Review

February 2022 will, sadly, be remembered for the shocking, unprovoked, invasion of Ukraine, the second largest country in Europe by land area with a population of c. 44 million, by Russian armed forces. Whilst Russia had amassed a large army of troops on the Ukrainian border over several months, expectations of them actually invading were, unsurprisingly, relatively low. The shockwaves sent globally as a consequence were certainly not lost on equity markets, which endured extreme volatility and general risk aversion towards the month end. Nevertheless, the MSCI UK Index managed to hold on to a small, but impressive, gain for the month climbing +0.78%.

At the time of writing the conflict is only a few days old and as a consequence there exists an extremely wide range of potential outcomes, making any predictions relatively futile. Initial suggestions are that the invasion has not, yet at least, gone to plan for Russia, with the Ukrainian military proving much stronger opposition than expected.

Condemnation of the unprovoked attack has been near universal and western countries have come together quickly to offer assistance to Ukraine through equipment supplies and humanitarian aid. At the same time a concerted effort is being made to severely hobble the Russian economy through targeted sanctions, freezing of assets internationally and denying access to airspace and, in many cases, the international financial payment system (SWIFT). Whether these responses are powerful enough to prompt a strategic rethink by Russia remain to be seen.

Given such a tragic and monumental event, other issues during the month barely seem worthy of mention. If we had to pick a couple, it would probably be the ongoing removal of Covid-19 restrictions in the vast majority of countries around the world and the gradually reducing expectations for the pace of interest rate hikes from major central banks, primarily in response to the Ukrainian developments.

Fund performance / Activity

Our fund is, broadly speaking, positioned in quality cyclical companies that benefit from ongoing growth both in the UK and globally. As such, it lacks exposure to traditionally more ‘defensive’ assets. As a consequence, the fund had a very difficult month in February, as the Ukrainian conflict unfolded and investors went into significant ‘risk aversion’ mode. Our portfolio lost -4.19% (share class A GBP Net Accumulation), underperforming the peer group average loss of -2.14%, and the MSCI UK Index’s gain of +0.78%.

Limited positive attribution came from defensive holdings such as Drax and Centrica as well as Standard Chartered and Burberry. Having no exposure to GlaxoSmithKline also proved beneficial as their relative performance suffered.

Underperformers were concentrated in the industrial and UK domestic sectors and included holdings such as Marks & Spencer, Wickes, DFS Furniture, Rolls Royce, DS Smith, Inchcape and Keller. Having no exposure to index giants Royal Dutch Shell and AstraZeneca also proved detrimental as both performed relatively strongly during the month.

There was a little more activity on the portfolio during the volatility of February. We made one new complete addition to the portfolio, namely mining company Glencore. This was funded through the complete disposal of our holdings in other mining companies Antofagasta and BHP.

We used elevated levels of volatility in the month to top up a large number of holdings including ITV, DFS Furniture, Wickes, DS Smith, Vistry, Marks & Spencer, EasyJet, Melrose and Bodycote. These were funded by new money inflows and profit taking in holdings such as Imperial Brands and Drax.

Market Outlook

We commented last month that we felt markets were moving on from the ongoing Covid-19 pandemic and shifting focus towards high levels of inflation and the potential for monetary policy tightening. We acknowledged the 'wild card' threat of military conflict in Ukraine but we, like most others, considered it very much an outlier risk with low probability of occurring. That was clearly wrong.

We mentioned earlier that making predictions about the outcome and implications of the Ukrainian invasion at this stage is clearly very difficult. We are, from a humanitarian perspective, as shocked and appalled as others over this development. From a pure numerical perspective, the combined Russian and Ukrainian economies account for just over 3% of global GDP and whilst a case can be made, therefore, for relatively limited impact on the world economy, the ongoing ramifications of a genuinely new 'cold war' could be far more meaningful. We simply do not know at this stage.

Our central tendency is to assume the 'worst' does not happen, which in market terms is usually correct. Market participants tend to behave extremely emotionally at times of unexpected shocks, with fear of the unknown and extreme loss aversion dominating behaviour. Whilst acknowledging the myriad of potential outcomes currently, we are reminded that there have been numerous 'geo-political' shocks over the last century and the vast majority have, perhaps surprisingly, impacted markets for relatively short periods of time, and frequently well ahead of the actual event itself. A commentator we highly respect recently summed it up far better than we can as follows:

"Markets are heartless: they will measure this crisis by the size and duration of its impact on global growth, commodity prices and central bank policy more than by its terrible impact on Ukraine and its long-suffering population."

Turning to our portfolio holdings, whilst mindful of the high degree of uncertainty currently, we continue to back the strength of the franchises in which we invest to emerge stronger through any near-term difficulties. As such, we have taken the opportunity, in many cases, to purchase more shares at increasingly attractive prices as markets have remained volatile. We would anticipate continuing that strategy through any further market dislocation.

Simon Murphy, Fund Manager, VT Tyndall Real Income Fund, 2nd March 2022
Data source (unless otherwise stated): Bloomberg, FE Analytics

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