Tellsons
INVESTORS LLP

EF Tellsons Endeavour Fund Q1 2022 Commentary

growth with income & downside protection

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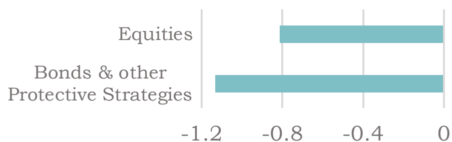
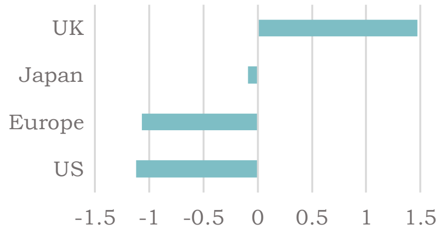
MARKET BACKDROP: The first quarter of the year got off to a similar start to 2021 with inflation and rising interest rates taking centre stage. In the US, the Federal Reserve put markets on notice that interest rates would rise to dampen the historically high prices that followed the pandemic shock and which were likely to be more persistent than anticipated. The central bank further emphasised that the increasingly tight labour market could encourage higher wages and fuel that inflation further. Higher interest rate expectations meant lower prices for bonds and significant losses in the period; expensive growth investments were aggressively discounted too. The areas of markets that do well with higher interest rates and inflation, such as energy and materials, and to a lesser extent banks, performed well initially. This was all before Russia invaded Ukraine, shocking the world with its brutality and upending the post WWII geo-political order. Nevertheless, by the end of the period both equity and bond markets had returned to their levels prior to the invasion.

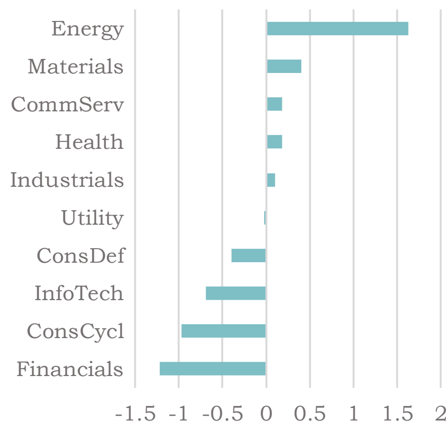
FUND PERFORMANCE: The Fund delivered a total return loss of -2.2% for the quarter compared to the benchmark which delivered -0.2% (comprising 50% of Consumer Price Inflation rolling five-year average and 50% of the FTSE Actuaries UK Conventional Gilts index up to five years). The peer group IA Mixed Investments 20-60 Sector returned a -3.3% loss in the period. The strongest sectors in the Fund were Energy and Materials (ex precious metals), contributing 1.9%. Detractors were led by Financials and Consumer Discretionary sectors, detracting 2.1%. Equities ended the quarter registering only a small loss of 0.8%. Bonds detracted -2.0% roughly equally between shorter-dated corporate bond investments and longer-dated US Treasuries. Bond losses were partially offset by other investments within Protective Strategies making gains of 0.8%, including precious metals mining companies that rose 16% on the modestly higher gold price, currency exposure to the US Dollar and Swiss Franc, and interest rate hedging. Reflecting the realities of widening economic growth differentials and likely changed patterns of global trade longer-term, your managers reduced some exposure to Europe in favour of the US. During the period, investments were added to Charles Schwab, Marathon Oil and Newmont, whilst BNP Paribas was sold and investments in BMW, Taylor Wimpey, and Lloyds were reduced. The managers also initiated investments into resources companies Norsk Hydro (aluminium), Freeport-McMoRan (copper) and Caterpillar (capital equipment), together with a more defensive reinvestment into National Grid in the UK after two years' absence and addition to Iberdrola, the Spanish renewables utility.

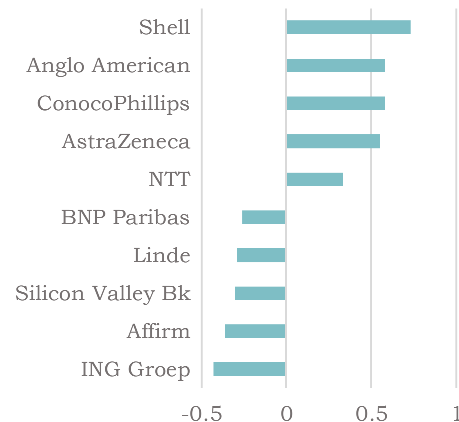
OUTLOOK: The war in Ukraine seems likely to continue as Western allies can only help Ukraine defend itself to avoid escalation of the war. With or without peace, supply blockages and high prices for critical resources undermine the prospects for European growth. The US is less dependent on external resource markets and as such, its economy has better prospects for continued economic expansion: corporate balance sheets are strong, household cash positions are still high and borrowing is low. There are also plenty of underemployed people facing higher living costs who may be tempted back into the workforce by higher wages. Three main scenarios present themselves to your Fund's managers: should inflation remain much above the US central bank's target in the medium-term, with or without an ongoing business cycle, almost half of Fund equities are invested in inflation sensitive sectors, which should continue to perform well as a hedge to those inflation risks; if the business cycle does continue, especially in the US, then the remainder of Fund equity investments should enjoy continued profitability from cost leadership and pricing power across many industry sectors; and if high inflation and interest rate hikes bring the cycle to an untimely end, just over half of the Fund is invested in defensive equity sectors and bonds, yielding c.3% combined, and will afford a steadier transition to that slowing growth environment. Such diversification seems to your managers to be both prudent and practical for this range of possible outcomes as central banks normalise the truly unprecedented policy support in the aftermath of the pandemic and, still flowing through the system, since the financial crisis of over a decade ago.

QUARTERLY RETURN CONTRIBUTION %









Quarterly Return Contribution: Local currency, gross of fees/costs. Materials sector excludes Precious Metals investments as they are included in Protective Strategies.