

## *Discovery Equity Fund*

### Market background

Risk assets were broadly flat over the quarter as a weak September offset the gains made in the prior two months. The turn in sentiment was initially triggered by the debt crisis at the Chinese property company Evergrande Group which coincided with China's sweeping regulatory crackdown across a number of sectors. However, the market quickly refocused towards fresh inflation pressures from rising commodity prices, the prospect of rate hikes and subsequent rising bond yields. There was a hawkish pivot amongst a number of central banks during the quarter, although the US Federal Reserve emphasised that any interest rate hike decision would be detached from tapering, which helped to calm investors' nerves.

Over the quarter, developed market (DM) equities (MSCI World Index, -0.0%) closed the quarter a shave lower, while their emerging market (EM) peers (MSCI Emerging Markets Index, -8.1%) absorbed most of the heavy blows from the global selloff.

Back home, South Africa's GDP print of 1.2% q/q over 2Q came in ahead of consensus expectations of 0.7%. Exports remained relatively robust, boosted by a reopening of trade markets and a strong commodity price boom which has been a boon for SA's mining sector and agricultural exports. Attention has now shifted to 3Q growth data, which is likely to come in weaker on the back of the July civil unrest and tougher lockdown restrictions amid the third wave of COVID infections. As widely expected, the South African Reserve Bank Monetary Policy Committee unanimously left the benchmark lending rate unchanged at its 23 September policy setting meeting but sounded a slightly more hawkish tone with members now pencilling rate hikes through 2022 and 2023.

The JSE All Share Index (ALSI) had a volatile September and a weak end to the third quarter of 2021. Rising market anxiety weighed on risk assets amid persistent COVID-19 headwinds, some weak economic data releases (particularly out of China) and a less supportive liquidity backdrop communicated by major central banks. The ALSI was not spared from the global sell-off. Despite declining 3.1% over September, and -0.8% over the third quarter (Q3), the index has still delivered a total return of 23.2% over the past twelve months and equities remain the strongest performing asset class in South Africa over that period.

## Performance review

For the quarter, the portfolio underperformed the benchmark.

Despite broad-based weakness in the resources super-sector, there were some notable outperformers in this space. Sasol rallied 31% over the quarter, benefitting from resurgent oil prices, but not holding the counter ended up being the biggest detractor from performance over the period. Being underweight FirstRand also weighed on relative performance, with financials, in particular the banks, continuing to outperform.

More positively, the offshore component of the portfolio contributed to performance and earnings were further enhanced by a weaker local currency.

In the local component, the overweight position in MTN Group was among the primary drivers of performance, with the company continuing to receive positive earnings revisions. These gains were further supported by underweight positions in the Naspers-Prosus stable, which benefitted relative performance. These shares came under immense pressure over the quarter amid intensifying regulatory headwinds coming out of China.

Significant purchases over the period included ABSA Group and FirstRand, while significant sales included Anglo American and Capitec Bank.

## 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 Exxaro Resources, while its significant underweight holdings include Anglo American and Naspers. Clicks displays strong relative quality attributes, while Exxaro is showing strong relative earnings revisions. In contrast, Naspers displays weak relative price momentum, while Anglo American exhibits weak relative value.

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