

Discovery Equity Fund

Market background

Global financial markets were broadly negative in October, after stronger-than-expected economic data in the US raised concerns that interest rates would remain higher for longer, sparking a sharp sell-off across global bond and equity markets.

In the US, preliminary estimates showed that the US economy expanded above market expectations for the third quarter (Q3) of 2023, while a sharp uptick in nonfarm payrolls pointed to a tighter labour market. Both manufacturing and services PMI data also came in stronger than expected for September, while retail sales continued to advance, underscoring the resilience of the US consumer despite higher prices and rising borrowing costs.

Although the UK's economic recovery has been significantly less robust compared to that of its US counterpart, monthly GDP numbers for August pointed to positive growth, in line with market expectations and outpacing the contraction recorded in July. Market participants consequently began pricing in the likelihood that the Bank of England would keep interest rates at elevated levels in November, placing additional pressure on equity markets. Meanwhile, in the Euro Area, the now-familiar narrative of lower growth and stubbornly high inflation continued its momentum into the month. Against this backdrop, the European Central Bank maintained its key interest rate in October, opting for a 'wait-and-see' approach as it attempts to rein in inflation without pushing the already fragile economy into recession.

Arguably the biggest news out of China in October was the announcement that the government would issue 1 trillion yuan in supplementary bonds for disaster relief and infrastructure enhancements. Other positive news came in the form of the country's Q3 GDP numbers, which showed the economy advancing above consensus forecasts for the quarter, largely driven by the raft of monetary stimulus measures over the past three months.

South African equities tracked their global peers lower, with some support coming in the form of stronger precious metals prices, particularly gold, but this was not enough to offset the broader risk-off

sentiment. Domestically, concerns over the country's fiscal outlook continued to weigh on investors, as did comments from the South African Reserve Bank Governor Lesetja Kganyago, who noted that local interest rates were likely to remain higher for longer to help curb inflationary pressure.

Performance review

The portfolio outperformed the benchmark for the month.

The portfolio's underweight positions in MTN and Sasol were among the largest contributors to relative performance. MTN's share price came under pressure after the wireless carrier announced that it was reviewing a demand from the Nigerian Tax Appeal Tribunal amounting to US\$72.6 million in unpaid taxes. Meanwhile, Sasol's share price declined on the back of lower oil prices, largely due to a sharp increase in US crude inventories, despite the potential for supply disruptions due to geopolitical tensions in the Middle East.

Among the largest detractors from relative performance were underweight positions in Gold Fields and AngloGold Ashanti. Gold miners benefitted on the back of a stronger gold price, as broad-based risk-off sentiment increased demand for safe-haven assets.

Significant purchases over the period included Old Mutual and Gold Fields, while significant sales included British American Tobacco and Exxaro Resources.

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 BHP Group and Old Mutual, while significant underweights include FirstRand Bank and Capitec Bank. Both BHP Group and Old Mutual display strong relative earnings momentum. In contrast, FirstRand and Capitec display weak relative value.

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