VT WOODHILL UK EQUITY STRATEGIC FUND

NEWSLETTER MAY 2021

Managed by Woodhill Asset Management LLP

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

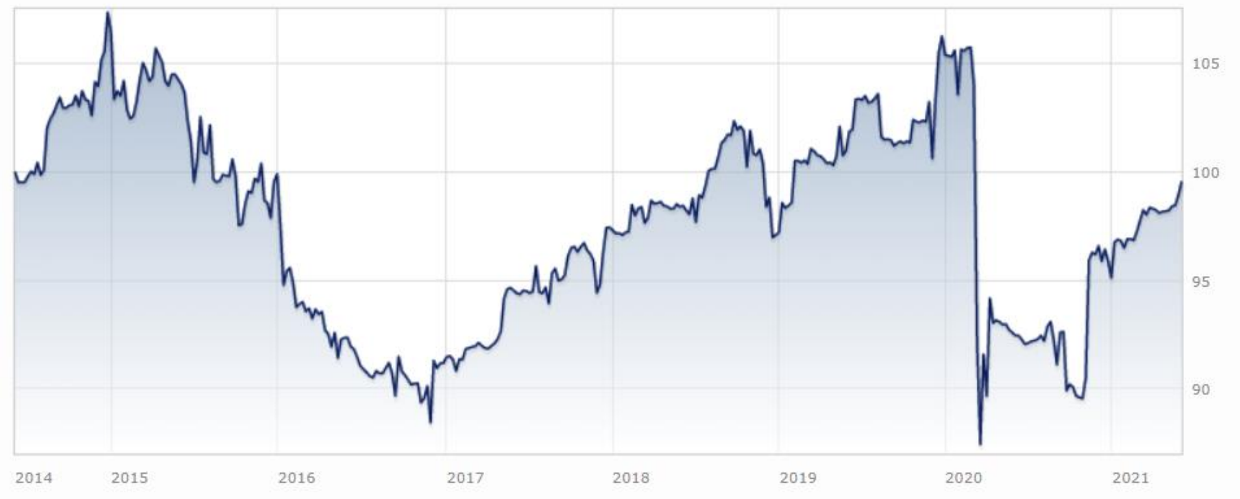
Fund value at midday 28th May was 77.4390

Assets under management: £24.1m

	Jun-20	Jul-20	Aug-20	Sep-20 *	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21 *	Apr-21	May-21
Total Return	-0.51%	0.36%	-0.25%	-2.43% *	-0.48%	7.38%	-1.09%	1.45%	0.78%	1.13% *	-0.17%	0.77%

*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

In May, both our fund and the UK stock market were slightly up. Our fund rose by 0.8%. For most of the relatively turbulent first half of the month we were fully hedged[1] but did take the hedge off in the second half of May. On a relatively short-term basis, we think the market had become somewhat oversold. At the same time volatility had risen, and previously extremely positive sentiment levels had retreated to more reasonable levels. From a longer-term perspective stock markets still look expensive, and are also somewhat overbought, and as a result we will continue to proceed carefully.

Markets, and much of the world, already have a type of *summer holiday* aspect to them. There are however some interesting developments. One of these is the debate around inflation and commodity prices. It is true that recent inflation data, in almost all countries, has been higher than expected and, in some ways, higher than we have seen for some time. For those who believe that inflation is here to stay there has been quite a lot of talk about a return to a 1970s style inflation. On the other side of the coin are the central banks along with a smaller number of commentators who state that the current inflationary surge is temporary.

Our experience with these types of debates is that the reality usually lies somewhere in the middle. Extremes rarely come to pass. It has certainly been the case that there has been an unprecedented level of monetary stimulus at play in much of the world, but this was also the case following the 2008/9 financial crisis. In the years following the financial crisis inflation did not turn out to be a significant problem. It is also true that there have been covid-related bottlenecks that do seem at least in part to be in the process of being resolved. On the other hand, it does also seem that much of the Western world and especially the US wants to turn on the fiscal spending taps in a determined way. This is something new and could well have some inflationary impact,

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.

although the amount of time needed for such spending plans to come into law, and then for the money to be spent on infrastructure and other projects is probably longer than many expect.

However, something that is different about the current fiscal stimulus plans is that they come on top of a labour market, in both the UK, and the US that is much tighter than in other downturns. It does seem that the widely expected mass job losses that were to follow covid have not come to pass. We do not believe that the end of the furlough scheme in the UK is likely to see a wholesale and sharp rise in unemployment from levels that are currently more like the sub-5% unemployment seen at the end of an economic cycle rather than at its start. In this sense it does appear that governments want to spend large stimulative amounts of money with a starting level of unemployment that already implies a tight labour market.

This could really make a difference. For decades now, wage growth in the West has been stubborn, and as a result when the price of goods has risen the rise has not lasted for long because demand has fallen in response to higher prices. In essence consumers have been unable to accept higher prices. There have been a few reasons for this stubborn wage growth. Labour unionism has been less and less effective, globalisation has been a continued headwind against rising Western wages, as has immigration. Much of this is potentially now changing. In the UK, Brexit means it is less easy for employers to import labour, Chinese wage rates have been steadily rising and given the current shortage in many areas of the Western labour markets there is now a better chance for sustained wage growth than for many years. Once the covid related bottlenecks have been resolved we may find that some of the remarkably high near-term inflation numbers we are seeing may retreat but then if wage growth builds inflation may turn out to be stickier and higher than we have been used to.

For the first time probably since the end of the cold war, labour could start to benefit relative to capital. At a corporate level this would be likely to be seen in a potential squeeze in corporate margins. It would also mean that eventually a somewhat robust response from central banks is likely to be necessary. In the shorter term the central banks may, for a while, somewhat have their day and they may be able to hold rates down at low levels as bottlenecks are resolved, but longer term, there may well be a problem building. In this regard it is interesting to see what has been going on at the long end of the US and UK government bond markets. In short, there has been no apparent panic at all. Long term rates have remained astoundingly low. This is especially interesting given the large amounts of government borrowing that have and are likely to take place in the future. Either the bond markets are looking through the current bump in inflation or that bond prices are astoundingly distorted by QE. It is possible that a bit of both is true. Consequently, if the current calm mood in government bond markets remains the case, any rise in inflation over the short term is likely to be equity positive as it means that low real interest rates are getting even lower. It is even possible that even when rates do start to rise that real rate could continue to fall. Eventually however, if our view about wage growth turns out to be correct then central banks will have to act and when this happens the outlook for equity markets could darken appreciably.

The more that real interest rates fall without a determined central bank response the more equity markets will be likely to melt up, but the underlying foundations will become more and more unstable and dangerous. It does seem that we are entering a world that is quite different to the one we are used to, and we may be closer to the end of the current economic cycle than is commonly perceived. In this regard covid could be regarded as not the start of a new cycle but rather as an interruption to the one that has been taking place since 2009/10. This will require careful navigation and as always, we will continue to proceed carefully.

TOP FIFTEEN EQUITY HOLDINGS 28TH MAY 2021

AstraZeneca	5.3%
HSBC	4.7%
Rio Tinto	4.4%
BP	4.2%
Diageo	4.0%
Royal Dutch Shell 'A'	3.7%
BATS	2.8%
BHP Group	2.7%
Ferguson	2.5%
Prudential	2.4%
Unilever	2.4%
National Grid	2.4%
Lloyds bank	2.3%
Compass Group	2.3%
Reckitt Benckiser	2.0%

Fund manager: Paul Wood

4th June 2021

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