Review

At the headline level June was another relatively quiet month, with the MSCI UK Index notching up a modest gain of +0.4%, bringing the return for the first 6 months of 2021 to a healthy +11.3%. However, at the underlying stock level events were more significant, as the month witnessed a sizeable rotation away from cyclical and reflationary beneficiaries towards more defensive and growth focussed companies.

The rotation was accompanied by a significant pull back in government bond yields and a general flattening of yield curves, following the latest US Federal Reserve meeting at which the Fed brought forward it's expectation of when interest rates may start to rise. The so-called 'dot plot' of projections now forecasts at least 2 rate hikes in 2023 whereas previously they had forecast none until 2024. They also confirmed they had started to discuss when they might begin reducing their bond purchasing programmes, although they gave no guidance as to when that actually might be.

The other key issue grabbing investor attention during the month has been the continued spread of the so-called 'delta' variant of Covid-19 around the world. Here in the UK, it has rapidly become the dominant strain of the virus and that, coupled with a sharp rise in cases, caused the Prime Minister to delay so-called 'Freedom Day' – when all Covid restrictions are supposed to be removed – by 4 weeks until the 19th July at the earliest.

The good news, from a UK perspective at least, is that so far a rapid rise in cases has not been accompanied by anything like the rise in hospitalisations and deaths that would have been expected in previous waves, highlighting just how effective our vaccine rollout project has been. Others, however, may not be so fortunate as the variant takes hold around the world, and in many countries with far less developed vaccination programmes. This fear also played a significant part in the underperformance of many travel and leisure related stocks during the month.

Fund performance / Activity

It was an extremely disappointing month in terms of performance for the fund which fell -4.8% (share class A GBP Net Accumulation), underperforming the peer group average fall of -0.6% and the MSCI UK Index gain of +0.4%.

There were no individual stand out negative contributors during the month, but rather a significant number of our cyclical holdings collectively contributed negatively including JD Wetherspoon, National Express, Marks & Spencer, Standard Chartered, WH Smith and Vistry. Having no exposure to several large companies that performed relatively strongly during the month, including AstraZeneca, GlaxoSmithKline and Royal Dutch Shell also proved detrimental.

Positive attribution, such as there was, came from a small number of holdings including Micro Focus, Entain and Intermediate Capital. Having no exposure to heavyweight banking group HSBC also proved relatively favourable.

Portfolio activity was relatively limited during June. We added no completely new holdings to the portfolio during the month. We took advantage of recent share price weakness to add to several of our core holdings including Melrose, National Express, Prudential, WH Smith and JD Wetherspoon.

These additions were funded by one complete disposal, that of Electrocomponents, a company that has performed exceptionally well for the fund, but where we now feel there are better capital deployment opportunities elsewhere. We also took profits in Entain and Intermediate Capital Group.

Market Outlook

As noted above, and as can be seen from the performance of our portfolio, June has seen an aggressive shift within the equity market away from reflation/recovery/cyclical stocks towards more defensive and growth orientated companies. As mentioned, this has been accompanied by a decline in longer term bond yields and a flattening of yield curves globally. This raises the obvious question as to whether this is the start of a sustained move in that direction or more a short term pause in an ongoing trend.

From our perspective we are not at all convinced that this represents the end of the reflationary period for markets. Economic activity is rebounding and arguably still has a lot further to go as economies eventually fully reopen post-pandemic. Consumers appear in incredibly robust shape and keen to spend on activities post lockdown. Company reporting, generally, continues to surprise positively and anecdotal signs of building inflationary pressures remain in abundance.

Of course, eventually, super-easy policy will need to be curtailed and we will continue to see more and more discussion surrounding the timing and nature of that policy withdrawal over the coming months. Historically, not withstanding the capacity for short term volatility, the initial phase of policy withdrawal has not coincided with the end of equity bull markets and we very much doubt that will be the case in this cycle.

Concerning our portfolio holdings, we remain extremely optimistic on the medium-term outlook for significant further progress. In a great many cases we view our holdings as being roughly one year into a multi-year recovery process. Of course, there will be bumps along the way, but the medium-term upside still looks exceptional to us and, as such, we are happy to keep the exposures we currently have, and indeed we remain comfortable utilising any near term weakness to add to favoured positions.

Simon Murphy, Fund Manager, VT Tyndall Real Income Fund, 5th July 2021
Data source (unless otherwise stated): Bloomberg, FE Analytics

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