VT Lyndon Fund

Quarterly Commentary 29th September 2023

ContraCapital

Most global equity markets drifted lower during the third quarter, with the MSCI World, S&P 500, Stoxx Europe and MSCI Emerging Market indices all down between -2% and -4% (in local currency). The U.K. equity market performed a little better, with the benchmark index slightly up, buoyed by its large exposure to the rallying Oil & Gas sector. Within the U.K. market, large cap stocks once again outperformed their smaller brethren, with this continuing a trend that has now been firmly established for over two years. This large cap outperformance is highly notable both in terms of its duration and, even more so, its quantum. Over the last thirty plus years the only similar period was the late 1990s when the TMT bubble was approaching its apogee. Perhaps slightly forgotten now, but as well as being obsessed with the TMT sectors, investors had also come to fetishize bigness for bigness' sake, with the seeming success of Jack Welch's 'go big or go home' strategy at General Electric somewhat influential in this regard. Then, as now, smaller stocks got left behind, before subsequently going on to hugely outperform their larger peers. For now at least, the relative ascendancy of the biggest stocks remains an unhelpful backdrop for Fund performance, albeit a positive return of +3.4% was eked out for the quarter, making it +15.8% for the year to the end of September (figures cited are for B Accumulation shares).

Rather than equities, the real action this year and last has been in the more typically soporific fixed income markets, with interest rates rising in a way not seen in several decades. Since the beginning of last year, U.K. base rates have been raised 13 times, from 0.25% to 5.25%, whilst U.K. 10 year gilt yields have risen from 0.90% to 4.60%, having been as low as 0.08% in 2020.

Source: S&P CIQ

The market wisdom is that central bankers tend to hike interest rates until something 'breaks', with the surprise being that, as of yet, nothing more substantial than a handful of moderately sized U.S. regional banks has broken. Last year the rather more systemically important U.K. defined benefit pension scheme system also, of course, had a rates-related scare, but this was much more to do with weapons grade political ineptitude than excessively aggressive Bank of England action.

What we do know is that interest rate moves of such magnitude have historically prefigured recessions, but we are still waiting on the recession that everyone (us included) was expecting. The lesson of the 2010s could be that interest rates are not so powerful an influence on economic growth as widely imagined, as despite rock-bottom rates, growth in most of the western world, especially the U.K., was paltry. Other explanations for the U.K.'s utterly dismal growth rate are available, however.

One thing that interest rates clearly do affect is asset markets, not least that for residential property. The U.K. housing market is estimated (by Savills, an estate agent) to be worth c. £9tn, which is equivalent to c. 350% of GDP, making it comfortably the U.K.'s largest asset market. Higher interest rates have already significantly slowed the U.K. housing market, with transactions falling and prices softening. A significant adjustment is likely underway and, in some areas, notably London, one has arguably already occurred.

The impact of higher interest rates on equities is less clearcut than that on property markets, or at the very least it is a more complex relationship. But with government bonds now offering c. 5% (and corporate debt more), the TINA (There Is No Alternative) era of equities is over.

(Source for equity returns and index movements is S&P CapitalIQ and are quoted in local currency unless otherwise noted).

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