VT Tyndall Real Income Fund

Monthly Commentary | October 2022

TYNDALL

Review

After the substantial weakness in equity markets over the past few months, October saw a welcome, if somewhat surprising, recovery across most markets globally. The UK equity market participated to a modest degree, with the MSCI UK Index gaining +2.80% for the month.

Reasons for the rebound were not entirely clear as sentiment surrounding global economic activity remained weak, and there was no obvious let up in geopolitical tensions surrounding Russia/ Ukraine and 'zero Covid' policies in China. If anything, the election of President Xi for an unprecedented third term has reinforced the notion that China will not be moving away from its zero Covid approach soon, regardless of the profound short term economic consequences.

Plausible explanations for the rally include building expectations that the US Federal Reserve, whilst most likely still hiking interest rates another 0.75% in November, may start to signal a slowing in the pace of increases going forwards. The associated, modest fall in the US Dollar and bond yields also proved a welcome development given ongoing concerns over the impact of their recent strength.

Meanwhile, corporate earnings season is in full flow and, despite some very high-profile disappointments in the technology space, has broadly come through more resiliently than many had feared. Finally, as we have noted numerous times recently, investor sentiment has become so negative that it does not take much in the way of positivity for a meaningful rally to develop.

Here in the UK, political events took an even more surreal turn following the chaos in markets post the controversial Truss/ Kwarteng economic plans. First, Kwarteng was replaced as Chancellor in an effort to restore market credibility, and then Truss was forced to resign, becoming the shortest serving prime minister in UK history, after just 45 days in office.

Following a hastily arranged leadership contest, Rishi Sunak became the third Conservative prime minister of 2022. Seen as an economic 'safe pair of hands', alongside new Chancellor Jeremy Hunt, a degree of stability has returned to UK financial markets with Sterling strengthening and government bond yields falling quite materially. Whether we are now, finally, at peak bearishness towards the outlook for the UK's economy and financial markets remains to be seen.

Fund performance / Activity

In a similar way to the previous month, the broader market performance was amplified in the performance of our fund, only this time, thankfully, in a positive way. The portfolio gained +7.12% (share class A GBP Net Accumulation) for the month, materially outperforming both the peer group average gain of +3.58% and the MSCI UK Index gain of +2.80%.

Outperformers were concentrated in the industrial and consumer discretionary sectors and included holdings such as DS Smith, Dunelm, Melrose, ITV, EasyJet, Vesuvius, Inchcape, and DFS Furniture.

Despite the strong relative performance there were several detractors, particularly in the financial sectors, including holdings such as Premier Miton, Prudential, TP ICAP and Standard Chartered. We also suffered for not owning index heavyweights Shell and GSK.

We made no new additions to the portfolio during October and two complete disposals, of Centrica and Barclays. The former has done very well for the portfolio and the latter less so, but in both cases, we decided to redeploy the capital to opportunities that we consider have greater upside potential in the medium term.

We utilised the sale proceeds to add to a variety of holdings, at what we consider to be highly attractive prices, including Intermediate Capital, Melrose, Howden Joinery, OSB Group, EasyJet, Ashmore and Vistry.

Market Outlook

Our views on the market outlook have remained consistent for some time now and hence this section has tended to be somewhat repetitive of late.

Broadly speaking, we expect a degree of economic weakness in the near future, driven primarily by rapidly rising interest rates and the effects of high and sticky inflation on real incomes, alongside the impact of the Ukraine/ Russia war on energy costs and other global factors such as China's insistence on following zero Covid policies.

However, we remain of the view that there are several counterbalancing forces which should help prevent a more significant economic downturn, specifically the strength of consumer, corporate and banking sector balance sheets, alongside extremely tight global labour markets. If our assumptions are broadly correct then we struggle to get anywhere near to the level of bearishness that has dominated equity markets, and in particular the most cyclically sensitive sectors, for much of 2022.

Given the above, it should hopefully not surprise any of our readers that we have maintained a highly cyclical portfolio full of what we believe to be incredibly strong franchises with, given the degree of share price weakness already incurred, outstanding medium term upside potential.

Market movements will likely remain volatile in the near term as investors wait for greater clarity regarding the outlook. Notwithstanding this uncertainty, we remain extremely enthusiastic for the upside potential for the portfolio, 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, November 2nd 2022
Data source (unless otherwise stated): Bloomberg, FE Analytics

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