Discovery

Discovery Global Equity Feeder Fund

Market background

The MSCI All Countries World Index (ACWI) declined during the quarter, as investors grappled with Russia's invasion of Ukraine. The West's response was to impose wide-ranging sanctions aimed at punishing key sectors of the Russian economy. However, by the end of the quarter, global equities had recovered some of the losses as news of peace talks between Ukraine and Russia emerged. The US Federal Reserve (Fed) started its long-awaited rate normalisation cycle by raising rates by 25 basis points and signalling that six more hikes would be needed this year to deal with the highest inflation in four decades. The European Central Bank (ECB) opted to keep rates unchanged at 0%, citing high inflation and risks to economic growth, as the region is likely to bear the brunt of the fallout from the ensuing conflict in Eastern Europe. Elsewhere, the People's Bank of China (PBOC) maintained its accommodative policy by lowering the one-year loan prime rate and injecting a net 100 billion yuan into the banking system with its medium-term lending facility.

Oil, precious and industrial metals as well as agricultural commodities also rose to multi-year highs before correcting as geopolitical tensions eased. Over the quarter, value stocks outperformed growth.

Energy was the strongest performing sector over the quarter, benefitting from elevated commodity prices. Consumer discretionary was the weakest sector, reflecting the pressure on discretionary spending amid high gas prices and waning consumer sentiment in the US and other developed markets. The communication services sector also declined. In China, the possibility of further regulatory pressure led to weakness for internet stocks.

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Performance review

In a difficult period for markets, the Fund outperformed the comparison index.

Overall, the value style performed best. Stock selection in the energy and materials sectors was positive. US oil producers Pioneer Natural Resources and Hess Corporation responded positively to higher energy prices. Australian energy business Santos likewise benefitted from a strong rise in oil & gas prices as demand continued to recover strongly post COVID and the energy supply concerns following Russia's invasion of Ukraine.

Copper miner Freeport-McMoRan responded well to higher commodity prices. We believe the long-term demand story for copper is positive, which combined with limited new supply is likely to be supportive for pricing.

Stock selection in the technology sector was also helpful. Semiconductor giant Nvidia reacted positively to the company's investor day where management increased its forecast for the size of the company's total addressable market.

In contrast, stock selection in the industrials sector proved more challenging. Building systems provider Trane Technologies declined, as it was weighed down by disappointing earnings guidance. Our position in heating and plumbing engineer Ferguson detracted as shareholders voted to transfer the stock's main listing from London to New York, which led to forced selling from UK and ex-US funds.

A number of European manufacturers warned that, despite strong demand, 2022 results would be below expectations due to an increase in material cost inflation, and this held back German industrial giant Siemens. Elsewhere in Germany, semiconductor business Infineon Technologies was impacted by supply issues and weak demand as global auto production estimates were revised down, amid growing concerns about the semiconductor cycle reaching its peak.

Outlook and strategy

With geopolitical concerns, supply chain issues and worries over a slower Chinese economy, it is perhaps remarkable that global stock markets have held up as well as they have. All current market chatter though seems to be focused on whether the US yield curve inversion is a harbinger of recession or not. It is true that historically an inverted curve has materialised ahead of each global economic downturn, although it is also correct that not all inversions have presaged a recession.

Stock markets do not do well going into a recession, so investors have good cause to be alarmed, but there are some reasons to suggest that the current situation may not be as dire as some believe. Key among these is that monetary policy is not tight at all. Although short rates have been climbing, the US 1-Year Treasury Bill still only yields around 1.6%, compared with a US year-on-year inflation rate of 7.9%, which is hardly deflationary. At the same time, longer term yields are distorted to the downside

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by the lack of supply given the size of the Fed's balance sheet. It could also be argued that despite the further cost-push impact of raw material prices due to the war in Ukraine, supply disruption is potentially a shorter-term phenomenon and that given the greater flexibility of labour markets today, inflationary expectations are less likely to become entrenched than in the past.

However, with so much market uncertainty, we have to recognise that this is a difficult environment. We still believe that a focus on strong companies that are operating well and that offer some value and relative momentum will prove rewarding over the longer term.

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