VT Tyndall Real Income Fund

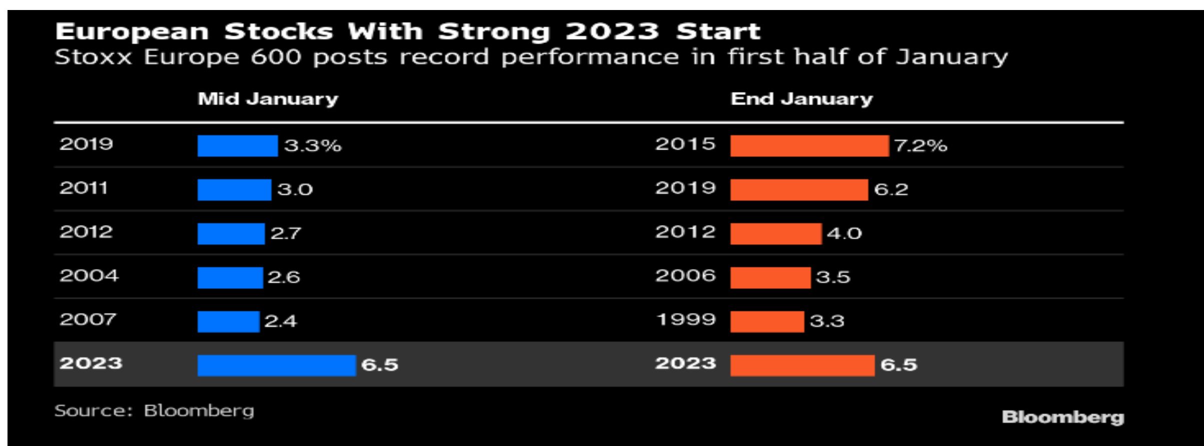
Weekly Commentary | January 16th 2023

TYNDALL

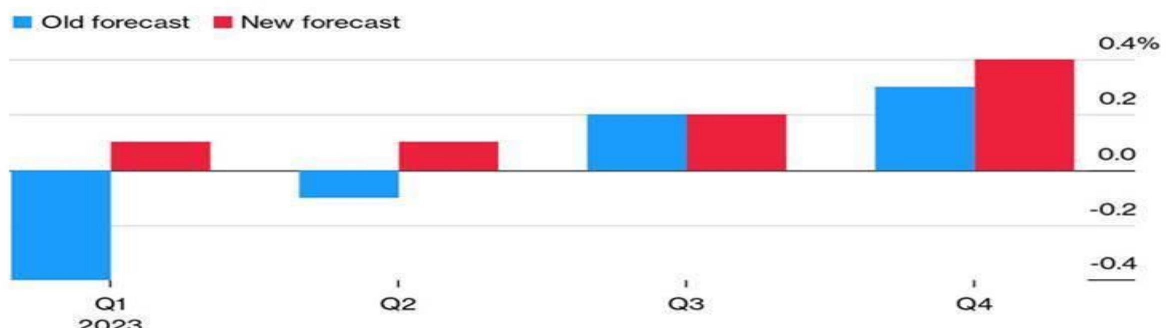
“European stocks marked their biggest gains in the first two weeks of the year **on record**” – Bloomberg 15/01/23.

As the comment from Bloomberg suggests, 2023 has certainly started with a bang, not just in European equity markets but more broadly as well. We are reminded of a funny scene from an old Inbetweeners episode, where Will is thrown in a pond as an initiation ceremony whilst on work experience, and one of his ‘colleagues’ shouts “Wasn’t expecting that, was you, mastermind?!”

We have commented many times previously on the high levels of negative sentiment that pervaded equity markets during 2022, and we feel certain that such a brisk ‘risk on’ start to 2023 has caught many investors by surprise. Whether it lasts, of course, remains to be seen but it has certainly been an interesting first couple of weeks, as the chart below highlights.



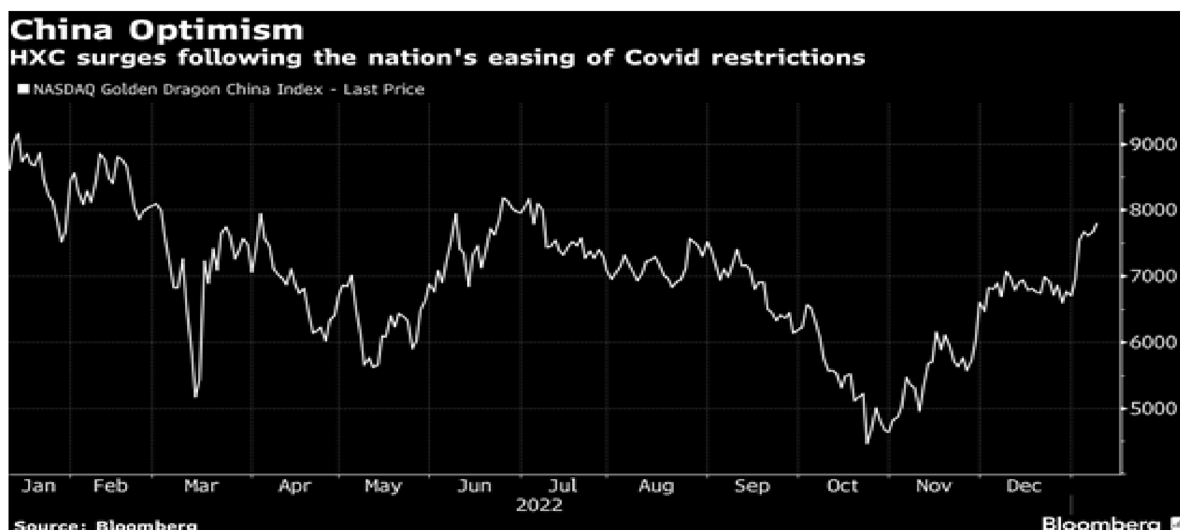
The proximate causes of this change in sentiment towards European equities appear to be a combination of US inflation continuing to cool, giving hope that the Federal Reserve is nearing the end of its interest rate hiking regime, optimism around the reopening of the Chinese economy post the end of ‘Covid zero’ restrictions (Europe has significant export exposure to China), and a milder than expected winter so far, causing material declines in energy prices and alleviating the risk of blackouts across the continent this year. The combined impact has been powerful enough for economic forecasts to improve significantly, as the table below from Goldman Sachs confirms.



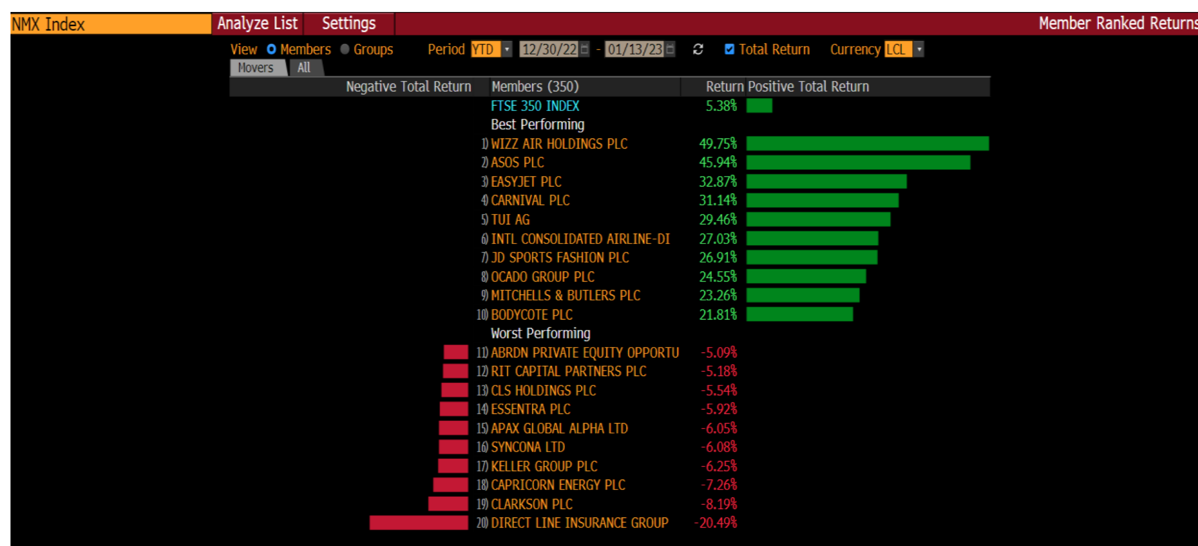
Capital at Risk – the value of investments can fall as well as rise and you may not get back what you invested

Past performance is not a reliable indicator of future results.

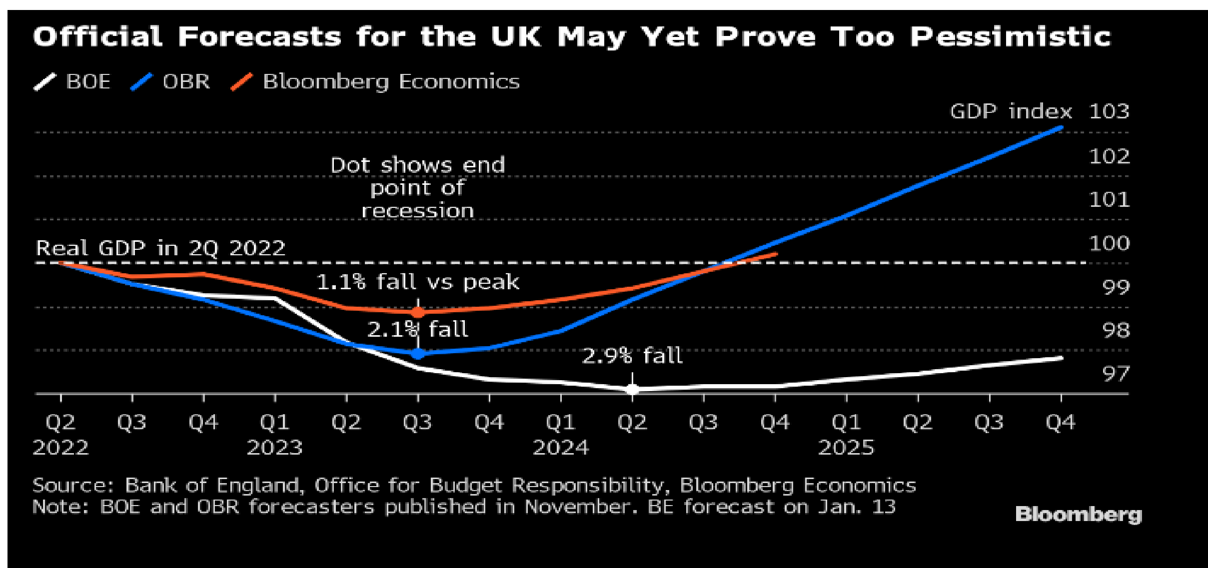
The markets clearly appear optimistic that a genuine reopening of the Chinese economy will happen this year, as can be seen in the recent performance of Chinese companies listed in the United States (shown below). The potential positive implications for global growth should certainly not be underestimated, given China remains the second largest economy in the world.



Positive sentiment has even found its way into the UK as well. The chart below highlights a +5.4% rally in the FTSE 350 year to date, led by highly cyclical stocks such as those in the retail, travel and leisure industries.



Continuing the theme, there was near universal 'surprise' last week when the UK economy grew 'unexpectedly' in November. Indeed, whilst it is still early days in terms of the current reporting season, the initial post-Christmas trading statements from companies in the retail space suggest that UK consumers are not entirely spent just yet. These datapoints, alongside the fall in energy prices noted above, have many economic commentators revising up their, hitherto, extremely gloomy forecasts for the UK economy in 2023, as the chart below alludes to. We have noted before just how ridiculous, in our opinion, the Bank of England's eight quarter recession forecast was, and it will be interesting to see whether they decide to revisit that forecast over the coming months.



Whilst the positivity being seen in equity markets 'appears' to have developed relatively recently, it is interesting to note, as the chart below highlights, that economically sensitive cyclical stocks in Europe have been outperforming more defensive companies consistently since last summer – perhaps not the most intuitive development given the level of bearishness generally being shown towards the economic growth outlook in recent months.

Of course, the other major thematic change that has been developing in markets over the last 12 months or so has been the improvement in performance of so-called 'value' stocks relative to 'growth' stocks. The chart below notes the scale of recent outperformance, albeit following several years of substantial underperformance.

Whilst this theme has been developing for some time, the second chart below suggests the improvement in performance for value has plenty of scope to build further, something we would wholeheartedly agree with.

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

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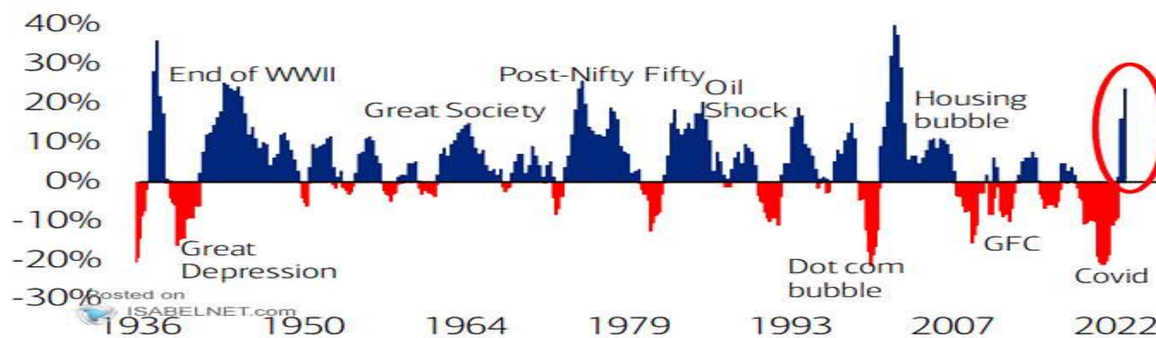

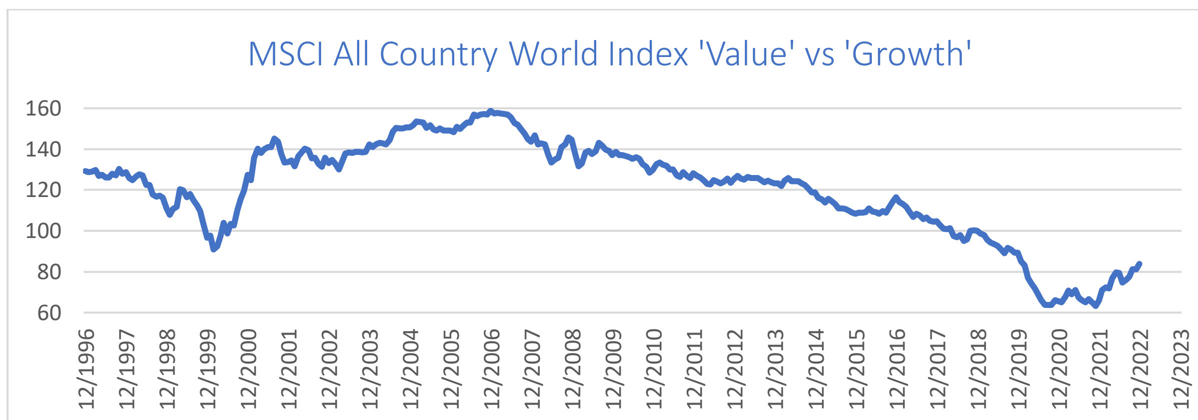

Source: Bloomberg 30/12/2022

Regular readers will recognise that an analysis of our current portfolio holdings would characterise the fund as highly cyclical and heavily 'value' orientated, and given the developments noted above, it is perhaps not surprising that we have seen a material pick up in performance over the last several months. Whilst obviously welcome, we are struck once again by the difficulties in 'timing' markets. After all, with everything that has been thrown at the economic outlook over the last 6 months, how many would have predicted a strong performance from such a cyclically exposed portfolio?

As a reminder, our approach is to invest in companies that we believe have strong franchises and management teams and, for whatever reason, are currently offering excellent value from a medium-term perspective. Then we patiently wait. We are confident in our ability to identify such opportunities, and considerably less confident predicting when that value will be realised. Often, perhaps as this recent period shows, it can be when it is least expected. Such is the way of markets.

Simon Murphy, Fund Manager, VT Tyndall Real Income Fund, January 16th 2023
Data source (unless otherwise stated): Bloomberg.

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