

Discovery Global Equity Feeder Fund

Market background

The last quarter of 2020 ended an extraordinary year with strong returns as equity markets celebrated the approval and the start of the roll out of vaccines to defeat COVID-19. Although economic activity in much of the world remains constrained by restrictions to combat the resurgence of the pandemic, the prospect of a return to more normal conditions in the course of 2021 resulted in double digit gains by markets around the world. The US elections and the eleventh-hour negotiations over Brexit added an element of political uncertainty, but it did not interrupt market optimism. Positive sentiment was sustained by loose monetary conditions and further fiscal stimulus globally.

Following the announcement of the high degree of efficacy of the Pfizer/BioNTech vaccine, there was a sharp rotation into 'value' stocks, which had suffered for much of 2020. Markets and sectors that had lagged significantly from the start of the pandemic had the biggest rallies. The energy sector rose along with the oil price. Banks and insurers also did well as bond yields rallied and yield curves steepened. Conversely, sectors less exposed to economic recovery, such as utilities, consumer staples and health care, trailed the market, though all made significant gains.

Emerging markets generally performed well in anticipation of global recovery, with notable gains from Brazil, India, Taiwan and South Korea. China made more modest gains as the recovery there is more advanced and policy normalisation is anticipated soon. The US lagged other regions, not helped by currency weakness as real yields fell.

Performance review

The Fund marginally underperformed the MSCI ACWI over the quarter, gross of fees*.

It has been a particularly challenging period for the portfolio's consumer discretionary exposure, partly as increased regulatory scrutiny of the Chinese internet sector had a negative impact, especially on e-commerce giant Alibaba. After the suspension of its financial subsidiary Ant Group's IPO, Alibaba is also facing anti-trust investigation by the market regulator into its activities. In addition, in a period where US equity performance remained dominated by a few stocks, not owning Tesla detracted from returns as it outperformed on increased assumptions over production volumes and market share.

The approval and rollout of vaccines against COVID-19 resulted in profit taking for more defensive assets such as gold. Consequently, Canadian miners Barrick Gold and Kinross Gold both gave back some of their prior outperformance. Within software and services, Fidelity National Information Services fell after the announcement of its proposed acquisition of Global Payments raised questions about its market positioning. Continued concerns about the impact of a new administration in the US on drug prices hurt pharmaceutical stocks. French drug company Sanofi also suffered after announcing in December that there would be a six-month delay to its COVID-19 vaccine.

Conversely, stock selection in the technology, consumer staples and industrial sectors contributed positively over the period. South Korea's Samsung Electronics outperformed due to positive sentiment driven by both memory chip pricing and the potential for better capital return.

The market continues to reward the beneficiaries of economic recovery. Heavy equipment manufacturer Sany Heavy Industry delivered strong performance on the back of continued strength in excavator sales as well as a positive 2021 outlook, helped by the government's infrastructure stimulus programme. Improving copper demand and a more positive view on economic recovery also drove good performance from US miner Freeport McMoRan. Elsewhere in the materials sector, Hengli Petrochemical joined the cyclical rally, helped by increasing recognition of the earnings power of its modern integrated refinery and petrochemical complex as new units came online. A rally in US bond yields helped financial stocks perform better over the quarter, including US bank SVB Financial, which delivered strong results. Also in the US, home security company Resideo Technologies was helped by results and company guidance well in excess of market expectations. The results demonstrated that the company was making progress on restructuring, and that consumer demand for home improvement products is recovering faster than previously expected.

Outlook and strategy

Following an extraordinary year there do seem to be signs of a degree of market normalisation. For the first time in a while, the last months of 2020 saw market breadth improve, the 'Value' Factor deliver alpha, and small and medium capitalisation stocks outperform. The question is whether this change in leadership persists through 2021. There are some broad indicators that suggest it might. While it has been apparent for some time that the 'Value' Factor looked cheap relative to history, it lacked any momentum, with poor earnings revisions compared with the quality segment of the market. Not only has this begun to change, the absolute level of earnings growth in the more cyclically sensitive areas of the market should outpace that of the technology sector for the first time in many years.

Second, the prospect of a post-COVID world looms larger as vaccines are rolled out. Economists are raising their expectations for both growth and inflation, while analysts are raising their earnings forecasts for the next two years at a rapid pace. This is an environment that also tends to favour cyclical stocks.

Of course, a smooth transition to a broad-based more cyclical market is highly unlikely. It is clear, however, that investors still remain relatively crowded into the large capitalisation winners that have dominated performance since 2008 and have not yet completed moving to a more balanced portfolio exposure across factors and size. Major shocks permitting, this is a rotation that will likely persist over 2021.

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