elections. Recent results for global payment provider Mastercard showed a slight beat, but future guidance was reduced at the margin, which weighed on the shares.

Outlook and strategy

Structurally, we believe we shall see higher and more volatile inflation through the cycle, resulting in an interest rate expectations cycle with greater amplitude. So far this year, growth in a more disinflationary environment has encouraged the market to price in a soft landing. Economic growth has been sufficient for the market to take heart from a path to lower inflation and interest rates.

These easier financial conditions, low leverage and lower inflation have all contributed to ongoing outperformance from technology stocks, in particular semiconductors – the key growth sector benefiting from the build-out of the data centres needed to support AI developments.

While some elements of US inflation have remained sticky, against a backdrop of slowing wage growth and softer rent increases, the most recent data opens the door to interest rate cuts in the coming months. In Europe, we saw a first ECB rate cut in June, with Switzerland and Canada also easing their monetary policy during the period.

A stuttering Chinese recovery, with still weak Chinese consumption, has seen an earlier stock market rally give back all its gains. There is now hope that China's 3rd Plenum later in July will provide some improved Chinese policy for the coming five years. The UK and Japan have emerged from technical recessions and are showing better growth potential. In particular, a combination of increased shareholder activism, rising wage inflation and improving confidence in Japan are providing an investment opportunity.

The Russia / Ukraine crisis, the threat of escalation in the Middle East, and the possibility of tensions in the Taiwan Strait ensure geopolitical risks remain high – all of which can produce oil price volatility and fast-changing inflation and rate expectations. However, it is the elections globally which are taking centre stage for now, with India, Mexico, France and the UK all seeing either new leadership emerging or existing leadership seeing their mandates change as the electorate votes against the incumbent 'elite'. Most importantly for our portfolios, the US election now sees the market trying to price a Trump vs. Biden race where the consensus is that Trump will likely win.

This complex macroeconomic picture is the reason we continue to advocate a balanced approach to portfolios today, through our multi-factor process with a strong emphasis on stock selection and being nimble rather than either stylistically biased or beholden to thematic growth narratives – regionally, sectorally, or otherwise.

Market indices reveal a continuing high concentration in the largest US technology stocks with the strongest balance sheets and structural growth drivers. The enthusiasm for AI-related investments has shown no signs of abating, although we are aware that any disappointment can result in share price volatility, despite the obvious long-term growth opportunity. Our investment process is designed to help us navigate such inflections using our alpha model with associated fundamental analysis to focus on the latest trends as they emerge.