VT Tyndall Real Income Fund

Monthly Commentary | August 2023

TYNDALL

Review

After the strong equity market gains of July, August was a typically quieter summer month. With a 'consolidation' feel to it, the UK market declined modestly, and the iShares UK Equity Index tracker fell -2.00% for the month.

At the annual Jackson Hole economic symposium, the US Federal Reserve, alongside a variety of other central bank officials, were at great pains to stress that the fight against inflation is far from over. Thus, whilst we may well be nearing a peak in the interest rate hiking cycle across much of the western world, the official mantra remains very much 'higher for longer' for interest rates until the job is done, and inflation trends sustainably back towards the 2% region.

Whilst the talk certainly remains tough, the real-world data is starting to weaken more significantly, particularly with respect to widely followed purchasing manager indices (PMI's). Across much of the globe, manufacturing PMI's are now significantly below 50, indicative of a contraction in activity. These are rapidly being followed lower by service sector PMI's that have, until recently, been much more resilient. To what extent economic activity starts reflecting these weaker surveys remains to be seen, and it will be interesting to see whether central banks have their resolve tested in terms of keeping interest rates in restrictive territory in the face of slowing activity levels.

Elsewhere, China continues to announce new policy initiatives, seemingly daily, aimed at stimulating economic activity once more. To date, markets remain relatively underwhelmed by the scale of the efforts, although it is worth noting again that commodity markets, such as for iron ore and copper, are gaining some strength of late which is, perhaps, a sign that these stimulus measures will prove more meaningful than currently expected.

Here in the UK, inflation has continued to fall sharply, with the latest headline annual figure coming in at 6.8% for July, down from 7.9% in June, due largely to a significant drop in energy prices over the past year. Whilst clearly welcome news, core inflation remained stable at 6.9% and service sector inflation actually rose from 7.2% to 7.4%. These high underlying inflation rates, alongside wages growing at 8.2% year on year in the 3 months to June, continue to make life difficult for the Bank of England and those trying to predict the future path of UK interest rates.

Fund performance / Activity

Following an excellent performance in July, August was a solid month in terms of relative performance. Whilst the portfolio fell -1.73% (share class A GBP Net Accumulation), it held up better than the iShares UK Equity Index tracker, which fell -2.00%, and performed in line with the peer group average, which also fell -1.73%.

There were a variety of relative contributors to performance in August, including holdings such as Hill & Smith, Rolls-Royce, TP Icap, Wickes, and DS Smith. Not owning HSBC and AstraZeneca also proved beneficial as their share prices underperformed. Detractors to performance were equally varied and included Entain, MoneySuperMarket, EasyJet, Bodycote, and Inchcape.

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.

August was a busier month in terms of portfolio activity, with 2 complete disposals of Melrose and NatWest. Melrose has been an outstanding performer for the fund, and we have taken the opportunity to recycle the capital into a new industrial holding, RS Group. We also added to a variety of holdings including EasyJet, WH Smith, Inchcape and MoneySuperMarket. We took profits in Hill & Smith, Rolls-Royce, Standard Chartered and Ashtead.

Market Outlook

As seems to have been the case a lot recently, we do not have much new to add in terms of market outlook this month. Inflation continues to come down in much of the western world, but remains at elevated levels relative to recent history. Meanwhile, economic activity, as noted above, is showing signs of a potentially material slowdown, which presumably will help further alleviate stubborn inflationary pressures.

Given the pace and extent of interest rate increases in the US, UK, and Europe over the past year, it is likely that there are still significant lagged effects to work through economies and, given the backdrop noted above, those lagged effects may well be sufficient to justify an end to the rate hiking campaign sooner rather than later, even if interest rate cuts remain a more distant prospect.

Meanwhile, reasons for optimism surrounding the economic trajectory from here are not hard to find. Corporate and consumer balance sheets remain relatively healthy, unemployment is still very low by historical standards, wage growth is still robust and energy prices alongside other 'cost of living' prices are gradually coming down. Throw in resilient corporate earnings and a potential reacceleration of activity in China, the worlds second largest economy, and the infamous 'soft landing' does not seem like a particularly outlandish call to make.

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, September 1st 2023
Data source (unless otherwise stated): Bloomberg, FE Analytics

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