

# Discovery Equity Fund

## Market background

Global equity market returns moderated over the second quarter (Q2), with the MSCI All World Index closing 7.4% higher, following a softer June return of just +1.5%. Emerging markets (MSCI Emerging Markets Index, +5.1%) lagged developed markets (MSCI World Index, +7.9%) over the quarter, while the MSCI South Africa Index lagged the peer group, declining 1.8% in US dollar terms, after a particularly weak June of -6.6%, a month in which the rand depreciated 3.8%. In local currency terms, the FTSE/JSE All Share Index (ALSI) ended the quarter a flat 0.1%.

When reviewing our market's flat return, it dragged lower by the resources sector declining 5% over Q2, and index bellwether Naspers and Prosus (down 15% and 14.5%, respectively). Given the positive macroeconomic developments in recent months, it is no surprise that over the quarter, it was the local cyclical sectors, general retailers (+16%), banks (+10%) and general industrials (such as construction +15%) that offset the weakness among the global cyclical stocks, and the corporate action developments at Naspers.

While the ALSI's return left a lot to be desired, it belies the positive investment opportunities arising. Macroeconomic data has turned decidedly positive in South Africa (hereon SA) as the year has progressed, although we acknowledge, this comes off an extremely low base and the economy remains in a precarious position. Notwithstanding, SA has benefited greatly from the strong commodity price environment. Tax receipts from the mining sector aided in the February's main budget deficit narrowing far further than expected (-14.6% forecasted in October 2020's budget, to realise an actual -11.1% in February). The 2021/2022 deficit is expected to narrow further to 8.3%. Our terms of trade have improved to a record R54.6 billion in May, and will help lift the country to a current account

surplus in 2021. Lastly, while there is global investor anxiety over the risks of rising inflation, this is less prominent in SA. Although our inflation rate is expected to rise (following global trends), it will remain within the SARB's 3%–6% target range, and we expect no rate hikes in the second half of this year, further supporting the country's economic recovery.

## Performance review

For the quarter, the portfolio underperformed the benchmark.

The offshore component of the portfolio was the biggest driver of relative performance over the period.

In the local component, the underweight index bellwether Naspers, was one of the primary contributors to relative performance over the period. This was further enhanced by exposure to select 'SA Inc.' stocks (Capitec Bank, Sanlam and Mr Price Group). SA banks rallied in line with government bonds on the improving macroeconomic outlook, while trading updates during the quarter also confirmed a stronger-than-expected operating environment.

The cyclical recovery outlook, however, did not extend to the resources counters. The platinum and diversified miners all retreated over the last six weeks of the quarter, amid market anxiety of a slowdown in global growth, and for resources in particular, in light of China's attempts to curtail rising commodity prices. As a result, overweight positions in Anglo American Platinum and BHP Group, hurt relative performance over the quarter.

Significant purchases over the period included MTN Group and BHP Group, while significant sales included Standard Bank Group and Richemont.

## 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 Spar Group, while its significant underweight holdings include FirstRand Bank and Naspers. Both Clicks and Spar display strong relative quality attributes. In contrast, FirstRand displays weak relative price momentum, while Naspers exhibits weak relative value.

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