VT Tyndall Real Income Fund

Monthly Commentary | December 2021

TYNDALL

Review

Notwithstanding the extremely alarming headlines concerning the new Omicron variant of Covid-19, equity markets performed surprisingly strongly during December, with the MSCI UK Index gaining +4.81% over the month.

December news flow was dominated once more by the ongoing Covid-19 pandemic, and in particular the furious spread of the new Omicron variant around the world. In the face of such rapid transmission, countries across the globe rushed to implement further restrictions both on domestic activity and overseas travel, albeit with limited obvious benefits in terms of halting the spread.

Interestingly, as we detail below, not only did equity markets rise strongly in the face of the accelerating case count, but some of the biggest gainers in the month were those stocks most exposed to potential disruption from the virus. To what extent that reflects nothing more than a typical 'Santa rally' remains to be seen, although it is entirely possible markets are reacting to the early data suggesting this mutation of the virus is significantly less deadly than previous versions, and the implications that may have for public health policy in due course.

Here in the UK, the government have so far resisted, in England at least, calls for further restrictions on everyday activity, as they await further data on the ultimate impact Omicron will have on rates of hospitalisations, deaths and the overall strain on the NHS. However, despite strong opposition from within his own party, the Prime Minister did, in early December, move the country officially to 'Plan B' involving compulsory face masks in most indoor venues, working from home where possible and vaccine passports for certain settings.

Other news of note included the Bank of England surprising markets (again) by increasing interest rates from 0.1% to 0.25%, Omicron notwithstanding, driven by growing concerns over the persistence of high levels of inflation. In a similar vein, the US Federal Reserve announced it will shrink its monthly bond purchases at twice the pace previously announced, and likely end them altogether in March 2022.

Fund performance / Activity

Despite the rapidly escalating Covid-19 cases globally, December was, pleasingly, a very strong month in terms of fund performance as our portfolio gained +6.80% (share class A GBP Net Accumulation), significantly outperforming both the peer group average gain of +4.77% and the MSCI UK Index's gain of +4.81%.

In a mirror image of November's performance, positive attribution came predominantly from those companies significantly exposed to disruption from the Covid-19 developments such as WH Smith, J.D. Wetherspoon, National Express, EasyJet and Melrose. UK domestic stocks also performed strongly for the fund including Wickes, OSB Group, Premier Miton, Drax, Vistry and Taylor Wimpey.

Underperformers within the portfolio were limited, with modest relative underperformance from stocks such as Marks & Spencer, Prudential and Antofagasta. Other detractors primarily concerned large index constituents that performed well and where we have no exposure currently, including HSBC, Royal Dutch Shell, Diageo and AstraZeneca.

December was a relatively quiet month for activity in the portfolio. We made one new addition to the fund, namely automotive distributor Inchcape. We made one complete disposal of our holding in Phoenix Group. We do not believe the outlook for the company has materially changed but we feel we can deploy the capital to greater advantage elsewhere.

During early December we took advantage of significant price weakness to add to our holdings in ITV, J.D. Wetherspoon, Wickes, EasyJet and Melrose. We funded these purchases through profit taking in stocks such as OSB Group, WPP, Drax and Marks & Spencer.

Market Outlook

We mentioned last month that it was very early days with respect to the new Covid-19 variant Omicron but there was, at least, some early optimistic data coming from South Africa suggesting that, whilst almost certainly more transmissible, the variant might prove significantly less deadly. As we get more granular data, whilst still not certain, that does appear to be the most likely scenario. Hence, despite record numbers of infections in numerous countries currently, the degree of severe illness, hospitalisation, and deaths does appear, thankfully, to be significantly lower than previous strains.

Whilst this is an extremely welcome development, the sheer number of cases still has the capacity to cause meaningful disruption in the short term, given current policies towards testing and isolation around the world. As such, our base case outlined previously, of a modest setback to the global economic recovery rather than anything more sinister, remains our central scenario.

From a medium-term perspective, it is possible that, given the high degree of transmissibility of Omicron, we are entering the 'endemic' rather than 'pandemic' stage of the evolution of the virus. If so, this will likely require a significant change in mindset towards mandatory testing and/or isolation regimes around the world as we all truly learn to 'live with the virus'. We are already seeing early indications of such change, for example the US now cutting the isolation period from 10 days to 5, and South Africa floating the possibility of dramatically overhauling and reducing isolation, testing and contact tracing regimes entirely.

Turning to our portfolio holdings, we noted last month that we felt a great many of our pandemic disrupted companies were offering extraordinary investment opportunities for the medium term, as we eventually adapt to a world that permanently includes Covid-19. As previously asserted, we do not know exactly when the market will decide to focus on the shape of that future environment and reappraise the outlook for survivors/winners accordingly. Perhaps December's performance of many of these stocks suggests that time is now. Obviously, we hope that is the case, but in reality it matters little to us, as we feel sure that the companies we own will ultimately emerge stronger post pandemic and will provide outsized returns to our investors in the years to come.

Simon Murphy, Fund Manager, VT Tyndall Real Income Fund, 4th January 2022
Data source (unless otherwise stated): Bloomberg, FE Analytics

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