Discovery Global Value Equity Feeder Fund

Market background

Equities were volatile in Q1, notably from late February after Russia initiated military action against Ukraine. Western governments responded with sanctions on the Russian state and some individuals. Prior to this, the market had been focused on the potential for aggressive central-bank interest-rate hikes to address high inflation in Europe and the US.

The Russia-Ukraine conflict drove sharp rises in energy and other commodity prices, adding to already significant inflation pressures. In March, the US Federal Reserve increased its benchmark interest rate by 0.25 percentage points amid persistent US price increases, the central bank's first rate hike since 2018. Towards the end of the quarter, global growth expectations were dented as renewed COVID lockdowns in China raised the prospect of a slowdown in Asia's dominant economy.

Global equities declined overall, with the MSCI All Countries World Index (ACWI) losing 5.7% in Q1. Broad value benchmarks outperformed global equities amid persistent inflation and rising rates, though some cyclically-oriented sectors that typically contain value stocks – such as travel and autos – were negatively impacted by the Russia-Ukraine conflict.

Performance review

For the quarter, the Fund delivered a negative absolute return but outperformed the MSCI ACWI over the quarter.

At the stock level, the primary contributors to relative returns included our holding in oilfield services company NOV, whose shares gained along with the energy sector. Longer-term, we continue to see value upside in the company. Drug distributor McKesson also contributed after good results – in a volatile market, it also benefited from the fact that it is a steady and predictable business. Other contributors included British American Tobacco, another relatively defensive equity that did well in a volatile market, aided by strong results. Finally, our holding in American Express contributed, after the company delivered faster-than-expected growth.

Among the detractors, aircraft leasing company AerCap was the largest drag on relative performance. Its shares declined on the news that some of its leased fleet (less than 5%) was stuck in Russia. However, AerCap carries insurance and has managed to repatriate some aeroplanes, so we think the ultimate impact on the company will be small. Other detractors included Facebook-parent company Meta Platforms, which declined after a disappointing earnings update. Its performance reflected concern over Apples' privacy changes, which restrict data availability and make it harder to target ads. We expect Meta will find a way to work around this set-back, and we continue to regard the stock as cheap.

Portfolio activity

Significant purchases over the period included Kaspi Bank, a Kazakhstan-based fintech company. The company is growing extremely quickly and has acquired a large share of its domestic market. We took advantage of a buying opportunity after Kazakh assets sold off abruptly in Q1, in our opinion taking an overly pessimistic view of the geopolitical outlook for Kazakhstan.

On the other hand, we sold Jackson Financial, a US-based insurer that was spun out of Prudential. We acquired some Jackson Financial shares in Q3 2021 via the spin-off and added to the position partly as we believed the separate listing had created a market dislocation. Jackson's shares have since done well, and we sold the position as we believe the investment case had played out.

Outlook and strategy

With the value rally that appeared to be gaining momentum in Q1 of 2021 subsequently reversing all of its gains in the following months, the arguments that applied last year apply equally now, and don't need to be repeated in detail. Suffice to say, though, that value stocks remain cheap in absolute terms, relative to their own history, and particularly relative to growth/quality segments of the equity market.

At a sector level, we currently have significant exposure to auto parts, financials and air travel businesses (airlines, airport operators and related businesses). In addition, we own single-stock exposures in a number of different sectors, including defence, consumer staples, health care, insurance and oil & gas. Regarding our views on some of these sectors, starting with auto suppliers, we continue to believe that they are very cheap, and that the current negative sentiment (informed by energy transition threats and supply-chain blockages) will prove short-lived. When it comes to banks, we see a combination of rising interest rates, fading legacy and legal costs, and excess levels of capital combining into attractive economics for shareholders. Finally, as the world reopens, travel stocks should be reassessed as the growth businesses they were regarded as prior to the COVID pandemic. Each of these themes could drive significant outperformance of the portfolio. At a regional level, the UK still screens very cheaply, having significantly lagged other markets since the Brexit vote, and is trading at a discount to global equities not seen for 15 years.

A final point to make is that if markets become less macro-driven (COVID, inflation scares, war, etc.) then this should be the perfect environment for a bottom-up stock-picking investment strategy, with performance increasingly driven by stock-specific issues, rather than macro trends towards value vs. growth, or reopening vs. risk-off. If that is the case, this could be a pretty good set-up for value generally, and for our portfolios specifically, for 2022 and beyond.

