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

NEWSLETTER MARCH 2024

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

Fund value at midday 28th March was 89.5265

Assets under management: £30.0m

	1 month	6 month	1 year	3 year	5 year	Inception
Total Return	0.35%	6.44%	15.3%	25.4%	24.7%	26.1%

VT Woodhill UK Equity Strategy Fund, five-year performance, dividends re-invested (UKp)

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS *Source: VTIM*

The high levels of market enthusiasm and overwhelming optimism on behalf of investors continued in March with the UK equity market up just over 4%. We had a positive but quiet month but are pleased to be able to report that despite us taking a defensive stance[1] (in the face of what times feels like euphoric sentiment) that we have broadly kept pace with the market so far this year. In the first quarter we are up 2.8% versus the overall UK market which was up 2.9%. We have been fully hedged most of the time this year, and the fact that we have been able to keep pace with a very excitable stock market while taking dramatically less risk is a comfort to us. This is especially the case given that we do believe that both shorter- and longer-term risk is currently high for equity market investors.

In the near-term positioning, sentiment, retail enthusiasm, market narrowness, positioning and elevated risk appetite are pointing strongly to the need and likelihood of at least a notable pull back. From currently overstretched levels, a notable pull back has nearly always occurred. Longer term concerns include valuation which is very high from a cyclically adjusted perspective, unsustainable government debt levels and a year of potentially dramatic politics. In addition, corporate profits margins are dramatically above trend.

While our performance is positive this year, we would much prefer to see a better risk and reward balance from which we can enter the market. Waiting is hard but rewarding. In this sense these quiet times (from our fund's perspective) are periods in which our '*batteries are recharging*.'

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.

The current market enthusiasm has a narrative, which is compelling, but which, sadly, may not be correct. The idea that central banks are going to substantially cut interest rates into rising public spending, record low unemployment and booming stock markets has, understandably, got people excited. The reality however is that the longer-term historic correlation between levels of interest rates and valuations is not very clear at all. For very understandable reasons investors have become obsessed with what Western central bankers may or may not do. However, valuation and interest rates are not as correlated as many believe, at least not from a long-term historical perspective. Here are some examples.

- At the peak of the US stock market in 1929 the CAPE (cyclically adjusted price earnings ratio) was 31.4x and the US 10-year bond yield was 3.4%. By May 1932 the CAPE had fallen to an astoundingly low 6.4x and the US 10-year bond yield had hardly moved at all – it was at 3.5%. Valuations had absolutely collapsed with no change in interest rates.
- Following the end of WWII the CAPE was at levels below ten times and US 10-year bond yields were around 2.3%. The market got steadily more expensive right up to 1965 (CAPE of 23.9x) and this happened as interest rates steadily rose to 4.1%. The market got dramatically more expensive at a time when interest rates roughly doubled.
- In more recent history the CAPE, following the drama of the financial crisis, saw a low of 14x and a 10-year bond yield of 2.5%. In a bumpy way the market has since rerated to current CAPE levels of 35.1x and the 10-year bond yield is at 4.2%.

To put it simply the correlation between valuation and levels of interest rates is not clear at all – and, in fact, if anything, there appears to be a negative correlation. Despite all the obsession around interest rates the direction of corporate profits appears much more important. Looking back into the whole post WWII period, corporate profits are currently around 35% higher versus GDP than the average. This is also a strongly mean reverting series. Reversion to the mean can happen through a recession (still possible) or through taxation or through rising input costs.

The other issue is general market enthusiasm. At this point we would very much like to recommend a superb book called 'The Great Depression A Diary' by Benjamin Roth. The book is a collection of diary entrees written by an American lawyer based in the Mid-West. His insights and the lessons that he tries to learn and pass on are invaluable. We would recommend that anyone interested in financial history or markets today should consider reading it.

There are two notable aspects to the book from our perspective. One is how enthusiastic and excitable the stock market was in the run up to the 1929 crash.

"Without being able to explain it the fact remains that after the war (note WWI) people became stock market conscious….it seemed that every man, woman, and child had determined to make a fortune by playing the market on margin. By the summer of 1929 stocks were selling twenty, thirty and forty times their earnings…all sense of caution was lost, stocks were bought blindly".

And the next is just how cheap the stock market eventually became, even when conditions were much better, and when the Great Depression was certainly over. In 1941 – a time when the US was not yet involved in WWII, when the author of the diary was positive in his outlook, and when business was booming the author's diary read as follows:

"The stock market is at a standstill. Steel mills operate at 100% (full capacity) …stocks sell at 6 times earnings and pay dividends of 5% and 6% but no buyers…. a stock market seat sells for $27,000 – lowest since Spanish American war. This reflects the pessimism of the stockbroker…."

Interestingly US interest rates in 1941 were at around 2% to 2.1% while in 1929 they were at around 3.5%. One clear aspect to the book is how sentiment, quite independent of interest rates or even of business profits was a major driver of valuation. Today it is certainly the case that sentiment is more like it was in 1929 than in 1941. The drivers of sentiment are one of the true mysteries of investment – and are one of the most powerful forces in determining returns. However, like corporate profits, sentiment in the longer term seems to have its own mean reverting aspect.

And finally, the book consistently tries to learn lessons and to essentially come to investment conclusions – his conclusions, repeated frequently throughout the diary can be summarised as follows.

1. Do not buy when there is generalised high levels of positive sentiment.
2. Always have money put aside so you can buy when the market is down.
3. Never buy speculative stocks and instead focus on quality names.
4. Never borrow money to invest in stocks.

At Woodhill we found this advice reassuring and interesting. This is what we do. We concentrate on buying higher quality stocks. We 'put money aside' through hedging so we have the capacity to buy when the market is down. We avoid speculation and follow our process, and obviously never use leverage. These rules if they had been followed in the 1920s and 1930s would have meant that an investor would have profited greatly in what were turbulent times. Today is of course not 1929 and we are not predicting a return of the Great Depression – however, the future looks far from being plain sailing. We have the experience and the will to do our very best to allow our clients to benefit from whatever difficulties and volatility that lie ahead.

TOP FIFTEEN EQUITY HOLDINGS 28th MARCH 2024

Shell plc	7.5%
AstraZeneca PLC	7.1%
HSBC Holdings PLC	5.8%
BAE Systems PLC	4.0%
BP PLC	3.9%
Relx PLC	3.4%
Rio Tinto PLC	3.3%
Compass Group PLC	3.0%
GSK plc	3.0%
Diageo PLC	2.9%
3i Group PLC	2.6%
National Grid PLC	2.5%
British American Tobacco	2.2%
Unilever PLC	2.1%
Glencore PLC	1.8%

Fund manager: Paul Wood

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