Review

After the exciting start to 2023 that was January, markets felt more in consolidation mode during February. The UK equity market was no exception, although it did still make further progress, and the iShares UK Equity Index tracker gained +2.24% for the month.

Following a brief period in which markets seemed increasingly comfortable that inflation was firmly under control, a series of 'hotter' than expected datapoints, particularly in the USA, gave investors pause for thought during February. This, alongside scant evidence of a material economic slowdown yet, had investors reassessing the likely timing of any forthcoming recessionary period.

Expectations of the ultimate peak in US interest rates, the so-called 'Fed terminal rate,' pushed higher over the month from c. 4.9% to more like 5.4% currently, and this had an associated effect on government bond yields and the US dollar, both of which rebounded sharply during the month, in a reversal of January's moves.

Elsewhere, enthusiasm towards the impact of China fully reopening, post the end of 'zero Covid' restrictions, cooled somewhat in February. The situation was not helped by increasing geopolitical tensions, firstly over the shooting down of suspected Chinese 'spy balloons' over US territory, and then by further signals of China's continuing support for Russia over the war in Ukraine.

Ongoing mild weather kept energy prices under pressure in Europe during February, maintaining the hope of seeing the winter through without a dramatic price shock, whilst the corporate earnings season came to a relatively uneventful conclusion.

Finally, at the time of writing there appears to be the potential for a new deal between the UK and the EU over post-Brexit trade arrangements for Northern Ireland. As usual, the devil may well be in the detail, but any meaningful progress on this extremely thorny issue should be welcomed by UK investors in due course.

Fund performance / Activity

Whilst February could not quite match the extremely strong fund performance of January, it was nevertheless a solid month of further progress, and the portfolio gained +3.17% (share class A GBP Net Accumulation), comfortably outperforming both the peer group average gain of +1.94% and the iShares UK Equity Index tracker gain of +2.24%.

Significant outperformance came from a variety of our industrial, consumer discretionary and financial holdings such Rolls-Royce, Vistry, ITV, Hill & Smith, Dunelm, Standard Chartered and TP ICAP. Detractors included portfolio holdings DS Smith, NatWest, Prudential and PageGroup, although once again the biggest detractors were large index constituents that we do not own, such as HSBC, Shell, and AstraZeneca whose share prices performed well in the rising market.

February was a marginally more active month in terms of portfolio activity with one new addition, the sports betting and gaming group Entain, and no complete disposals. We added to several existing positions in companies such as PageGroup, Imperial Brands, EasyJet, Vistry, Wickes, Ashmore and DS Smith. These additions were funded via profit taking in holdings such as Burberry, Ashtead, Rolls-Royce, Dunelm, Howden Joinery and OSB Group.

Market Outlook

Post the vigorous market moves of recent months it was always likely that a period of 'consolidation' would be needed prior to any meaningful further progress, and to a degree that is very much what February has felt like. On the one hand, the still relatively strong economic and corporate datapoints are positive, but on the other hand, the subsequent increase in expectations for where interest rates may ultimately be headed could be seen as a material negative further down the road.

Whether the positive or negative interpretation will prove correct will, of course, only be known in the fullness of time. However, to repeat the point we made last month, our position has been, and remains, consistently on the side of the more optimistic rather than pessimistic viewpoint. This is primarily driven by the unusual, and much healthier, starting conditions for entering this period of economic turbulence, in terms of employment, consumer and corporate balance sheets and so on. Whilst we do not think we are necessarily out of the woods economically speaking, we do believe that the extreme bearishness that has been priced into many, particularly cyclical, areas of markets is simply too excessive.

We continue to expect a degree of volatility in markets 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 attractive prices, in any further bouts of market weakness.

Simon Murphy, Fund Manager, VT Tyndall Real Income Fund, March 1st 2023
Data source (unless otherwise stated): Bloomberg, FE Analytics

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