Review

At the headline level equity markets appeared relatively calm during the month of May, with the MSCI UK Index recording a modest gain of +1.33%. However, this masked a significant sell-off in the first half of the month followed by a relatively sharp recovery towards the month end. The key themes that have been dominating investor concerns for several months now, including persistently high levels of inflation, the potential for a global slowdown/recession and the war in Ukraine remained at the forefront of the investment debate during May.

Inflation, and the necessary policies to combat it, remains a constant source of angst for market participants. Despite the ongoing high levels of inflation in the system there are early, tentative, signs of inflationary pressures peaking. Whether that proves to be the case remains to be seen, but the associated fall in government bond yields that occurred in the second half of the month was most likely a significant contributory factor behind the equity market recovery.

Meanwhile, the global economic outlook remains cloudy, with multiple conflicting data points both at the macroeconomic level and also throughout company earnings reports. There were several high profile earnings ‘misses’ during the month, particularly in the US, but equally, although much less publicised, pockets of strength and resilience. There was also a raft of announcements from China aimed at supporting and improving economic activity in the months ahead as they, hopefully, emerge from meaningful Covid related lockdowns.

Here in the UK the major newsflow of note was a significant further support package announced by the Chancellor to help households cope with the cost of living crisis and in particular rising energy prices. The package has been broadly well received and should, at least, help limit the worst of the squeeze on real incomes.

Fund performance / Activity

After several disappointing months recently, May was significantly better for the portfolio as many of our cyclical holdings recovered somewhat. Our portfolio gained +3.46% (share class A GBP Net Accumulation), materially outperforming the peer group average gain of +1.09%, and the MSCI UK Index’s gain of +1.33%.

Outperformers were concentrated in the consumer and industrial sectors and included holdings such as Melrose, WH Smith, Vistry, Marks & Spencer and National Express. Having no exposure to index heavyweights AstraZeneca and Diageo also proved beneficial as they underperformed relatively.

Negative attribution came from holdings such as DS Smith, Keller, OSB Group and EasyJet. Having no exposure to Shell, HSBC and Unilever also proved detrimental as they performed relatively strongly during May.

We were a little more active during the month, adding one new holding to the portfolio in the shape of equipement rental company Ashtead Group. We have owned this business previously and have taken advantage of the recent 40%+ share price decline to reintroduce a holding. This was primarily funded by the complete disposal of our holding in Drax Group. This has been an exceptional performer for the fund and we now consider better opportunities exist elsewhere.

We added to a variety of holdings including Burberry, Intermediate Capital, Rolls-Royce, Prudential and TP ICAP. These were funded by further profit taking in holdings such as BP, Glencore, OSB Group, Standard Chartered and Centrica.

Market Outlook

Our outlook remains the same as in previous months. For sure the economic growth outlook has deteriorated somewhat recently, and this deterioration has not been lost on equity markets, and in particular the cyclical sectors of the market that have seen significant share price weakness of late.

Notwithstanding a modestly better month in May, investor sentiment remains extremely poor and expectations for the global growth outlook remain exceptionally downbeat. To repeat, we are less fearful than many when it comes to the degree of economic slowdown potentially ahead. We think the world still has a significant degree of 'reopening' to do, as we slowly emerge from the long shadow of Covid. We also believe there are considerable offsetting factors, for consumers and corporates alike, to the inflationary headwinds, including generally strong balance sheets, and healthy labour and housing markets.

Recent company commentary during the latest earnings reporting season has generally remained robust, whilst acknowledging the uncertain outlook in the months ahead. As yet there has been scant evidence of any meaningful demand weakness in the areas markets seem most concerned about, such as UK housing activity for example. To what extent a better performance during May, from many of the cyclical areas of the market, reflects the start of a reappraisal of the outlook or is, in fact, just a bounce from oversold levels, remains to be seen. We are hopeful of the former but only time will tell.

We believe the collection of companies in our portfolio have incredibly strong franchises and are more than capable of withstanding any near-term economic difficulties. They also, in general, look exceptionally good value to us at current price levels. As such, we remain extremely enthusiastic for the upside potential for the portfolio and we remain happy to purchase more shares at attractive prices in bouts of market volatility.

Simon Murphy, Fund Manager, VT Tyndall Real Income Fund, June 6th 2022
Data source (unless otherwise stated): Bloomberg, FE Analytics

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