

Discovery Equity Fund

Market background

Financial markets were broadly negative in May, as investors kept a close eye on the debt ceiling negotiations in the US, while weighing up the likelihood of the world's largest economy defaulting on its debt obligations. President Joe Biden and House Speaker Kevin McCarthy eventually reached an agreement regarding the debt deal, which once approved, would see the debt limit suspended until 2025 and prevent the US from defaulting on its debt. By month-end, the bill had passed through the House of Representatives and was en route to the Senate for approval.

Against this backdrop, central banks continued to raise interest rates, including the US Federal Reserve (Fed), the Bank of England (BoE) and the European Central Bank (ECB) whose 25 basis points (bps) hike left interest rates at levels last seen during the Global Financial Crisis. Minutes from the Fed's policy meeting noted that further tightening may not be necessary if the economy continued to progress in line with current forecasts, essentially signalling that the Fed may be done with its tightening cycle. Supporting this view were lower inflation prints for April. Subsequent data releases, however, reversed this sentiment, driving US Treasury yields higher.

Meanwhile, the People's Bank of China (PBoC) elected to keep rates on hold and add more liquidity to support China's economic recovery, continuing its policy divergence from developed markets. Chinese stocks closed lower as weaker-than-expected economic data weighed on investor sentiment, highlighting the 'patchy path' of the country's post-pandemic economic recovery.

Turning to South Africa, a string of negative data and newsflow saw the local bourse close deep in negative territory. National Treasury provided Parliament with an update on the financial position of several state-owned enterprises, with Eskom the standout underperformer. The South African Reserve Bank (SARB) published the first edition of its 2023 Financial Stability Review, noting that nationwide loadshedding is expected to detract two percentage points from overall growth this year. The rand reached a new record low against the US dollar on the back of the government's decision to grant diplomatic immunity to participants at the upcoming BRICS meeting, which includes Russian President



Vladimir Putin. South Africa's relationship with Russia came under the spotlight following accusations by the US that the South African government had loaded weapons onto a US-sanctioned vessel while docked in local waters. In other news, the SARB increased the repo rate by 50bps to 8.25%, in line with market forecasts. The rand closed the month weaker against the US dollar, euro and pound sterling.

Performance review

For the month, the portfolio performed in line with its benchmark.

Contributors to relative performance included underweight positions in Standard Bank Group and Naspers. South African banks have come under pressure over concerns over rising credit loss ratios (CLRs). Capitec Bank released a concerning update that pointed to a deterioration in the credit performance of its customer base. This was followed by an update from Nedbank, which mentioned that the group's CLRs are currently above the through-the-cycle range of 80 -100bps. This points to the conclusion that the local consumer continues to feel the pressure from rising interest rates. Among the key detractors from performance for the month were overweight positions in Multichoice Group and Exxaro Resources.

Significant purchases over the period included Old Mutual and Anglo American Plc., while significant sales included Richemont and Exxaro Resources.

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 British American Tobacco and Multichoice, while significant underweights include MTN and FirstRand. British American Tobacco displays strong relative quality attributes, while Multichoice displays strong relative earnings revisions. In contrast, MTN displays weak relative momentum attributes, while FirstRand displays weak relative quality.