VT Tyndall Real Income Fund

March 2020

TYNDALL

March 2020 Review

We were premature in our assessment that the markets had moved into full blown panic mode in February as events in March proved much more dramatic. The accelerating global spread of Covid-19, necessitating population lockdowns the likes of which have never been witnessed before, was the primary driver of panic and despite ‘unprecedented’ intervention by fiscal and monetary authorities around the world, markets fell heavily everywhere. The MSCI UK Index declined -13.4% in March and has registered a substantial fall of -23.9% for the first quarter of 2020.

Faced with a deadly invisible foe in Covid-19 and a self-imposed shutdown of vast swathes of the global economy for an indeterminate period, markets in equities, credit and commodities (particularly oil) collapsed on a scale and timeframe not really witnessed before, despite numerous comparisons to 2008/9, 1987 and the ‘big one’ of 1929/32. On almost all metrics March was the most volatile month for equities ever with daily moves in major indices of 4% or more seemingly becoming the norm.

Fund performance/ activity

Our fund declined by an extremely disappointing -23.1% during March, significantly underperforming the MSCI UK Index fall. Whilst there were some positive relative performances in more defensive areas of the portfolio these were considerably outweighed by the detractors.

Given the large scale lockdown of air travel, non-essential retail operations and housing related activities it is unsurprising that our holdings in these areas suffered materially, with share price declines including Melrose (-56%), Vistry (-55%), Easyjet (-48%), Meggitt (-46%), WH Smith (-41%), Dunelm (-35%) and Next (-33%). Other heavy fallers included Intermediate Capital (-44%), ITV (-43%) and Barclays (-37%).

Whilst disappointing to say the least, the scale of decline in these equity values in one month is as dramatic as anything we have witnessed before save perhaps the banking sector meltdown of 2008/9. We do not, in any way, take these declines lightly. However, at times like these it is incredibly important to focus on the medium term potential of strong franchise businesses, and those that have the financial flexibility to come through this incredibly difficult short term period should emerge in a relatively stronger position compared to their competition and will offer fantastic long term return potential from these depressed price levels. We would include all of the above businesses in this category.

Viewed in the above context, we added to several of these positions as prices fell including Dunelm, Melrose, WH Smith, Vistry, Intermediate Capital and Barclays. We also added to Persimmon, GVC, Phoenix and Ferguson. We added one new holding to the fund, JD Sport Fashion, yet another market leading franchise with ample financial flexibility and whose share price had declined nearly -60% year to date at the time of purchase.

To fund additions to the portfolio we took money from stocks that have held up relatively well including BAE Systems, SSE, Severn Trent and AstraZeneca. We also disposed completely of holdings in Ascential and Smiths Industries to fund additions to higher conviction franchises.

Market Outlook

That markets are in a full blown panic is beyond doubt, and it is increasingly clear that an enormous exogenous shock has been forced upon the global economy by the containment measures deemed most effective in response to the virus spread. There will be extremely weak economic data points around the world in the next few months, unemployment will rise and many businesses in difficult financial positions will struggle to survive. In this sense the market reaction function is not a surprise.

However, it is important to try and keep a sense of perspective when investing in assets such as equities, where valuations are ultimately driven by the long term cash generation potential of an enterprise. Undoubtedly year one cashflow has been dramatically impaired in many instances, and possibly years two and three to a degree, but in the context of often indiscriminate share price declines of -50-60% or more then, for the strong businesses able to weather the short term disruption, medium term investment opportunities are arising.

It is important also not to lose sight of the speed and scale of fiscal and monetary support being provided by authorities globally. In the UK for example, HSBC estimate that the governments support measures for the economy are equivalent to c.4% of GDP whilst some commentators estimate that the US Federal Reserve now has the ability to provide an additional $4.5 Trillion in liquidity support to markets during these difficult times.

Ultimately much now depends on the duration of lockdowns and the interplay between the economic damage caused and the policy support being provided. We reiterate again that it is hard to have very high conviction in any given scenario at this stage. For what it is worth we feel that the speed and extent of policy support will provide the required safety net to allow economies to emerge from this period with productive capacity still in tact and that ought to facilitate a meaningful recovery in economic activity in a relatively short time frame. In this scenario we remain highly optimistic that our portfolio of strong franchises will be in an increasingly advantageous position relative to their competition and we remain extremely excited by their future investment return potential.

Simon Murphy 3rd April 2020