

Evenlode Global Investment View

June 2022 – Market swings



The Evenlode team have recently been on a research trip to the US, and we will be sharing an investment view on some of the findings in the near future. Analysing companies is where we are most comfortable, and the trip provided an update and insight across a range of industries. Given market activity in June we thought we would write a short summary of the situation and our view, before sharing some of the findings from our company-specific research. Global markets have been weak in 2022, almost no matter what sort of asset is being examined. Our focus is on equities, but a quick detour is warranted to set the scene.

A decades-long bull market in fixed income has had an abrupt about-turn, and a savage decline in the price of the more-recently-invented instruments of cryptocurrency has been in the news. The much-cited reason is inflation and the response of central banks to try and put the inflationary genie back in the bottle.

Central banks have raised interest rates, and this has had a direct impact on fixed income/bonds, where ultra-low interest rates and quantitative easing had pushed bond yields to extremely low levels, and the opposite is now in train. Rising yields means falling prices and this year has seen steep declines for bonds. According to FTSE indices, eurozone government bonds have provided a total return of -14% to date in 2022 in local currency termsⁱ, US government bondsⁱⁱ -11% and UK government bondsⁱⁱⁱ -19%.

Currency markets have also been volatile, fuelled by different levels of interest rate moves internationally. The US Federal Reserve's 0.75% rate increase in June was higher than those of the European Central Bank and Bank of England which has helped the dollar to be strong relative to the euro and sterling. The Bank of Japan has been more dovish, and the yen has been correspondingly weak.

Despite the upward moves in base interest rates, they still lag way behind inflation. The Bank of England's 1.25% base rate is dwarfed by the latest 9.1% rate of inflation in the UK as measured by the CPI index. The Bank themselves expect inflation to rise further to 11% as reported by the FT^{iv}. That there is such a differential might imply that central banking authorities expect inflation to then decrease ('transitory' in the much-mocked central bank lingo), or that higher interest rates could have undesirable side effects such as curbing demand whilst the world recovers from covid. Whatever the reason, the current gap between the interest rates being received by savers and investors, and the rate of loss of purchasing power, is clear.

Inflation is in part being caused by the continuing war in Ukraine impacting the price of agricultural commodities and energy. A further contribution to upward price pressure comes from the ongoing supply chain difficulties resulting from the coronavirus pandemic. These disruptions continue despite increased consumer optimism from a perceived return to normality in the UK, Europe and the US. That psychology is playing its part, as demand for goods and services rebounds with lockdowns eased but colliding with lockdown-induced supply challenges.

This brings us to equities. Global business is at the sharp end of managing the supply and demand dynamics. Some companies in the Evenlode Global Income portfolio have reported challenges in getting components to finish goods and ship them to customers. This has typically been in electronic

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components and semiconductors, but not exclusively, and in some cases, it is more a question of paying up and/or in advance to secure supply. The challenges have thus variously impacted revenue growth, cash flows, and profitability/margins.

Not all of the challenges are on the supply side; pandemic ‘winners’ such as technology companies facilitating at-home entertainment and shopping have seen their share prices come back to Earth with a bump as future growth expectations for their products and services have been tempered. This effect has been greatest for those technology companies that produced little current cash flow, hinting that questions of valuation are behind some of the share price moves we have seen. The MSCI World Index is down -12.5% in sterling terms^v, and the technology sub-sector^{vi} is down -22.2%. In US dollars the figures look starker, down -20.6% and -29.4% respectively. The Evenlode Global Income fund is down -12.5% in sterling terms and -20.7% in dollars^{vii}, in line with the MSCI World Index which is our comparator benchmark. Whilst avoiding the worst of the technology drawdown has been a benefit for the fund, and its holdings in consumer goods relatively resilient, a lack of exposure to energy-related and financial businesses has been a drag on relative performance.

The question of equity valuations brings together a lot of the themes discussed thus far. Low interest rates and unattractive prospective returns on alternative assets have been cited as a reason for what appeared to be high valuations on equities in general, and on some technology companies in particular. Another reason cited is idle pandemic stimulus cash being put to work by bored punters. There is probably some truth in these rationalisations, but we don’t speculate on the reasons, or the path of equity markets, interest rates or anything else when it comes to investment decision making. However, we can estimate and observe corporate and market valuations. Regular readers will know that we have been active in managing valuation risk within the portfolio in the last couple of years, in response to the rising market environment.

So where does the recent market downturn leave us? In short, in a more comfortable position valuation-wise. Some companies that have historically looked on the expensive side to us are now looking more interesting. The portfolio had got down to its lowest number of individual companies held, at 33, and if the current market environment persists, we expect that will increase, reflecting the broader opportunity set.

There are real-world challenges that the companies in the portfolio and in our wider investable universe are dealing with. We don’t diminish how much hard work it will take to meet them and acknowledge that there will be an impact on the financial performance of companies across most of the portfolio in one way or another. Those challenges have, however, caused the pendulum of valuation to swing in a more positive direction. We see a broadening opportunity to invest in market-leading businesses trading at good prices in the equity market. If one’s investment horizon is measured in months, it could be a volatile time to come, but if we lift our eyes and focus a bit further away then things look better. As investment opportunities go equities represent an increasingly attractive starting point for those with a horizon measured in years and decades.

Ben, Chris, Bethan, Rob and the Evenlode team
22 June 2022

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For full information on fund risks and costs and charges, please refer to the Key Investor Information Documents, Annual & Interim Reports and the Prospectus, which are available on the Evenlode Investment Management website (<https://evenlodeinvestment.com>). Recent performance information is also shown on factsheets, also available on the website.

Past performance is not a guide to future returns. The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested. Fund performance figures are shown inclusive of reinvested income and net of the ongoing charges and portfolio transaction costs unless otherwise stated. The figures do not reflect any entry charge paid by individual investors.

Current forecasts provided for transparency purposes, are subject to change and are not guaranteed.

Source: Evenlode Investment Management Limited, authorised and regulated by the Financial Conduct Authority, No. 767844.

ⁱ FTSE Eurozone Government Bond Index 31/12/21 – 21/06/22. Source: FactSet

ⁱⁱ FTSE US Government Bond Index 31/12/21 – 21/06/22. Source: FactSet

ⁱⁱⁱ FTSE UK Government Bond Index 31/12/21 – 21/06/22. Source: FactSet

^{iv} FT.com UK inflation hits 9.1% as food prices jump 22/06/22

^v MSCI World Index 31/12/21 – 21/06/22. Source: FE Analytics

^{vi} MSCI World Information Technology Index 31/12/21 – 21/06/22. Source: FE Analytics

^{vii} TB Evenlode Global Income B Acc GBP units 31/12/21 – 21/06/22. Source: FE Analytics