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

NEWSLETTER NOVEMBER 2021

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

Fund value at midday 30th November was 74.6478

Assets under management: £23.1m

	Dec-20	Jan-21	Feb-21	Mar-21 *	Apr-21	May-21	Jun-21	Jul-21	Aug-21	Sep-21 *	Oct-21	Nov-21
Total Return	-1.09%	1.45%	0.78%	1.13% *	-0.17%	0.77%	0.62%	1.99%	0.01%	-2.36% *	-0.08%	-2.42%

*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

We had a frustrating November. We were hedged for much of the month but took the hedge[1] off towards the end of November. There were a few reasons for this. What had been very positive sentiment had retreated, the UK stock market itself had pulled back enough to look oversold from a near term perspective. There were indications of imminent policy easing in China and flows from buy backs scheduled for December are normally very strong. It is also worth pointing out that sterling has been quite notably weak. Since the summer the pound is down around 7% versus the US dollar, and over the same period the stock market itself has basically been flat in sterling terms. Given that the bulk of earnings are in US dollars, the UK stock market is in our view more oversold than it looks. While we still feel that all these points are legitimate, we unfortunately found ourselves exposed when the news of the new covid variant hit markets. Since the news we have stayed long, but we do have a formal stop loss strategy that will be deployed if the market falls further from month end levels.

We are not virologists but regarding the threat posed by the new variant we would like to make a few points. First the world, including the pharmaceutical industry, is now much better prepared for new variants than it was at the start of this whole episode. Second, although the scientific commentary is a little contradictory, it does still seem that existing vaccines are going to be effective against this variant. Finally, it also appears that while the new variant is highly infectious, that the symptoms are mild or even extremely mild. This appears to be following the pattern in which the more transmissible a virus is the less dangerous it becomes. Although it is too early to tell, it is possible that this variant may be the beginning of the end of the covid story. If the world is fortunate the result of this mutation could mean that the virus changes into something that is much more like the common cold.

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.

Apart from the news on the new variant it is also, we believe, worth discussing inflation. We have been somewhat spellbound by the rise in inflation and have felt that rising wage awards means, for the first time in decades, there is a possibility that the current inflationary surge could be somewhat sticky. In an astounding turnaround the head of the US central bank, after relentlessly insisting on the transitory nature of the current inflation, has now decided that the word transitory needs to go. The view that inflation is transitory seems itself to have been transitory.

This change of official stance does seem to be important. The transitory argument has certainly been used by Western central banks to resist the need to tighten policy. It is quite possible that we have now seen the lows of a forty-year trend of falling interest rates. This is significant because interest rates are, in the Western world, lower than they have ever been. In the US this data goes back to 1790, in the UK it goes back further into the 1600s. It does seem remarkable to think that interest rates are currently lower than they were in the Great Depression. At some points in the 1930s unemployment rates in the US and UK were over 20% compared to today when both economies are basically running at full employment. Any mean reversion to something that could be thought of as normal is far away from where we are today.

Regarding interest rates it is interesting to look at what happened in the 1970s and early 1980s. In the mid-70s real interest rates were profoundly negative in the UK, like today. To tame inflation real interest rates had to be increased to around 5% before inflation was wrung out of the system and to create the following decades of low inflation and falling interest rates. Given that the world, and certainly the UK government and consumer, are much more indebted now than in the 1970s it may take a less aggressive change in real interest rates to defeat inflation. However, the longer it takes for central banks to act, the more likely it is that real interest rates will have to return to be positive levels if inflation is going to be defeated. Even a return to the real interest environment of the years before the financial crisis in 2008 would imply real rates of 2.5% or so. Just using the Bank of England's own 2% inflation target a real interest rate of 2.5% would imply base rates of around 4.5% which is also around the very long-term average seen in this country. This would be a profound change from the environment many investors and mortgage holders have become used to. The longer the central banks drag their feet the more likely it is that real interest rates will have to rise profoundly to get inflation down.

Another profound long-term trend that appears to be shifting is wages as a percentage of GDP. Wages as a percentage of GDP have fallen steadily since the 1970s, and this has certainly helped keep corporate profit margins up, and inflation down. However, the currently very tight labour markets along with increases in the minimum wage and less easy access to migrant labour means that this may now be changing. Labour is often the largest element in any company's costs and unless a company can pass these costs on easily then there is the real possibility of corporate margin pressures ahead. In a largely service sector-oriented economy like the UK this is even more important than the margin pressures stemming from high commodity prices.

Overall, our feeling is that although the language from central bankers has changed, they will still be slow to act decisively. The current generation of central bankers may have to leave the field before more determined action can be taken. If so, this probably means that a substantial equity market re-pricing problem may be a little way off. However, given high valuations and low real interest rates, it seems to us that some sort of market problem is going to be close to inevitable. Next year may well turn out to be much more challenging than 2021.

As ever we will proceed carefully.

TOP FIFTEEN EQUITY HOLDINGS 30th NOVEMBER 2021

AstraZeneca	5.3%
BP	4.6%
Royal Dutch Shell 'A'	4.5%
HSBC	4.5%
Diageo	4.3%
Rio Tinto	3.4%
Ferguson	3.1%
National Grid	2.7%
BATS	2.7%
BHP Group	2.7%
Relx	2.6%
Unilever	2.3%
Compass Group	2.2%
Prudential	2.1%
GSK	2.1%

Fund manager: Paul Wood

6th December 2021

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