VT WOODHILL UK EQUITY STRATEGIC FUND
Managed by Woodhill Asset Management LLP

NEWSLETTER AUGUST 2021

Bloomberg ID: VTWARNI LN **SEDOL: BMTRT64** **ISIN: GB00BMTRT641**

Fund value at midday 31st August was 79.4816

Assets under management: £24.8m

	Sep-20 *	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21 *	Apr-21	May-21	Jun-21	Jul-21	Aug-21
Total Return	-2.43% *	-0.48%	7.38%	-1.09%	1.45%	0.78%	1.13% *	-0.17%	0.77%	0.62%	1.99%	0.01%

***Inc. Distributed Dividend**

VT WoodHill UK Equity Strategy Fund, dividends re-invested (UK p)

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

Source: Morningstar

After a good run of positive outperformance, we had a quiet August with the fund up very slightly. We had remained hedged[1] for much of August based on a mix of high valuation, over extended markets, and a concern that, after months of above target inflation, that central banks may finally start to act. However, towards the end of the month we did take off the hedge for a few reasons. The extreme overbought nature of equities moderated slightly as did sentiment. Also, and probably most importantly, the economic data that we watch was clearly showing a slowdown in activity across the world. This was most notable in China and in the US. Regarding the US, where timely data availability is good, it is now clear that the economy has been seriously losing momentum since the end of March. This made us believe that central banks may pause in their promised tightening plans.

Whatever happens with inflation it now seems to be clear that central banks are mainly paying attention to economic momentum and employment. In this regard if economies keep losing momentum the date of central bank tightening is likely to be delayed. Overall, for a while at least, this environment, a type of *dark Goldilocks*, is likely to be supportive for equities.

The lack of economic momentum around the world is itself interesting. It is possible that some bottlenecks and the delta COVID variant have had an effect, but even allowing for this, the loss of momentum is curious. Governments are spending huge amounts of money and central banks have provided entirely unprecedented levels of stimulus. Despite these policies, following an initial bounce back, economies have struggled to keep moving.

1 From time to time, the fund uses FTSE 100 equity futures to protect the value of the fund. When the hedge is applied, net equity exposure is reduced, and the capital should be largely protected.

It feels to us that the Western world (and perhaps China) are starting to follow Japan of the 1980s. After the Japanese asset bubble of the late 1980s collapsed, the economy struggled to ever get going, even after relentless and large amounts of government and central bank support. For Japanese equites, despite very low interest rates, the following decade was very poor with the market experiencing a major derating. From our perspective this is now a real possibility for Western stock markets. The amount of debt in the system is very substantial, and if economies are not especially strong, then this debt will act as a drag on performance. Debt pulls future consumption into the present and an awful lot of future spending has been compressed into the last decade or so.

Another reason to consider a Japanese 1980s type of future is valuation. Equity markets (especially in the US) are more expensive than they have been at any time other than in the last moments of the dot com bubble. Any long-term historic analysis of valuation and performance suggests that a tricky decade is likely for equity markets. For Japanese investors, very low interest rates along with large government spending programs did not help once the collapse had arrived. Finally, the demographic (aging) aspect of China and the West look like that seen in Japan in the 1980s.

While the outlook described above is probably not at all positive on a medium-term perspective it is interesting to ask where we are today if the West is indeed shifting to a Japanese type of environment. Going back to the discussion about the world economy losing momentum and regarding central banks staying on hold, it is possible that such an environment could produce a final bubble peak. If investors start to believe that central banks are never going to enact a substantial tightening program, then this could be a situation in which valuations rise to levels even above that seen in early 2000.

It is not irrational to believe that after decades of debt build up that interest rate normalisation is now impossible. The chart of the US stock market is following an eerily similar pattern to the Japanese stock market in the final run up to the top of the Japanese bubble. Once the bubble burst Japanese equities fell by 80% between 1989 and 2009 (Japanese equities are still trading below the peaks seen in the late 80s). A true and final bubble could be forming in the West and the more it builds the worse the ultimate performance will be. The exact timing of bubble peaks and the cause of their collapse are mysterious. Events in the real economy are largely irrelevant in such circumstances.

Finally, the events in Afghanistan mark not only the failure of a long-term Western policy but also say something about emerging markets. Following the end of the Soviet Union a great enthusiasm swept the world for emerging stock markets. Communism was over, free markets were in the ascendency and emerging markets had the potential to do a great deal of catching up. From where we are now, thirty years after the fall of the Berlin Wall, it can only be said that in many cases this optimism was misplaced. Many emerging markets have lurched from crisis to crisis and Afghanistan, as well as many other poorer countries, have not been transformed into a thriving Western-style economies.

While Afghanistan is an extreme example it is also the case that many emerging market countries have disappointed expectations. Even China, the poster child for successful development now appears to be turning away from a liberal economic model. It is becoming more and more clear that the Chinese authorities are now acting to try and iron out some of the" excesses" of liberal economics. China appears to be trying to act to benefit those who have been left behind and is doing so at the cost of investors. This is a very different environment to what the world has seen in the last decade or so. More and more it appears that so many of the old certainties have shifted and that we have entered a world that is different to that seen by almost any investor working today.

As always, we will do all we can to navigate the currently strange environment but will also to proceed with a positive mindset and armed with caution.

TOP FIFTEEN EQUITY HOLDINGS 31st AUGUST 2021

AstraZeneca	5.5%
Diageo	4.0%
BP	4.0%
HSBC	3.9%
Royal Dutch Shell 'A'	3.9%
Rio Tinto	3.8%
BHP Group	2.8%
BATS	2.7%
Ferguson	2.6%
National Grid	2.4%
Prudential	2.3%
Relx	2.3%
Unilever	2.3%
Compass Group	2.1%
Lloyds bank	2.0%

Fund manager: Paul Wood

3rd September 2021

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