Review

May was a more turbulent month in equity markets, with a host of issues causing investors angst. The UK market was certainly not immune to these concerns, and the iShares UK Equity Index tracker fell -3.12% for the month.

Whilst fears over the health of the US banking system receded, they were swiftly replaced by serious concerns over a potentially catastrophic debt default by the US government, if Republicans and Democrats could not reach an agreement to raise the US ‘debt ceiling’ before the Treasury ran out of money in early June. Whilst negotiations went down to the wire it appears, at the time of writing, that an agreement has been reached, which will be voted through, and passed into law just in time.

Meanwhile, Artificial Intelligence (AI) has become the hottest investment topic in town, leading to a surge in performance from perceived winners from the adoption of AI (primarily the very large US technology stocks). Many ‘experts’ are proclaiming AI as the biggest development since the internet although, as was the case back then, identifying the ultimate winners (and losers) from such a nascent technological development, remains fraught with difficulty.

Elsewhere, economic data from China has continued to disappoint expectations of a vigorous post lockdown recovery, and that has had a meaningful impact on commodity prices, with significant weakness seen across the board. Expectations continue to build that the authorities will respond with further stimulus measures in due course although, to date, they have been notably lacking.

Finally, here in the UK, inflation data has been surprising negatively, with headline and core inflation numbers coming in higher than expected. This has led to expectations of further interest rate increases from the Bank of England, and subsequent increases in government bond yields and mortgage rates. Whilst domestic activity, including housing market related, has been holding up relatively well thus far, these will certainly not be welcome developments in the near-term.

Fund performance / Activity

Despite the more cyclical bias to our portfolio, we managed to relatively outperform in May’s falling market. Our fund fell -2.64% (share class A GBP Net Accumulation), modestly outperforming both the peer group average fall of -3.20% and the iShares UK Equity Index tracker fall of -3.12%.

There were several positive relative contributors to performance in May, including holdings such as Melrose, Intermediate Capital, Hill & Smith, Ashtead, and Vesuvius. Not owning some of the large index constituents, such as Shell, British American Tobacco and Unilever also proved beneficial as their share prices underperformed. Detractors to performance came from holdings such as ITV, TP ICAP, Wickes, Prudential, Ashmore, and Taylor Wimpey.

May was a quieter month in terms of portfolio activity, although we did introduce one new holding to the fund, Breedon Group, and we made one complete disposal of Keller Group. We also added modestly to Games Workshop, Weir, and MoneySuperMarket and took profits in Melrose, Rolls-Royce and Inchcape.

Market Outlook

With the 'debt ceiling' issue seemingly resolved for the immediate future, it appears that we are back to focussing on the 'traditional' factors such as interest rates, inflation, economic growth, and corporate profitability again, in determining the likely direction of travel for markets.

As has seemed to be the case for some time now, there are multiple cross currents to navigate in that regard. Economic activity, except for China perhaps, has held up well in recent months, and certainly better than most commentators expected. To what extent that remains the case, given the scale of monetary policy tightening we have witnessed over the last 12 months, remains to be seen.

Meanwhile, whilst it seems likely that one of the most aggressive interest rate hiking cycles in recent memory is at, or very close to, a peak, it does appear, certainly in the UK, that inflation is proving 'stickier' than might have been hoped. At the very least, that may well have important implications for the likely timetable for meaningful interest rate cuts in the future.

Regarding corporate profitability, that too has held up far better than most have expected, although there are early signs, primarily from US consumer facing stocks, that life is getting incrementally more difficult. We will, of course, be keeping a close eye on these developments, as well as trying to decipher the relevance of emerging uses for Artificial Intelligence, both positively and negatively.

As we have written numerous times recently, our default position has been, in the face of some of the most extreme pessimism we have experienced, to err on the side of a more optimistic take on prevailing economic and market conditions and we continue to hold that view today.

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, June 2nd 2023
Data source (unless otherwise stated): Bloomberg, FE Analytics

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