Woodhill

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

NEWSLETTER MARCH 2023

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

Fund value at midday 31st March was 79.953

Assets under management: £24.8m

	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23	Mar-23
Total Return	1.07%	-1.40%	-0.50%	-0.44%	0.58%	0.29% *	0.34%	0.67%	0.16%	1.15%	0.34%	1.41% *

*Inc. Distributed Dividend

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

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

Source: VTIM

In March our fund was up 1.4% (pre the fund going ex-dividend). This compared to the overall UK stock market which fell 3.1% during the month. So far this year we have had no down months with a positive return in January, February, and March. As well as our performance being ahead of the market in March it has also been ahead of the UK equity stock market so far in 2023.

We have spent most of this year hedged[1]. We have occasionally taken the hedge off, allowing us to benefit from oversold or over pessimistic conditions, but we have not done this for long. Given that we have only been exposed to the market very rarely so far in 2023 our performance is especially good from a risk reward perspective. This is something we hope to continue.

As the drama at Silicon Valley Bank (SVB) progressed we were anxious that the problem could spread as it did, to Credit Suisse. Post the Credit Suisse / UBS takeover we did temporarily take the hedge off, as at that point markets had fallen sharply and sentiment was very poor. However, we were very willing to re-hedge once the market had moved up. This is because there were aspects of the US banking drama that we believed were not fully appreciated. The core activity of most banks is that they make profits by taking in deposits and then lending them out at higher interest rates. The interest rate they were paying on deposits was a lot lower than

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.

was available on short-term US government bonds and deposits were flowing outwards. At the same time, because longer term interest rates were, and are still, below short-term rates (negatively sloped yield curve), the bank was in a position where if they were going to raise deposit rates to stop money flowing out, their solvency and profitability would get even worse. On top of this the ability of customers to move money very quickly was significant (SVB lost around $70bn in deposits in around 24hours).

In the US and in the UK, this means that when short-term sovereign bond yields are well above 4% then deposits should continue to move from banks into high quality short-dated bonds. Deposit rates should be a little higher than the sovereign rate to reflect the higher risk of having your savings with a bank rather than with the government. The long and short of all this is that despite authorities getting involved, the basic issue for banking systems is not resolved. If deposits can now move as quickly, then either deposit rates need to be much higher and / or lending rates need to be much higher. Neither of these things are good. What the banks really need is a positively sloped yield curve where short term interest rates (i.e., deposit rates) are lower than longer-term lending rates. This may well be what is ultimately going to happen, but this is not the situation now. It may take some negative economic developments to occur for this to occur, and unfortunately, we believe this is likely. One of the effects of the SVB drama is that lending standards have tightened, and loan growth is likely to slow. The next problem to emerge is likely to be in commercial real estate (offices and shopping centres) where a whole cycle of non-performing loans is likely to develop.

Although the US banking wobble seems to have been steadied by government intervention, it is likely that this is only round one. The next rounds are on their way. The issues are that deposits are still likely to be nervous, especially as short-term bond yields remain well above deposit rates. The other issue is that with the slowdown in lending (that is already taking place) commercial real estate prices and a consequent rise in non-performing loans is, in our view, highly likely. From our perspective all of this is likely to tip Western economies from being in a pattern of no to low growth into an actual recession. This will hit corporate earnings estimates, and while it is also likely to lead to the end of the Western central bank tightening cycle it is very much the case that a notable fall in corporate earnings usually brings stock prices down with it.

It is hard to know how quickly such events could emerge. However, we very much regard part of our job as waiting. So far this year we have been willing to be cautious, and to wait when it has been appropriate to do so. We will continue to be risk averse and only participate in the market if we really feel that sentiment is especially negative and if markets are especially oversold. When the real recession arrives, this may mark the time when we can start to be more structurally positive, but until then we are taking a “safety-first” approach.

We will continue to proceed with caution and as normal, would like to thank all our supporters.

TOP FIFTEEN EQUITY HOLDINGS 31st MARCH 2023

Shell	7.5%
AstraZeneca	7.2%
HSBC	5.8%
BP	4.1%
Rio Tinto	3.6%
Diageo	3.6%
BAE	3.0%
BATS	2.7%
Compass Group	2.7%
National Grid	2.6%
Relx	2.6%
Unilever	2.2%
Glencore	1.9%
GSK	1.9%
Reckitt Benckiser	1.8%

Fund manager: Paul Wood

4th April 2023
www.woodhillam.co.uk

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