Discovery Equity Fund

Market background

For the month, the MSCI Emerging Markets Index delivered a gain of 0.5%, compared to the MSCI World Index return of 0.2%. On a year-to-date basis, emerging markets are outperforming their developed markets peers, with the MSCI EM Index down 11.8% compared to the MSCI World Index's -13.0% return.

Newsflow over the month was dominated by the impact of war in Ukraine on commodity markets, and by China's continued 'zero-COVID' approach – with stringent lockdowns implemented in key economic hubs. While the final week of May saw risk markets pare back some of the losses suffered earlier in the month as China eased some lockdown restrictions, there has been no relief in energy prices. The oil price continued to rally following news of a European Union (EU) export ban on most Russian oil. Brent crude rose 12.4% in May, to end the month at US$122.84/bbl. Although OPEC announced that it will be increasing overall production, led by Saudi Arabia, the announcement failed to curtail oil price growth as market participants doubted the increase would be sufficient to offset the drop in Russian production (the world's third largest producer). How the Ukrainian war unfolds remains a key factor for global inflation expectations for the rest of 2022 and 2023.

Locally, equity markets had a muted month, with the FTSE/JSE All-Share Index declining by 0.4% and the Capped SWIX gaining 0.5% in local currency terms. In US dollar terms, the MSCI South Africa Index was up 1%, compared to a 0.2% fall by the MSCI World. The Monetary Policy Committee of the South African Reserve Bank delivered a widely expected 50 basis points (bps) rate increase at its scheduled May meeting. The market is currently pricing in a further 50bps increase in July. In an attempt to mitigate the impact of inflationary pressure on the consumer, the government extended its reduction in the fuel price levy for an additional two months and reintroduced the Basic Income Grant to ease the socioeconomic pressure valve. Although South Africa is one of the few emerging market economies that has not seen a big increase in food inflation so far this year, risks are clearly to the upside.

Performance review

For the month, the portfolio underperformed the benchmark.

The local equity component detracted from performance overall. Underweight positions in South African banks (i.e., Standard Bank Group) hurt relative performance as the sector rallied over the month, benefitting from a rising interest rate environment. The underweight holding in Naspers was also a drag on relative performance, as the technology firm found support from its Chinese associate, Tencent.

The offshore component of the portfolio also weighed on returns, and this was further compounded by a firmer local currency over the period.

Offsetting some of these losses was having no exposure to AngloGold Ashanti, and an overweight allocation to Investec Plc, which was among the better performers on the bourse.

Significant purchases over the period included British American Tobacco and Investec Plc, while significant sales included BHP Group and Capitec Bank.

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 Richemont, while its significant underweight holdings include FirstRand Bank and Standard Bank Group. Clicks displays strong relative quality attributes, while Richemont is seeing strong relative earnings upgrades. In contrast, First Rand is showing weak relative value, while Standard Bank displays weak relative quality attributes.

