Discovery

Discovery Global Value Equity Feeder Fund

Market background

After a volatile six months for global equities, the MSCI ACWI Index gained in the final quarter of 2022. Sentiment in stock markets began to improve as US inflation readings came in lower than expected, fuelling hopes that the US Federal Reserve and other major central banks would temper the pace of interest-rate raises and that inflation may have peaked. Price rises also slowed in the euro area and the UK from October to November. A loosening of COVID restrictions in China added to the more positive market mood.

Against this backdrop, more cyclical equities tended to outperform. Broad value-equity benchmarks performed strongly in Q4, with notable share-price gains within the universe of value equities among certain airlines and other travel-related stocks, as well as among some auto-sector-related businesses.

Performance review

The Fund delivered a positive return and outperformed its benchmark. On a relative basis, the Fund benefited from the outperformance of value equities generally in the final quarter of 2022, particularly from late October and through November. Within the portfolio, a diverse group of businesses helped relative returns, with notable contributions from our holdings in auto- and travel-related sectors, areas where we have been targeting value opportunities for some time. Air travel-related stocks in particular were strong from November, on the back of encouraging data on recovering flight traffic, and optimism on China's easing of COVID rules.

At the stock level, the main contributors included aircraft-leasing business AerCap, whose shares outperformed as the market began to price in the recovery in global air travel, as well as the scale benefits of AerCap's merger with GE's aircraft-leasing business (completed in November 2021). Other contributors for similar reasons include Turkey-based TAV Havalimanlari, which operates 15 airports in eight countries, and low-cost leisure airline Jet2. Oilfield services company NOV, which delivered robust results on the back of a strong energy sector, also aided relative returns. Finally, HeidelbergCement, a German

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company with a leading position in the European cement sector, contributed positively, its shares gaining partly as the macro outlook brightened in Q4. As a reminder, we added this position in Q1 2022 as its shares had been trading cheaply, not least because investors have been shunning high-emitting sectors. We felt (and continue to believe) this misses the fact that Heidelberg will be at the forefront of tackling sector emissions; the potential for market leaders to gain share at the expense of smaller players less able to invest in greener solutions; Heidelberg's ability to pass cost rises through to customers; and the fact that there are really no viable large-scale, low-carbon alternatives to cement.

The primary detractors from relative returns included Facebook-parent company Meta Platforms, which had a tough 2022 from a share-price performance perspective along with some other 'big tech' and social media companies, partly on concern over the trajectory of ad-revenue growth. We continue to see value in the business. Big Lots, a discount retailer with over 1,400 stores across the US, also detracted. Its Q3 results, released in December, reflected the ongoing challenges facing the sector, but in our view the stock continues to trade at a level that offers potential for significant upside. During the quarter we switched our holding in Chinese internet and technology company Tencent for a position in Prosus, a technology investment company that owns a substantial stake in Tencent, taking the view that Prosus' discount to net-asset-value offers essentially the same exposure but cheaper. Largely as a function of the timing of the switch, Tencent was one of the main detractors in the quarter, but this effect was more than offset by a contribution from Prosus. India-based online travel company MakeMyTrip was another detractor, despite reporting solid results in the period. The company operates in an area of structural growth, and we expect it to benefit from the continuing recovery of travel. The other main detractors in the period were stocks we do not hold, and which did well, the largest of which was oil major ExxonMobil, which produced bumper profits in a year of very strong fossil-fuel prices.

Outlook and strategy

Even after a relatively strong end to 2022 for value stocks, 'value' remains cheap in absolute terms and relative to history, globally and particularly in Europe. We think this leaves scope for significant outperformance of value if we see a return to the norm of value's long-term performance characteristics.

At a regional level, we have been significantly adding to our European exposure in the past year or so. European stocks are at multi-decade lows in terms of their valuation relative to growth stocks, while the discount of value vs. growth stocks within Europe is also at extreme (in fact, unprecedented) levels.

One interesting feature of current markets is that value stocks (at least in Europe) have exhibited much lower volatility than has been the case in the past. Typically, value discounts and volatility tend to trend in the same direction. But as researchers at Société Générale pointed out in a recent paper, value stocks were already cheap heading into the broad stock-market downturn in 2022, and hence they have been less impacted as investors shifted out of more richly valued parts of the market.

Finally, we would note that, after the market moves of last year combined with some of the portfolio actions we have taken, the weighted-average portfolio upside on our value strategies is well above the average of the past seven years. We believe this offers the potential for attractive returns from current

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levels, and supports our view that the current environment should provide good opportunities to generate returns from a (carefully applied) value-equity investment approach in the year ahead.

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