Discovery Equity Fund

Market background

Equity markets experienced some reprieve in July after the negative returns experienced over the second quarter. The MSCI All Countries World index gained 7.0% over the month (though it is still down 14.6% year to date), led by developed markets (MSCI World Index), which rallied 7.9%. Emerging market (EM) indices across Latin America and Europe, Africa and the Middle East all rallied over the month, but overall, the MSCI EM Index declined slightly (-0.7%), dragged lower by particularly weak performance from China, where the mainland's CSI 300 Index sold off a hefty 7.0%. Back in South Africa, the FTSE/JSE Capped SWIX index gained 2.8%, led higher by industrials and financials – rising 3.9% and 5.8%, respectively – with the resources sector delivering a moderate 1.3% return.

Markets continue to be driven by inflation and central bank policy. While equity markets ended the month in the green, it was only in the last week of the month that most of the gains were made, following the perceived more-dovish-than-expected rhetoric from the US Federal Reserve (Fed). This was in the aftermath of a unanimous 75 basis points (bps) increase in the Federal funds target range (to 2.25%–2.50%) by the Federal Open Market Committee.

However, in the subsequent announcement, Fed Chair Jerome Powell suggested that, depending on the data, it may become appropriate to reduce the pace of hikes while the Fed examines the effects on the economy; this boosted risk assets. Expectations are now for smaller future hikes (50bps), which are expected to put less pressure on equity markets and associated valuations. With the prospects of easing inflationary pressure and a less hawkish Fed, bond markets also found reprieve during the month as developed market government bond yields tracked lower (yields fall as prices rise).

Performance review

For the month, the Fund underperformed the benchmark.

Local bank stocks enjoyed a relatively strong month, rallying alongside South African sovereign nominal bonds into the month's close following the above-mentioned Fed meeting. However, our underweight allocations here, notably, Absa Group, was a key detractor from relative performance. The overweight allocation to British American Tobacco was another key detractor; after enjoying a strong rally over the first half of the year, the stock pulled back in July as the broader risk-on equity market rally left defensive shares, such as the tobacco sector, lagging.

More positively, the overweight position in Shoprite was among the leading contributors relative performance. The company released a strong trading update during the month, confirming its continuing market-share-taking revenue growth at both the Checkers and Shoprite brands. Being underweight petrochemicals firm, Sasol, also helped relative performance as the pullback in oil prices weighed on the share price.

The offshore component of the Fund was the biggest contributor to performance, and this was further boosted by a weaker local currency over the period.

Significant purchases over the period included Woolworths and Vodacom Group, while significant sales included Absa and Sasol.

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 Investec Plc and Clicks Group, while its significant underweight holdings include FirstRand and Naspers. Investec displays strong relative price momentum, while Clicks exhibits strong relative quality attributes. In contrast, FirstRand is showing weak relative value, while Naspers displays weak relative momentum.