VT Tyndall Real Income Fund

Monthly Commentary | January 2022

TYNDALL

Review

January was one of the most volatile months in recent times, particularly in global equity markets, many of which suffered sizeable declines for the month. The UK equity market held up, relatively speaking, much better and ended with the MSCI UK Index gaining +1.86% over the month.

January news flow was dominated by fears that, with inflationary pressures showing no signs of abating, central banks around the world were now 'behind the curve' in their policy positions and as such will need to hike interest rates and/or shrink balance sheets at a significantly faster pace than previously envisaged. This fear of liquidity withdrawal created huge levels of volatility in many markets globally, most notably in the USA where, for example, the Nasdaq Composite index, despite a vigorous rebound in the last few days, still finished the month with a loss of -9%.

Geopolitical tensions continued to build between the western world and Russia during the month, following a sustained build up of Russian troops on the border with Ukraine. Fears of a potential Russian invasion of Ukraine, and the broader ramifications that might follow such an event, added to the jittery nature of markets to start the new year.

On a slightly more positive note, whilst cases of the latest Covid-19 variant Omicron have spread rapidly throughout many countries around the world, it has become increasingly clear that the variant, whilst serious, is significantly less deadly than previous versions. Consequently, an increasing number of countries are starting to plan for populations to genuinely 'live with the virus' and to move away from 'pandemic' to 'endemic' status. Thus, despite high case numbers, many countries have continued to reduce Covid related restrictions on activity.

Here in the UK, the headlines have been dominated by the so called 'partygate' scandal surrounding numerous potential breaches of lockdown rules by members of the government. The potential for political instability as a consequence is real and is a highly unwelcome detraction from other pressing matters, such as implementing measures to help alleviate the ongoing cost of living problems for many. More positively, plan B Covid restrictions in England have been lifted and testing requirements for overseas travel have been significantly eased.

Fund performance / Activity

Our fund had an ok start to 2022, coping relatively well with the high levels of volatility and significant rotation that occurred during the month. Despite a generally 'risk off' tone to markets the portfolio lost -0.75% (share class A GBP Net Accumulation), broadly in line with the peer group average loss of -0.40%, although lagging the MSCI UK Index's gain of +1.86%.

Positive attribution came from a wide variety of holdings such as WH Smith, EasyJet, Standard Chartered, NatWest, Imperial Brands and WPP. Having no exposure to index heavyweights Diageo and Unilever also proved beneficial as their share prices came under pressure.

Underperformers were concentrated in the industrial and UK domestic sectors and included holdings such as Keller, Bodycote, Rolls Royce, Wickes, Vistry, Taylor Wimpey and DFS Furniture. By far the biggest drag to performance came from having no exposure to index giants Royal Dutch Shell and HSBC who both performed relatively very strongly during the month.

It was a relatively quiet start to the year in terms of fund activity. We made one new complete addition to the portfolio, namely utility company Centrica. This was funded through the complete disposal of our holding in retailer Next. This is a holding that has performed very well for the fund but where we now feel there is greater upside elsewhere.

We used the elevated levels of volatility in the month to top up several holdings including Inchcape, DFS Furniture, Imperial Brands and Taylor Wimpey. These were funded by profit taking in companies such as OSB Group and Burberry.

Market Outlook

Without wishing to diminish the seriousness of the ongoing Covid-19 pandemic in any way, it feels to us as though markets are shifting their focus more acutely to the ramifications of substantially higher inflation, for longer, than previously expected, and the consequences this may have for monetary policy tightening.

Markets, aided by relatively 'hawkish' commentary from leading central bank members, have moved quickly to price in several interest rate increases this year, specifically in the US and UK. This has, we are sure, facilitated the significant levels of volatility and 'factor' rotation we have witnessed in markets recently. To what extent this continues in the short term remains to be seen, however it will not surprise many of our readers that we err on the side that views this period as the start of a fundamental change in the investment environment to that we have experienced for many years.

The start of interest rate tightening cycles typically involves an initial degree of uncertainty and volatility as markets inevitably fret about the impact of lower liquidity provision and tightening monetary conditions. However, such episodes rarely spell the end of economic and stock market up cycles until the tightening cycle is much further advanced, and we suspect that will remain the case for this period as well. Notwithstanding the 'wild card' threat of military conflict in Ukraine, our central case remains an ongoing economic and stock market upswing, albeit with higher levels of volatility and changes in market leadership.

Turning to our portfolio holdings, we remain extremely enthusiastic over the potential for outstanding returns as the world slowly but surely learns to live with Covid. We also, contrary to some, remain far more upbeat about the prospects for the UK domestic economy. For sure there will be headwinds this year but fundamentally consumer and corporate balance sheets are in great shape, housing and labour markets are robust and financial conditions remain extremely accommodative, even with the modest interest rate increases now forecast by markets.

Simon Murphy, Fund Manager, VT Tyndall Real Income Fund, 31st January 2022
Data source (unless otherwise stated): Bloomberg, FE Analytics

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