Discovery

Discovery Global Equity Feeder Fund

31 December 2024

Market context

Global equities ended the final quarter of 2024 in negative territory, driven by a sharp December sell-off following the US Federal Reserve's (Fed's) cautious outlook on interest rate cuts for 2025. The central bank projected only two rate cuts for the year, down from the four previously anticipated. This dampened the positivity in the previous month when Donald Trump's decisive victory drove global equities.

There was significant regional divergence, with US equities rising to another all-time high in November before trailing off in the final month of the year, albeit still finishing the quarter in positive territory. Japanese equities also gained, supported by a weaker yen. However, there were pockets of weakness in markets at risk of proposed US tariffs, including China and Mexico and Europe's auto sector. France was a notable laggard after the government of Michel Barnier fell following the first successful no-confidence vote since 1962 after his proposed budget failed to pass. By sector, consumer discretionary, communication services and information technology were among the best-performing parts of the MSCI All Country World Index. Materials were notably weak, including some of the large mining stocks, with real estate and utilities also underperforming.

Performance

For the quarter, the Fund outperformed the benchmark.

Stock selection in consumer discretionary was the biggest driver of performance. Tesla re-rated, with Trump's re-election being viewed as a positive for Tesla's story, while confirmation of new model releases in H12025 and the release of its Full Self-Driving (FSD) version 13.2 was another tailwind for the shares. Amazon outperformed following its AWS re:Invent conference, which provided positive commentary for in-house chip capabilities. US-based luxury goods holding company Tapestry rallied after the Federal Trade Commission's (FTC) successful blocking of its proposed US$8.5 billion acquisition of Capri Holdings Limited. The termination of the merger allowed investors to refocus on Tapestry's standalone recovery and growth prospects.

In information technology, Broadcom outperformed following quarterly results at which the company provided positive medium-term guidance on AI semiconductor revenue potential. Despite our stock picking working favourably over the quarter, however, our underweight position in Apple stock hurt relative performance heading into year-end, a time when all large cap technology shares were strong. Within communication services, sports and entertainment company TKO Group outperformed following positive commentary towards sports rights at an industry conference, as well as increased synergy growth guidance. Shares of US financial services provider Synchrony Financial reached all-highs during the quarter following a strong set of results which pointed to resilient consumer activity, leading to raised full-year 2024 guidance, while the market further anticipated the benefits of more benign regulation under Trump's second term.

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More negatively, stock picking in healthcare hurt performance the most. Elevance Health unveiled a poor set of results with medical claims inflation in its Medicaid book trending higher than expected. Animal health company Zoetis underperformed due to underwhelming US sales of its drug Librela, a significant revenue driver. In materials, Barrick Gold pulled back on softer gold prices and operational challenges, while reported earnings fell short of expectations due to cost pressures. US diversified miner Freeport-McMoran came under pressure as copper prices weakened over the quarter. Within industrials, TransUnion shares were negatively impacted by back-up in bond yields into year-end, with higher rates for longer proving a drag on consumer loan demand.

Outlook

US equities ended 2024 on an ebullient note and at the start of 2025 the outlook for this market remains a key topic of debate. It is not hard to point to signals that might be of concern:

- Investor sentiment and equity allocations are both at cycle highs.
- Price earnings multiples are 25 times based on historic earnings and 22 times taking forward earnings.
- The top 10 companies by market capitalisation amount for over 35% of the total market, a level of concentration not seen since the 1970s.
- US exceptionalism was the dominant theme over the course of 2024, with US equity returns materially exceeding most other equity markets and the dollar posting gains for the year against other major currencies.
- The US equity market now represents 67% of the MSCI AC World Index.
- The market favoured US-centric cyclical names in expectation of high nominal GDP growth, even though Trump's immigration policies and tariffs may lead to a drag on growth while also boosting inflation. The long end of the bond yield curve has already moved up materially and certain areas of the economy such as housing, commercial real estate and SMEs will at some point feel the pinch from re-financing costs.

Yet when we dig a little deeper, we find countervailing points that suggest it is too early to move underweight US equities. Most importantly, there are abundant stock-specific investment cases that we continue to find. Even at the aggregate level, we find the US market rests on more solid foundations than is often portrayed. In particular, we note that:

- The concentration of the US market is not high compared to concentration in other countries.
- The outperformance of the US market and US mega-cap tech stocks in particular has been driven primarily by fundamentals, with the 'Magnificent 7' delivering compound revenue growth of a remarkable 16% per annum over the last 10 years while the average company in the MSCI AC World has seen 0% revenue growth in US dollar terms over this period.
- The stronger US earnings growth has underpinned most of the historic performance differential whilst the higher multiple the US market trades on can be justified by this growth in combination with the markedly higher return on equity (ROE) of the US market.

Looking outside the US, we continue to find ideas across regional markets but in terms of global market direction there is no denying the importance of the outlook for China. Unlike the US, in China, growth has disappointed. Confidence amongst consumers and entrepreneurs has remained stubbornly negative, the result of a continuing deflationary property bust. Growth has been heavily dependent for a second year on booming exports and government-directed capital investment. The new round of policy actions, initially announced in September, reflect the level of seriousness with which the issue is being taken. China's 'New Economy', such as the production of electric vehicles and renewable energy infrastructure, has continued to expand rapidly, but this has been obscured by the property bust and associated deleveraging. Response to the threat of US tariffs creates further uncertainty,

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particularly whether China lets its currency fall to bolster manufacturing - the one area of the economy that is still performing relatively well.

Given the complex macroeconomic landscape, we advocate a balanced, multi-factor approach with a focus on stock selection and flexibility. Resources, notably materials, remain attractive for diversification, while selective investments offer growth potential in electric vehicles and infrastructure. Technology remains the market's locomotive for now, particularly in AI and data centres, but we are cognisant of valuations and demanding expectations as we enter 2025.