Review

The weakness in equity markets that has been building throughout 2022 accelerated sharply in September as markets tumbled around the globe. The UK equity market was certainly not immune, and the MSCI UK Index lost -4.98% for the month.

Recently released economic data continue to point to an ongoing loss of growth momentum around the globe, most notably in Europe and China. Meanwhile, persistently high inflation numbers have convinced investors that central banks will continue to increase interest rates aggressively, potentially leading to a much greater degree of economic downturn in due course.

One consequence of very aggressive central bank action has been the strength of the US Dollar against almost all other currencies globally. This strength accelerated significantly during September raising concerns over potential financial market accidents (as all too frequently happen in sustained periods of Dollar strength).

Over in Europe, there still seems to be no end in sight to the ongoing conflict between Russia and Ukraine, despite Ukrainian forces appearing to make substantial progress in reclaiming sizeable areas of territory initially occupied by Russia.

Here in the UK, a new government has been appointed with Liz Truss and Kwasi Kwarteng as Prime Minister and Chancellor respectively. Early, welcome, moves to introduce a significant energy price cap for consumers and businesses have been superseded by controversial plans for aggressive, seemingly unfunded, tax cuts aimed at accelerating the nation's economic growth potential.

The degree of scepticism surrounding these moves is substantial and has generated extremely volatile moves in both the value of Sterling and the value of government bonds (Gilts). Threatened with a severe dislocation in the functioning of the Gilt market, the Bank of England was forced to intervene and offer to purchase unlimited quantities of longer dated Gilts again, in order to prevent major financial problems occurring in some of the nation's biggest pension funds.

Fund performance / Activity

Another extremely difficult month in equity markets was, unsurprisingly given our current positioning, amplified in the performance of our fund. The portfolio lost -9.48% (share class A GBP Net Accumulation) for the month, materially underperforming both the peer group average loss of -7.17% and the MSCI UK Index loss of -4.98%.

As with August, underperformers were concentrated in the industrial and consumer discretionary sectors and included holdings such as Vistry, Melrose, Bodycote, WH Smith and Vesuvius. Select financials also suffered materially including Intermediate Capital and OSB Group.

Perhaps surprisingly, there were some stocks in these areas that delivered positive attribution during the month, including TP ICAP, Burberry, Dunelm and Wickes. We also benefitted from not owning index heavyweight AstraZeneca.

Capital at Risk – the value of investments can fall as well as rise and you may not get back what you invested

Past performance is not a reliable indicator of future results.

We made one new addition to the portfolio, emerging market specialist asset manager Ashmore, and one complete disposal of British American Tobacco. The latter has done very well for the portfolio, certainly relatively in recent times, and we decided to redeploy the capital to opportunities that we consider have greater upside potential in the medium term.

We added to several stocks during the aggressive sell off such as Intermediate Capital, Vistry, Melrose, Wickes, Howden Joinery and Dunelm. These additions were funded by profit taking in stocks such as TP ICAP, Centrica, Imperial Brands, Glencore and BP.

Market Outlook

Markets have, without doubt, voted with their feet on the global economic outlook and the verdict is clearly not very pretty. The combination of persistently high inflation, extremely hawkish central banks and seemingly non-stop strength in the Dollar, has investors convinced a deep, painful global recession is inevitable.

We have been of the view that a degree of economic weakness has been inevitable for some time now although we have, generally speaking, taken a less bearish view than most, given the strength of consumer and corporate financial positions coming into this period of turbulence. We broadly hold to that view today, although the risk of more significant economic weakness and/or material financial market accidents is clearly rising, as evidenced by the requirement for the Bank of England to intervene in the Gilt market recently.

Offsetting this heightened level of risk we have a variety of factors, not least the extreme level of pessimism already being shown by investors around the globe, the likes of which we can only really recall back during the global financial crisis of 2008/9. We have also seen a substantial amount of damage inflicted to equity and other asset prices already, most notably in the more cyclical areas of the market. Finally, we are not as convinced as many that the hawkishness currently being displayed by central banks, and specifically the US Federal Reserve, will persist in the face of increasing concerns over the orderly functioning of a variety of different asset markets.

Market movements will likely remain volatile in the near term as investors wait for greater clarity regarding the outlook. Notwithstanding this uncertainty, we remain firmly of the view that the collection of companies currently in our portfolio have incredibly strong franchises and are more than capable of withstanding any near-term economic difficulties. What's more, given the scale of share price falls for many of them recently, they also look exceptionally good value today. As such, we remain extremely enthusiastic for the upside potential for the portfolio over the medium term, and we remain happy to purchase more shares, at increasingly attractive prices, in any further bouts of market weakness.

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

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