# Discovery Global Value Equity Feeder Fund

## Market background

Equities remained volatile in Q3, with markets growing increasingly fearful of a recession after the US Federal Reserve and other central banks reiterated they would prioritise taming inflation over supporting growth. Late in the quarter, concern over the new UK government's tax and spending plans added to investor anxiety. The MSCI ACWI Index declined by about 6.8% in the three months in USD.

Value equities and sectors moved approximately in line with the market for most of the quarter, but in September the combination of hawkish central bank comments, elevated inflation data and some extraordinary events in specific markets (notably the UK) caused them to underperform. In fact, value was the worst-performing style in the month of September globally, while in Europe, the sharp sell-off left most cyclical value sectors (such as energy, autos and financials) trading at multiples significantly below where they typically trade even during a recession.

## Performance review

The Fund delivered a negative absolute return and underperformed the comparison index. Almost all of the underperformance came in September, for the reasons discussed in the market background section.

By sector, the biggest drag on relative returns came from our more cyclical holdings, particularly those within autoparts, travel and retail. These negative effects were largely offset by the outperformance of our larger positions, even those within the cyclical sectors mentioned, as well as our more defensive holdings. As we comment in the Outlook section, the outperformance of larger companies is one of the notable features of the current environment.

The main stock-level detractors from relative returns included Continental, whose share-price performance reflected weakness in the autoparts sector, and more specifically concern over the impact of high fossil-fuel prices on tyre margins. Bayer also underperformed, after the results of a drug trial were not as positive as the market had been expecting, leading to some short-term selling; but they were nonetheless positive, and we continue to view the stock as cheap. The underperformances of retailer Next and low-cost airline Jet2 reflected cyclical concerns generally, and particularly mounting worries over the outlook for the UK. Lastly, US discount retailer Big Lots underperformed in expectation of a slowdown in discretionary spending.

The main contributors to relative returns included Vitesco Technologies, a German automotive supplier of drivetrain and powertrain technologies. We added this stock to the portfolio as we saw it as positively exposed to the electrification of transport, and it seems this view is increasingly gaining traction in the market. Drug distributor McKesson was another contributor, maintaining its strong performance and benefiting from the defensive nature of the business. Online autos marketplace Cars.com also outperformed; there was no company-specific news, but it is benefiting from increasing competition to sell cars (and hence desire to advertise) as disruption to auto production has faded. Finally, airport operator TAV and aircraft leasing business AerCap contributed, with the market increasingly seeing earnings improvements from here for these travel-exposed companies as passenger numbers continue to recover.

## Outlook and strategy

As we have highlighted in recent updates, value stocks continue to trade at decade-high discounts to growth stocks and the overall market. The current extreme cheapness of value is a phenomenon that applies across regions, including the US, other developed economies and emerging markets, while the 10-year rolling performance of value relative to growth is close to all-time lows. We think this leaves scope for significant outperformance of value if we see a return to the norm of value's long-term performance characteristics.

At a regional level, we've been significantly adding to our European exposure in the past year or so. European stocks are at multi-decade lows in terms of their valuation relative to growth stocks, while the discount of value vs. growth stocks within Europe is also at extreme (in fact, unprecedented) levels.

One interesting feature of current markets is that we've increasingly seen a small number of large stocks both drive performance and trade at significant premia to the rest of the market (declining 'market breadth', as we believe it is called). This explains why large-cap benchmarks have been so much stronger than mid-cap or equal-weighted indices this year (again, particularly in the UK).

Last but by no means least, the recent sell-off, and some of the portfolio actions we've taken, have combined to see our weighted-average portfolio upside on our value strategies hit a level not seen outside of the COVID lows. We believe this offers the potential for attractive returns from current levels and supports our earlier comments that it is volatility and situations like the current one that provide the opportunity to generate the best returns.