VT Tyndall Global Select Fund

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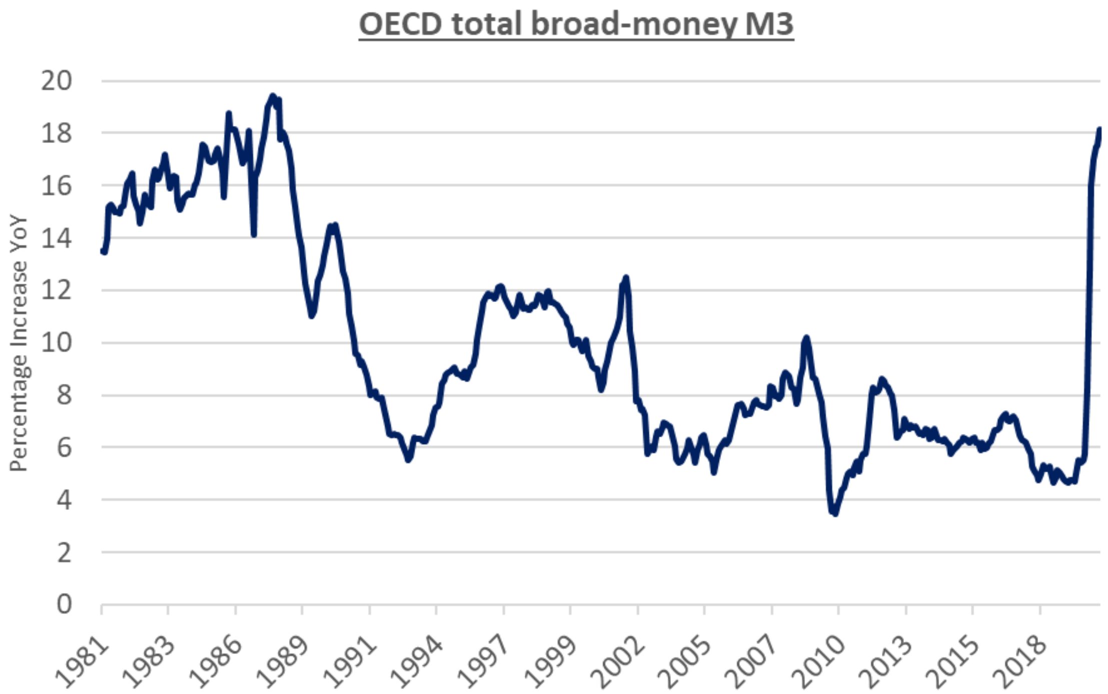
Weekly Commentary 18th December 2020

Taking Aim – Inflation is Now a Moving Target

"By a continuing process of inflation, government can confiscate, secretly and unobserved, an important part of the wealth of their citizens." John Maynard Keynes

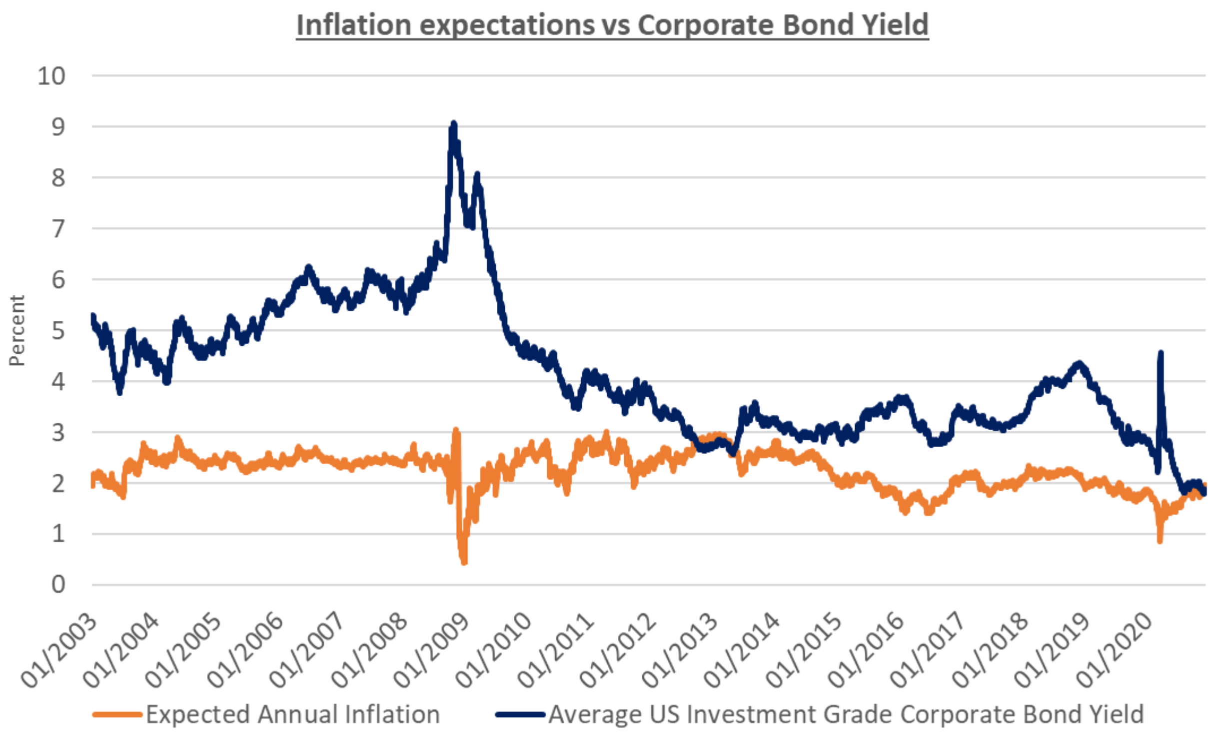
What a difference a vaccine and a few months doth make. For much of 2020, the pandemic raised concerns over the impact of negative growth and the onset of deflation occurring simultaneously; now, however, it appears inflation is potentially the greater threat on the horizon.

After the significant increase in money supply from central banks in the wake of the Great Financial Crisis, many expected that the resultant effect would be the onset of inflation, yet this proved not to be the case. The difference this time is, rather than merely making up for the lack of money creation as a result of reduced bank lending, the central banks' efforts (base money) have been amplified by the state of household bank balances (broad money), as captured in M3. As the chart below shows M3 rose gradually in 2009, while today, it is spiking to levels last seen in the early 1980s.



Source: TIM/OECD

Lending to the private sector has increased as firms have capitalised on the low interest rate environment, in many cases borrowing to remain operationally viable. Meanwhile, OECD Central banks' balance sheet have increased by more than 20% of their combined GDP in order to pay for the various stimulus measures enacted to keep businesses and citizens afloat during lockdowns and thereafter. Inflation expectations have thus been gradually rising, and now have crossed above the yield investors can achieve from investing in corporate debt, thus destroying the real value of money for anyone investing in that asset class.



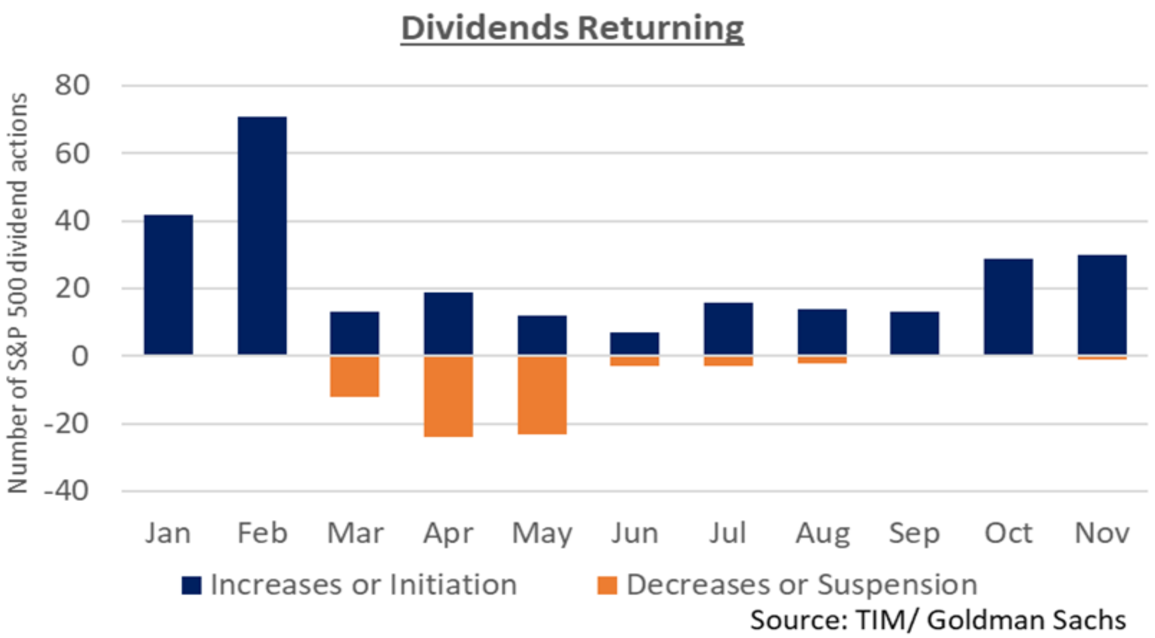
Source: TIM/ Bloomberg Barclays/ St Louis Federal Reserve

Some of the increase in inflation expectations comes from the rollout of vaccines that have increased growth expectations for 2021 as the world returns to work. The rollout should coincide with the calendar effect of lapping the March-May 2020 lock-down period where the world experienced deflation, and therefore even modest inflation may well register above the 2% level on a year over year basis.

When consumer confidence returns, we may well see an increase in spending, making up for the lost opportunities in 2020, and supply may not be able to keep up. Travel, retail & leisure, which were (and continue to be) hit hard are likely to see pent up demand once economies reopen for business and will be reluctant to continue offering discounts to lure customers back; with Airline prices down 17% over the past year, even a small increase on the current levels will be inflationary. In the UK, Brexit is already causing companies to highlight the bottlenecks in their supply chains as essential parts get delayed at the border, which could compound these inflationary pressures.

With increasing inflation expectations and the bond market destroying the real value of capital invested, investing in global equity markets appears to be the most prudent way of allocating investors' funds. While many companies may struggle with inflation and the damage caused by 2020, those companies that score well on Porter's five forces[1] should be able to offset these pressures, given their ability to pass on costs and ensure continuity of supply.

[1] Porter's Five Forces: 1. Threat of new entrants, 2. Bargaining power of customers, 3. Threat of substitute products or services, 4. Bargaining power of suppliers, 5. Rivalry amongst existing competitors.



With dividend cuts abating and buybacks and pay-outs returning, the total return from investing in a concentrated selection of global best-in-class equities should enable fund managers to '*protect and increase the real value of capital invested*', which remains the aim of the VT Tyndall Global Select Fund.

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