

Discovery Equity Fund

Market background

Company earnings, expanding vaccinations and continued support from fiscal and monetary policy kept risk sentiment steady despite climbing Delta-variant cases across regions. Developed market stocks (MSCI World Index) closed 2.5% higher, slightly trailing their emerging market peers (MSCI Emerging Markets Index), which delivered a +2.6% return in US dollar terms.

Locally, the Capped SWIX returned a moderate 2% over the month, ahead of the FTSE/JSE All Share Index's (ALSI) return of -1.7%, as capped indices fared much better during the month amid regulatory headwinds from China on ALSI heavyweights Naspers and Prosus. At a super-sector level, resources (-4.8%) gave up the previous month's gains, as did industrials (-4.5%), while financials bounced back strongly (+11.9%).

After the disappointing social unrest in July, we witnessed some positive developments to buoy investor sentiment during the month. The second-quarter GDP print of 1.2% quarter-on-quarter was a small beat on economists' expectations of 0.9%, but importantly supports what were already increased GDP estimates (3% at the start of the year has already been revised upward to 4.2% for the year). Although we acknowledge this is weak in the context of the contraction experienced in 2020, it is the delta in expectations that moves market pricing, and it is undoubtedly positive. South Africa is distinctly unique to most other countries in that we are not experiencing a surge in inflation. Prices remain comfortably within the South African Reserve Bank's (SARB's) 3–6% target band (July CPI was 4.6%), placing no pressure for rate hikes near term (we only expect to see rate hikes in second half of 2022). Monetary policy has room to remain accommodative for longer to support the economic recovery.

With a better-than-expected economic backdrop, we saw equity market leadership shift away from global cyclical sectors (predominantly resources) to 'SA Inc.' shares; Banks, general retailers and health care stocks have outperformed the ALSI by double digits over August and the past three months to end August.

Performance review

For the month, the portfolio slightly underperformed the benchmark.

Select overweight positions in SA banks, notably ABSA Group and Capitec Bank aided relative performance over the month. The JSE Banks Index (+12%) outperformed all sub-indices over the month, led higher by robust financial results for the first half of the 2021 calendar year. Provision unwinds have been larger and faster than expected as the macroeconomic outlook for the country has turned out less gloomy than initially expected. These gains were further supported by an overweight position in MTN Group (which has seen exceedingly good operational results in key markets i.e., South Africa, Ghana and Nigeria) and an underweight index bellwether Naspers which came under immense pressure from regulatory headwinds in China.

More negatively, the offshore component of the portfolio dragged on performance, with the firmer rand over the period eroding offshore earnings. In the local component, the resources sector experienced a weak month due to concerns on the global growth environment, which led to weaker commodity prices and, in turn, weaker performance from the miners. As such, positions in Impala Platinum and BHP Group were a drag on relative performance over the month.

Significant purchases over the period included Exxaro Resources and Anglo American Platinum, while significant sales included Naspers and Capitec.

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 Clicks Group and Exxaro Resources, while its significant underweight holdings include Anglo American and Standard Bank Group. Clicks displays strong relative quality attributes, while Exxaro is showing strong relative earnings revisions. In contrast, Standard Bank displays weak relative price momentum, while Anglo American exhibits weak relative value.

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