# Discovery Global Equity Feeder Fund

## Market background

The quarter started poorly as bond yields continued to rise, economic activity remained soft, and geopolitical issues added to the prevailing pessimism. However, positive surprises from inflation data prompted hope that central banks had achieved a soft landing by bringing inflation back to target without triggering a recession. The global headline inflation number of 2.5% in November was a significant retreat from the peak of 7% in the summer of 2022. This raised expectations that the US Federal Reserve could start cutting rates as early as March, with indications of a 75bps reduction over the course of the year. December data suggested that the manufacturing cycle may have bottomed, especially in emerging markets. Only China remains a laggard, with deflationary pressures compounding the problems of its property sector.

Strong bond markets lifted equities in November and December. Despite increased political tensions in the Middle East, the oil price fell over the period and the dollar weakened in anticipation of lower interest rates. However, gold did well. Overall, emerging markets lagged, held back by China, but Latin American markets put in a strong performance and a recovery in semiconductor stocks lifted South Korea and Taiwan significantly. Large-cap technology stocks also boosted US benchmarks. European markets generally outperformed, but the UK was a significant laggard.

Falling bond yields helped financials outperform, and also lifted real estate stocks outside of China. Economically sensitive stocks in the industrial and technology sectors did well in anticipation of better conditions in 2024. Energy stocks fell along with oil prices, and less cyclically sensitive stocks in the healthcare and consumer staples sectors also trailed the benchmark.

## Performance review

For the quarter, the Fund delivered a positive absolute return but underperformed the benchmark.

In a strong quarter for equities, relative performance was held back by poor stock selection in materials and communication services. In the latter sector, Chinese gaming stocks underperformed following the publication of a consultation paper, which outlined proposals for new regulations around spending limits and user engagement through the use of incentives. This impacted our position in Netease. We believe the share price corrections were overdone and more reflective of the sentiment and uncertainty created by potentially another round of unexpected regulation.  We continue to hold the stock, particularly at current valuations, but will continue to monitor and analyse as the matter evolves.

In materials, news that the Panamanian government would seek a referendum on restructuring its recently agreed mining licence for the Cobre Panama mine impacted First Quantum Minerals. Australian clean energy metals miner Igo pulled back on concerns that lithium prices would fall from current elevated levels as China ramps up domestic supply. Oil prices fell over the period, resulting in underperformance from our position in Exxon Mobil.

Credit scoring business TransUnion sold off following results amid concerns about weakening consumer finance activity but has since recovered somewhat. US engineering firm Jacobs Solutions reported results that underwhelmed due to delays to several large government contracts. The rotation out of value and defensive stocks resulted in the derating of pharmaceutical company Sanofi.

In contrast, technology stocks performed well. Broadcom outperformed following results in which the company provided a stronger-than-expected outlook for recently acquired VMware. German semiconductor business Infineon reacted positively to results which suggested an improving outlook for the sector. German industrial giant Siemens continued to perform well following positive quarterly results where orders beat expectations and a new buyback was announced.

Stock selection in the consumer discretionary sector also boosted performance. US luxury goods business Tapestry was helped by expectations of a shift in US interest rate policy and also benefited from improving investor sentiment across the consumer space following strong holiday sales data. Online giant Amazon posted strong results, which showcased a continued improvement in North American retail profitability. Not owning Tesla also helped relative performance.

## Outlook and strategy

As we enter 2024, the lagged effect of a shift in monetary policies around the world is starting to impact, with rapidly falling inflation now a feature across much of the developed world. The steepest interest rate hiking cycle in decades has set global economic activity on a course that is difficult to predict, making it particularly important that we build robust diversified portfolios to withstand a range of possible outcomes. After strong growth through 2023, we are expecting a higher probability of stagnation or potential contraction in economic growth in the coming year, with the market fixated on the pace of eventual rate cuts as central banks respond.  We believe upside risks to inflation and downside risks to growth have become more symmetrical. However, recession risks remain elevated, in our view, due to stagnant supply and demand growth across developed markets. After a rally across many financial markets in late 2023, riskier assets appear priced for an economic soft landing and may be underestimating both upside and downside risk, so we expect a volatile ride during 2024.

Consensus forecasts certainly continue to incorporate little expectation for a slowdown or mild recession next year.  That said, if we witness a resilient consumer in the face of only a modest uplift in unemployment, as well as signs of productivity gains at corporates who have so far proven remarkably good at adapting to new regimes, we are likely to see further progress in markets this year.

Positive structural growth drivers persist in many industries we are exposed to, such as technology and semiconductors. China, whilst growing slower than expected, if boosted by some well-targeted stimulus, should provide useful cyclical tailwinds as we move forward. Equity valuations appear to be reasonably attractive in Asia & EM, particularly in China, but ultimately earnings growth will need to be delivered. The divergence in performance and valuations between the largest US companies and the rest of the global market is well understood, but an important implication is that, whilst headline index valuations might appear somewhat elevated, there is a broad opportunity set of individual companies, with plenty of upgrade potential at very reasonable valuations.

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