

## *Discovery Global Equity Feeder Fund*

### Market background

The third quarter (Q3) was a volatile period for investors, initially underpinned by strong corporate results and helpful monetary and fiscal policies. Subsequently a range of concerns weighed on markets including supply chain disruption, the persistence of the COVID-19 Delta variant in Asia and power rationing and the possible default of a large property developer in China. These issues pulled back markets towards the end of the quarter, resulting in global equities slightly lower by quarter end.

The US Federal Reserve suggested US interest rates could rise in 2022, leading to a rise in US Treasury yields. The Bank of England also implied that interest rates could rise next year, while the European Central Bank indicated that financial conditions would remain loose, leading to the euro trading near its year-to-date low against the US dollar. IHS Markit's indicators registered its lowest rise in US purchasing managers' activity for 14-months, while equivalent data for European manufacturing marked a five-month low. The Asian Development Bank highlighted a deteriorating pace of recovery in southeast Asia as a result of the delta variant, leading to lower GDP projections for countries with lower vaccination rates. In contrast, Singapore, China and South Korea are expected to benefit economically from their higher vaccination coverage.

Energy was one of the few sectors to rise over the quarter, supported by attractive supply and demand dynamics. The price of Brent crude rose to a near three-year high in response to supply disruptions, while natural gas prices jumped, benefitting from a demand recovery and supply concerns. Financials were also supported by expectations of higher interest rates. In contrast, the materials sector lagged as the price of iron ore corrected by almost 50% over the period in response to falling Chinese demand. Consumer stocks also weakened.

## Performance review

For the quarter, the Fund underperformed the benchmark.

Stock selection within communication services was the biggest sector headwind, primarily due to regulatory pressure facing Chinese internet companies, including NetEase, Tencent, Tencent Music Entertainment, as well as Alibaba. The form of regulatory intervention differed but included requiring changes to address safety concerns in social entertainment, restricting time spent by minors on gaming platforms and curbing monetisation opportunities in online retail. We therefore assessed the impact this would have on each individual company business model and the likely valuation impact. Consequently, we exited Alibaba and Tencent Music Entertainment while retaining Tencent and NetEase.

Samsung Electronics underperformed due to concerns on the memory pricing outlook as a result of higher-than-expected memory inventories at certain PC & mobile customers. Utility Iberdrola underperformed after the government intervened to effectively introduce a windfall tax on electricity generators in an attempt to curb energy bills for consumers. One immediate and unfortunate outcome of this decision has been that Iberdrola has decided to put on hold investments in new renewables projects in Spain.

More positively, Google's parent company Alphabet outperformed following positive results, boosted by media reports that reiterated continued cost discipline. US business software and services business Concentrix performed well after reporting better-than-expected results, raising full-year forecasts and announcing a capital return. Additionally, stock picking in financials aided returns as the benefits of increased capital returns and gearing to rising interest rates came into focus.

## Outlook and strategy

Given the seemingly overwhelming flow of negative news ranging from supply chain issues to rising inflation, an energy crisis, strains in the Chinese property market and steepening yield curves, the resilience of global equity markets can be viewed as remarkable, particularly in the face of an impending tapering exercise by the US Federal Reserve. Much of the positive argument for equities rests upon their attractiveness relative to other asset classes, and despite the recent rise in longer-dated bond yields, this remains true. However, it does seem improbable that we will see any further price multiple expansion through a further broad rise in market levels. The sustainability of this remarkable bull run is dependent upon stocks growing profits into these valuation levels. This is why in today's world the word 'transitory' is so important. All of the newsflow listed above are currently perceived as short-term impediments to the post-COVID normalisation process that the global economy will overcome. This of course may prove an overly optimistic view, but at this time, given the paucity of the investment alternatives, there appears one scenario where investors can still be rewarded by further earnings growth, albeit at a slower trajectory than we have seen so far in 2021.

If this outcome does materialise, the key to adding value relative to benchmarks will be stock selection, not only in terms of identifying key areas of growth in global markets but in finding those individual companies which can beat profit expectations, while at the same time avoiding the pitfalls of growth disappointments, which are likely to be punished severely. An unwavering focus on those market constituents that demonstrate high quality, good value and momentum should prove a highly effective strategy in a market that is likely to become more selective in distributing its reward.

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