Woodhill

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

NEWSLETTER FEBRUARY 2021

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

Fund value at midday 26th February was 77.5136

Assets under management: £24.1m

	Mar-20 *	Apr-20	May-20	Jun-20	Jul-20	Aug-20	Sep-20 *	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21
Total Return	-12.36% *	0.68%	-0.48%	-0.51%	0.36%	-0.25%	-2.43% *	-0.48%	7.38%	-1.09%	1.45%	0.78%

*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

The fund spent all of February fully hedged[1]. Despite this our underlying portfolio performed well meaning that we were up 0.8% on the month which compares to the UK stock market that rose by just a little more than that. As a result, so far this year we are up 2.2% versus the market which is up 0.6%.

We remained hedged in February for a few reasons. In our view, markets remain expensive on any long-term measure of value, and, at the same time equity markets felt overbought. In addition, there were many signs of speculative excess, especially in the US. The levels of speculation in all sorts of marginal assets, along with the heavy participation of retail investors, is most usually a sign of heated end-of-cycle activity, much like the feeling of the year 2000. However, what is different today is that most commentators believe we are at the start of a new cycle rather than near its end. It is certainly true that short term interest rates had been rising for some time before the 2000 top and this is not the case now.

Making sense of this curious situation is not especially easy. Usually after a crisis it takes years for valuations to rise back to their pre-crisis levels. Valuations today are now higher than they were before the crisis started and are the highest outside the late-1990s early-2000 tech bubble. Post the 2008/9 financial crisis it took nearly four years for pre-crisis levels of valuation to be re-established, this time it took less than a year.

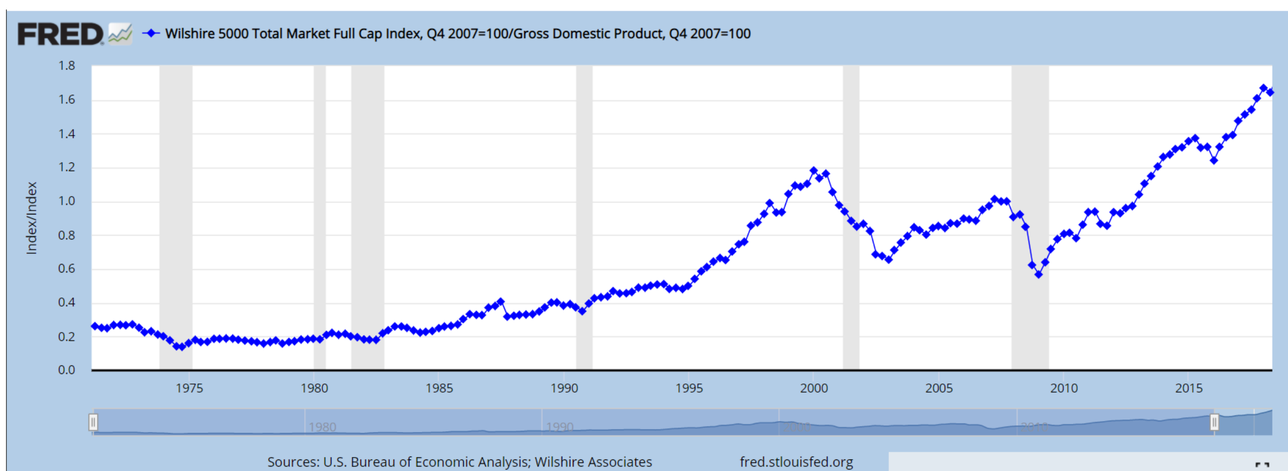
It seems that the clearest explanation for this sudden snap back is the huge liquidity actions taken by the world's central banks. It appears that a large divergence has opened up between economies and their financial markets. This we suspect explains the curious late-cycle feeling that markets have at the moment. In the real economy we may well be near the start of a new cycle. However, regarding liquidity and central banking, we

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.

may be at the end of a cycle of ever-increasing activity that has been going on for decades. It is even possible that the recovering economy may put an end to the ever-increasing liquidity wave.

Ever since central banks started to become highly active the performance of equity markets has been more and more driven by central bank activity and less by underlying economic realities. We believe this trend started to really get going in the late 1990s following central bank liquidity responses to the Russian and LTCM crisis. Ever since then, equity markets have been characterised by strong liquidity driven booms and consequent collapses which are then met with more liquidity and another run up. Interestingly, at least with the UK stock market, the performance of the UK market during this age of central bank super activity has been both highly volatile and poor. Excluding dividends, the UK market is still actually down compared to its year 2000 peak levels.

An indicator we have not discussed before is Mr. Warren Buffets' favourite stock market indicator. This is the simple relationship between the size of the US economy and the size (value) of all US equities. On this basis equities are substantially more expensive than they were even in 2000 and more expensive than they have been since the data series started in 1970 (St Louis Fed).



There are of course lots of ways that this indicator could be criticized. It does not take account of interest rates nor the huge Nasdaq growth names. However, the purpose of showing the chart is not to make a point about valuation but rather, from our perspective, this chart indicates how, in the era of 'super' central banking, financial markets have become a hugely different thing to the underlying economy and company earnings. The more QE central banks have done the more markets and the economy have, it seems, become different things. QE has acted to propel markets upwards but has less effect on the real economy.

From where we are now there is a possibility that something different may be close at hand. The US stimulus package currently making its way through Congress and the Senate is something quite new. If passed in its current form it will put actual money into the hands of individuals. It then has a good chance of being spent and influencing demand and inflation.

In conclusion, the current stimulus package could have the effect of benefitting the economy at the expense of markets. QE has produced inflation in some financial assets but not the wider economy. The current fiscal plans may well produce inflation in the real economy. If the economy does well markets may have to pay a price for this. Higher long term interest rates, even if they are just at the long end of the curve, will affect market valuation levels. It is also worth pointing out that the best predictor of shorter-term interest rates is what is happening at the long end of the interest rate curve. If inflation does emerge, and if long-term interest rates continue to rise, either central banks will have to put up short-term rates more quickly than is currently expected or they may suddenly appear to be 'behind the curve'. At some point the divergence that has opened between economies and markets might close and at the very least this is likely to be a turbulent affair.

As a final word it is also notable that with the UK budget coming up that the fiscal cost of the pandemic may soon have to be addressed. Tax increases of some sorts are likely, and the upcoming budget may only be the start of fiscal tightening. This is something that is likely to be a global phenomenon. Something similar appears to be on the way in the US and HK has already increased the cost of trading to raise revenues.

From where we are now markets are, on a very short-term perspective, a little less overbought than they were and there may well be some shorter-term opportunities ahead. However, given the background described in this note, we will proceed carefully and as always would like to thank everyone for their support.

TOP FIFTEEN EQUITY HOLDINGS 26TH FEBRUARY 2021

AstraZeneca	4.6%
Rio Tinto	4.5%
HSBC	4.5%
BP	4.0%
Royal Dutch Shell 'A'	4.0%
Diageo	3.4%
BHP Group	2.9%
BATS	2.6%
Prudential	2.3%
Unilever	2.2%
Ferguson	2.2%
Compass Group	2.1%
National Grid	2.1%
Reckitt Benckiser	1.9%
Relx	1.8%

Fund manager: Paul Wood

4th March 2021

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