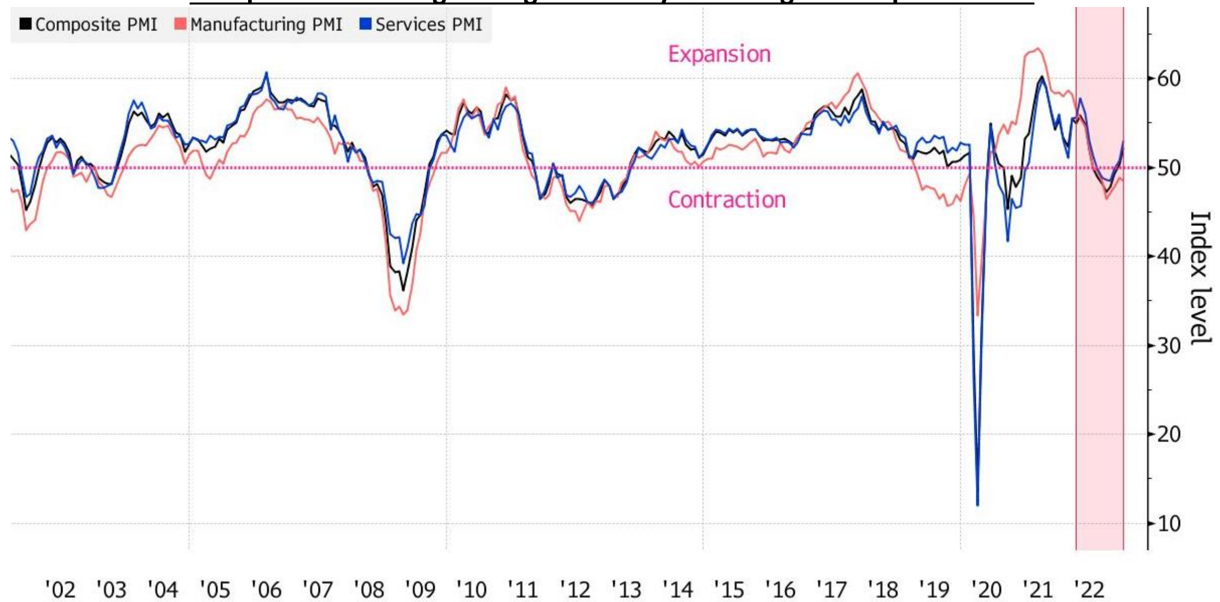
“The greater the obstacle, the more glory in overcoming it”. – Moliere

The 2023 rally that started the year off on a positive note continued into February before the data dependent US Federal Reserve that focusses less on the outlook and more on each backward-looking individual data point voiced its views to the investing world. Many of the demons of 2022 such as the war in Ukraine, central bank hawkish rhetoric and subsequent rising bond yields, and even a return of a strengthening dollar re-emerged during the month, despite a raft of more positive economic data.

In Europe the Purchasing Manager Index (PMI) data improved, and more encouraging the output and future output data for the region all turned into expansion levels, while at the same time the Business Climate Indicator for the region halted its decline and turned upwards. Consumer Confidence had been at all-time lows in September with a percentage balance of those surveyed reading of -28.7%, however this has improved for the fifth month in succession and now stands at -19%; at the depths of the Financial Crisis the survey only fell to -22.5%.

European Purchasing Manager’s Surveys show signs of improvement.



Source: Bloomberg

Further East, in China, life is returning to normal, and even Hong-Kong, which has had one of the most stringent facemask requirements has almost dropped all of these rules. Underground passenger numbers in Beijing have surged close to pre-pandemic levels and in other areas such as Shenzhen, exceed these number. The latest PMI manufacturing data surpassed expectations, surging from 47 in December to 52.5 in February signalling that the Chinese economy is returning to life and growing at a better rate than most the Western world.

Shenzhen Metro Passenger Volume- 7-Day Average

Source: Bloomberg

Post the release of strong non-farm payroll numbers in the US and signs that personal consumption expenditure (PCE) is not falling as fast as the market had expected the Federal Reserve reiterated its determination to bring inflation down to close to the 2% target, and to use interest rates as the mechanism to do so. As a result, bond yields started to rise once again and the US dollar strengthened, while expectations of the timing of peak rates increased to over 5.25% and moved out to December this year. The ECB is also expected to maintain its hawkish stance as inflation remains stubbornly high in the region, despite gas prices falling to near the levels experienced prior to Russia's invasion of Ukraine; rates in Europe are now priced to peak at 4% in December.

As the chart below shows, markets have had a high inverse correlation to the direction of the US 10-year yield over the past 18 months, and this has continued as the hawkish rhetoric returned this month, and consequently markets became more volatile in the second half of the month.

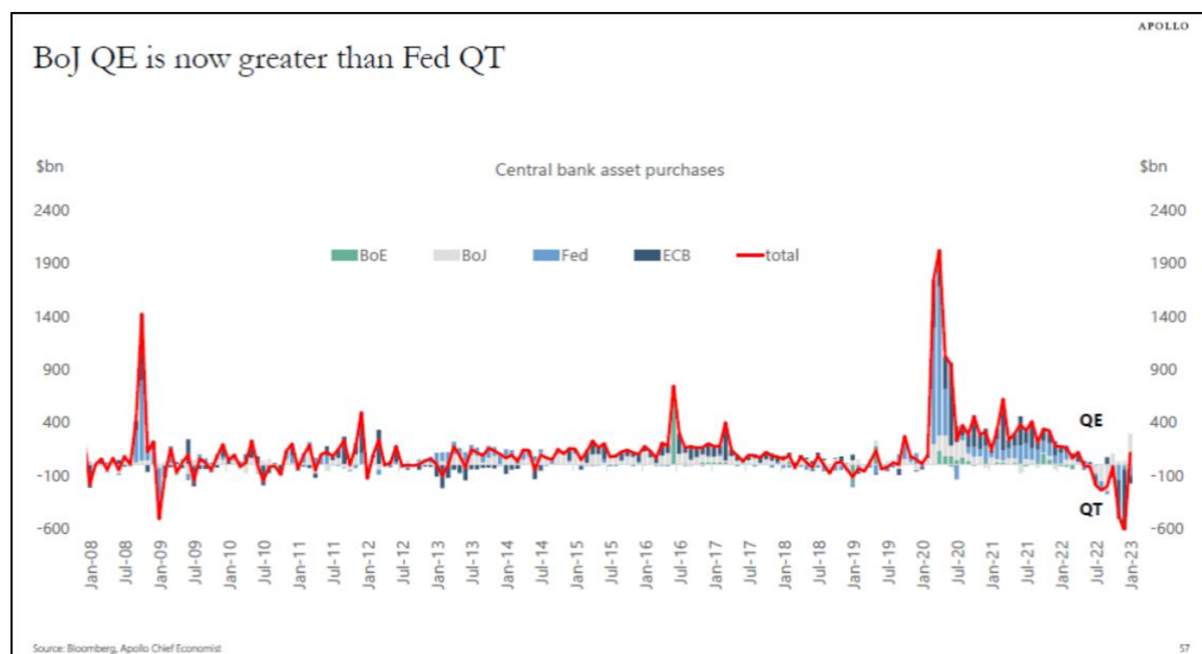
Why the direction of the US 10-Year matters

Source: Bloomberg

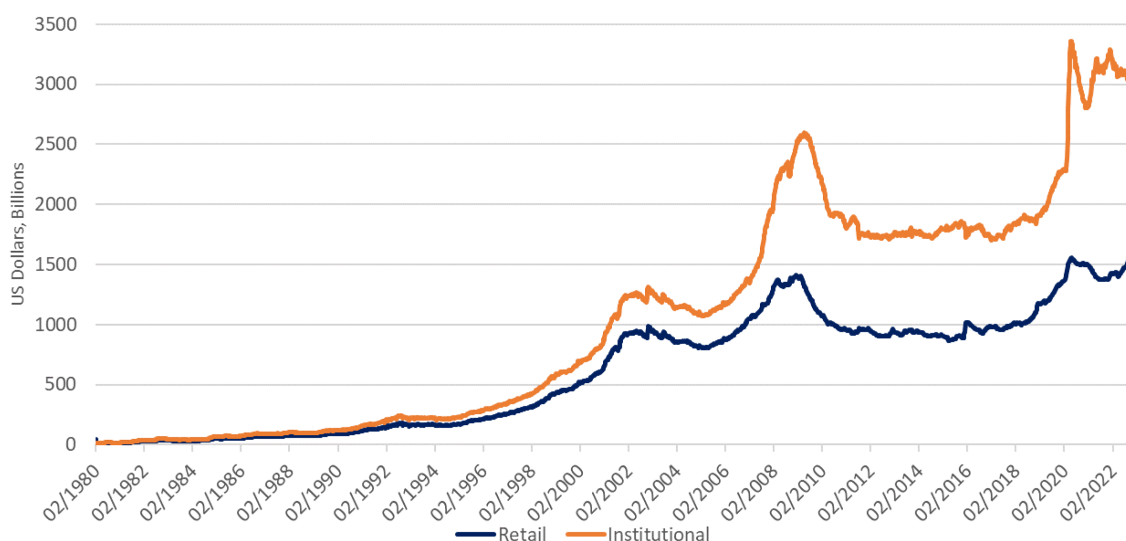
Value of investments can fall as well as rise and you may not get back the amount you have invested

As easy as it may be to be despondent about the impact of hawkish central bankers and their policy decisions, we expect that markets will start to take the prospect of rates being higher for longer in their stride, and long-term to them to normalise to levels experienced prior to the Financial Crisis, we do not expect rates to return to the abnormally low levels experienced in the past 10 years, despite how well the market might react to such an outcome.

One reason why we are more optimistic about the global equity markets is that despite the US conducting quantitative tightening and reducing the money supply, the liquidity coming from Japan and Asia is such that the net volume has actually turned positive again and markets normally respond well to increases in liquidity.



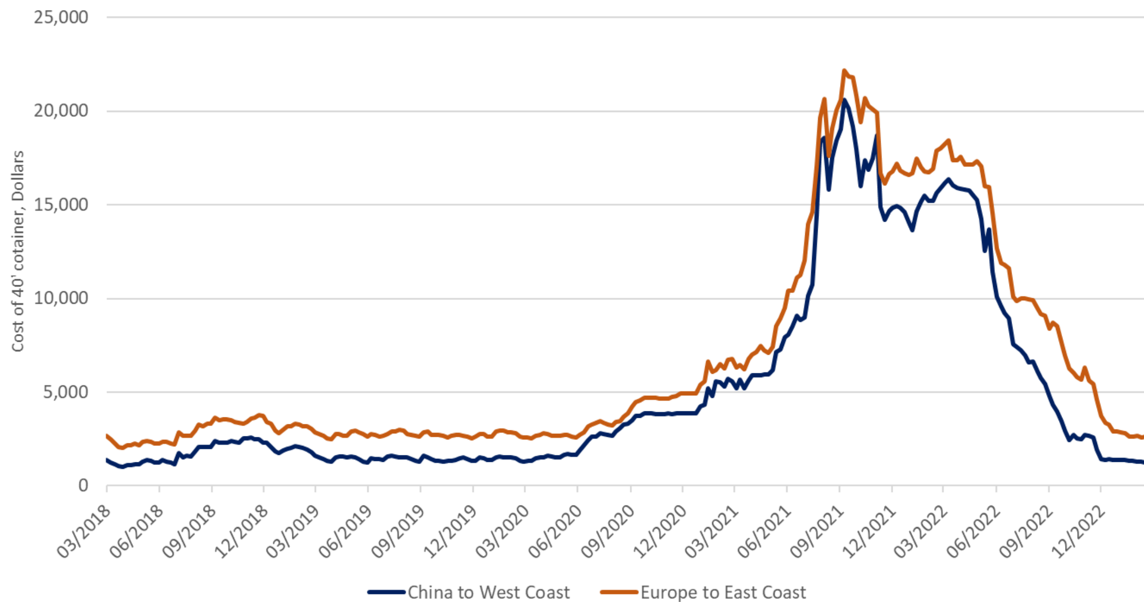
The significant increase in retail money market holdings suggest that there are substantial levels of capital that could be invested in equity markets once investor confidence returns. Interestingly, recent investor surveys and flow data has shown that retail investors are more optimistic on the outlook for markets than the investment management community, who are divided as to whether we are experiencing a bear market rally or the start of a new bull market.



Source: TIM/St Louis Federal Reserve/ICI/Bloomberg

Another positive data point is that the supply side backlogs that hampered sales last year have started to normalise, no longer are their scenes of ships at anchor of the west coast of the United States as the backlog has now fallen to zero, and even on the East Coast the number of ships waiting to unload has fallen from close to a hundred to 28; consequently, the costs of shipping goods to the US have also fallen significantly. Although the transportation costs on from the ports remains high, the reduction in shipping costs should help with corporate profitability and bring down inflation.

Freight costs to the US return to pre-pandemic levels.



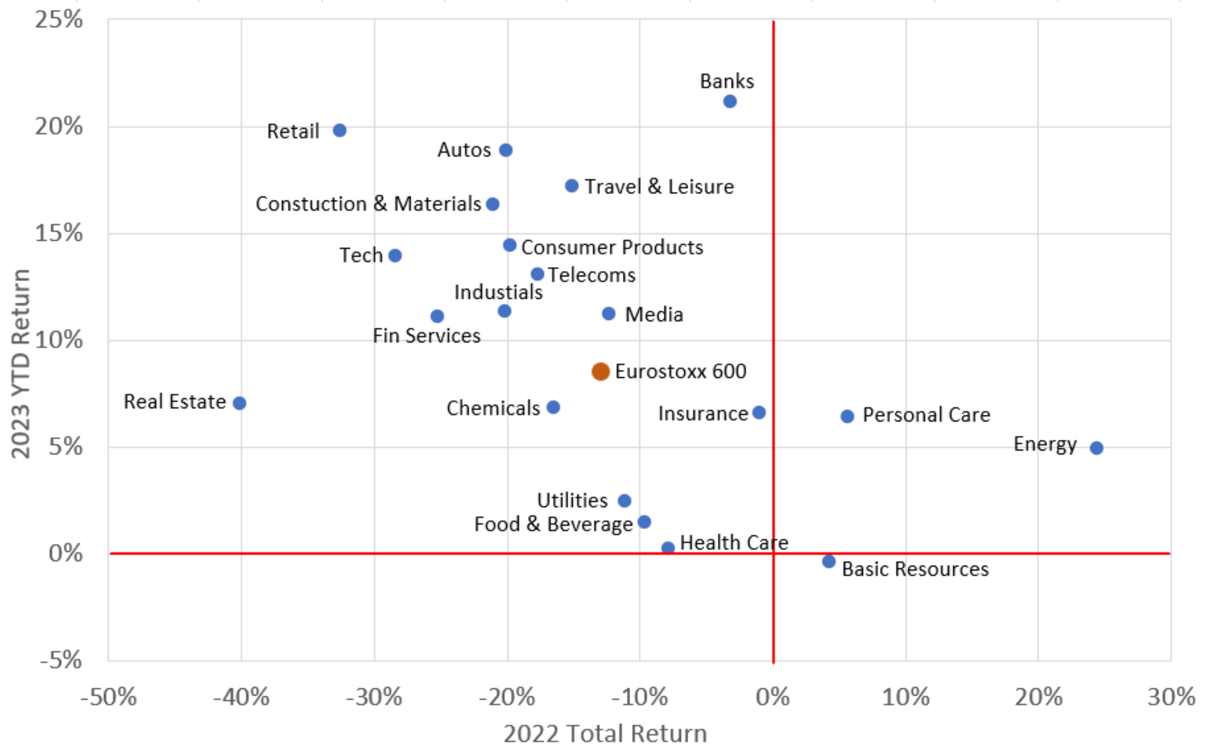
Source: TIM/Bloomberg

The VT Tyndall Global Select Fund B Acc (GBP) rose by 1.30%. The month started well with the rally in global equity markets continuing, however by mid-month, the year rally slowed down, and investors turned their attentions to interest rates and central bank policy in the later part of the month. The Fund has risen by 4.48% in the year-to-date.

Fund Activity and News

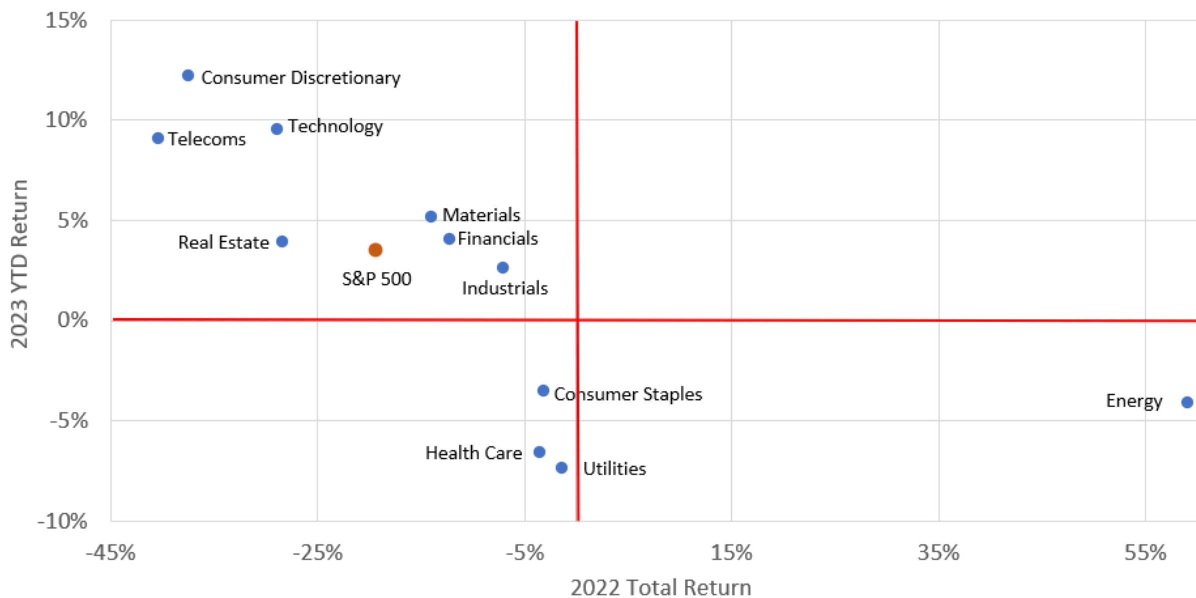
During the month we did not make any outright sales or purchases of new positions.

The performance of European (and UK) equities since the turn of the year has been dramatically different to the past decade, with demonstrably better performance than that of their US counterparts. Investor confidence has been at multi-generational lows prior to the reporting season, and expectations were also suitably depressed. With these conditions, even a slight comment on trading conditions being better than the market expected, share prices were likely to react positively. As the chart below shows, every subsector (in aggregate) within the region has posted positive returns so far this year, with the greatest performance coming from the more cyclical sectors.



Source: TIM/Bloomberg

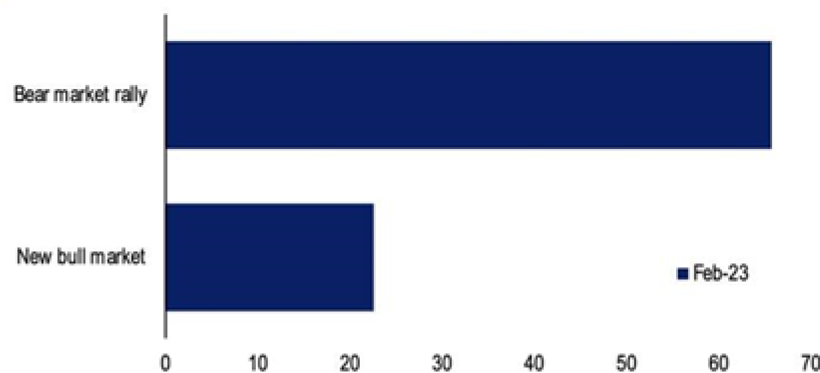
The dispersion of returns on the other side of the Atlantic is more diverse with an almost perfect negative correlation to 2022.



Source: TIM/Bloomberg

With all the commentary that abounds talking about an impending recession it is interesting to look at the underlying factors that have led to the rally so far this year as the outcome is that companies that display volatility, high percentage of international sales and high leverage have outperformed the most. The factors are normally found to outperform in the early stage of a bull market, and collapse during a recession suggesting that the latest Bank of America Global Fund Manager survey may be

wide of the mark, and investors are still overly cautious and have latent memories of being caught out by signs of a European recovery in the past only for their fingers to be burnt a few months later.



However, with the structural underweight position in the Europe and the UK that most investors have, and the level of investor cash positions, it may well prove that the rally in European equities has further to run, whether the region faces a recession or not. The Tyndall Global Select Fund has historically had a higher weighing in European equities than its peer group average and this remains so today, despite sector and regional weighing being an outcome from the underlying companies within the Fund, than an active decision or target.

By investing in quality companies that have a high percentage of recurring revenues and durable and strong cash flows that enable these companies to continue to invest through the cycle, we feel confident these companies should be able to weather the range of outcomes better than their wider peers and come out of any period of economic malaise stronger, capturing the lion's share of any growth.

Richard Scrope, Fund Manager, VT Global Select Fund, 28th February 2023
Data source (unless otherwise stated): Bloomberg.

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