

## *Discovery Global Equity Feeder Fund*

### Market background

The roll out of vaccine programmes to combat COVID-19 and palpable signs of economic recovery resulted in another strong quarter for global equity markets.

The period ended with the developed market manufacturing PMI at its highest level in over a decade as improving business and low inventories encouraged restocking ahead of the anticipated rebound in demand.

A recovery in commodity prices, evidence of emerging supply constraints – for example in semiconductors – and a rebound in consumer demand as economies began to re-open all raised the spectre of a return of inflation, at least in the short term. Combined with substantial fiscal stimulus in America, this caused US bond yields to almost double in the quarter, back to levels last seen at the beginning of 2020.

The 'value' stocks that had suffered last year posted better performance as profit forecasts were raised in anticipation of an economic recovery. A steeper yield curve helped financials do much better, and firmer oil and metal prices boosted the energy and materials sectors. Industrials also did well, supported by the improved economic outlook. More defensive sectors such as consumer staples, health care and utilities lagged the rally.

Emerging markets underperformed the global benchmark, with China largely unchanged over the quarter as some of last year's big gainers saw profit-taking. Successful vaccination programmes and the impending re-opening of their economies helped the UK and US markets. In contrast, the frustratingly slow distribution of vaccines and a third wave of infections led to European markets underperforming other global peers.

## Performance review

The Fund outperformed the MSCI ACWI over the quarter, gross of fees\*.

US standby generator business Generac outperformed after better-than-expected 2021 guidance, while power outages in Texas were seen as creating additional demand for its generators. This led to a positive contribution from stock picking within industrials. Materials also had a good quarter as metal prices rose. Miner Freeport-McMoRan outperformed as copper prices gained, helped by Chinese demand.

Stock selection within the consumer discretionary sector helped relative returns. Auto manufacturer Volkswagen outperformed after receiving increased market attention following an investor day that detailed the benefits and targets around its electric transition. US online auction site eBay outperformed on increasing optimism on demand growth. Conversely, Amazon.com underperformed for two reasons. First, a continued market rotation towards stocks that will benefit from economies re-opening and profit taking in stocks – like Amazon – that had performed well as a result of the pandemic; and second, President Biden nominated Lina Khan, who has been a critic of Big Tech, to the Federal Trade Commission.

Within technology, business service company Concentrix reported good results showing an acceleration in growth – materially above what had been expected following its spin-off from Synnex. Also within this sector, NXP Semiconductors outperformed due to the announcement of its S&P500 Index inclusion as well demand for auto semis continuing to materially outstrip supply. Conversely, Samsung Electronics underperformed as despite bullish expectations around memory pricing, there has been a lack of earnings upgrades from analysts. This weighed on the shares, together with Intel's announcement that it will enter the 'foundry' business (chip manufacturing) with a standalone unit. Internet domain registration company GoDaddy underperformed due to a combination of earnings downgrades, new management in place, and an underlying concern that margins may be reset to facilitate growth. Given these headwinds, we have exited the position.

Rising bond yields affected some of our holdings, including consumer credit reporting company TransUnion. Its valuation lagged as it is a growth company with long-dated cash flows and a higher discount rate reduces the present value of these cashflows. Spanish utility business Iberdrola likewise underperformed due to the rotation trade from defensives into value and cyclical stocks; utilities tend to underperform in a rising interest rate environment. London Stock Exchange underperformed after its full-year 2020 results indicated that costs to achieve the Refinitiv integration will be higher than originally guided. Consensus earnings expectations were cut mainly due to higher-than-expected costs on the back of the news.

## Outlook and strategy

Somehow since the beginning of the year market expectations have switched from a worldview of a nascent but fragile economic recovery to an impending boom such as we have never seen before,

featuring a resurgence of inflation which will necessitate an earlier-than-expected tightening of monetary policy.

As a result, long-dated bond yields have risen sharply – albeit to levels which can hardly be described as “enticing” – with global stock markets struggling to find a clear direction. On one hand investors are uncertain over the sustainability of the recent ‘value’ rally that has been in evidence as upwardly revised expectations for growth and inflation have lifted cyclical stocks. On the other hand, against this same backdrop investors are concerned over the impact of higher discount rates on the ratings of non-cyclical stocks – those with a high proportion of their net present value at the longer-dated end of their cash flow streams.

Add into the mix recent news flow around extreme leverage accidents (notably, the unwinding of the Archegos investment fund) and anxiety around greater regulatory intrusion and you might expect a “risk off” reaction in markets. But this hasn’t happened, reflecting the increasing optimism around the positive impact of government stimulus packages on broad economic growth and corporate earnings, coupled with the very dovish statements emanating from the world’s central banks – which continue to resist any notion of a need to raise short-term interest rates.

This combination of loose money and fiscal stimulation has had a significant impact on asset values. Clearly, the bond market is suggesting that the prolonged period of deflation we have seen since the early 1980’s is unlikely to deepen but, at the current absolute yield level, is not yet reflecting any conviction as to an inflationary upsurge which will eventually require monetary authorities to step on the brake pedal and spoil the “risk on” party. We believe its balanced approach to investing in the equity market puts our 4Factor process in a good position to navigate this investment environment.

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