Woodhill

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

NEWSLETTER OCTOBER 2021

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

Fund value at midday 29th October was 76.4980

Assets under management: £23.8m

	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21 *	Apr-21	May-21	Jun-21	Jul-21	Aug-21	Sep-21 *	Oct-21
Total Return	7.38%	-1.09%	1.45%	0.78%	1.13% *	-0.17%	0.77%	0.62%	1.99%	0.01%	-2.36% *	-0.08%
*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 another relatively quiet month in October, which contrasts starkly with developments in the real world. Since the late summer, the UK stock market has moved broadly sideways, although in a volatile way. Although it may have been possible to take advantage of some of this up and down volatility, we have remained hedged[1] for much of the period. There are a few reasons for this.

We cannot remember a time in which equity markets have been more willing to ignore a steadily rising list of risks. In the past any one of these risks would have been enough to cause turbulence. These include: the looming end of central bank excess liquidity with the potential for interest rates to rise, rising inflation that may or may not be temporary, labour market shortages, rising taxes, rising energy prices, large tech names announcing disappointing earnings forecasts, a substantial slowdown in the Chinese economy with the potential bursting of a massive property bubble, signs of a truly extreme speculative environment, and, finally rising global geopolitical tensions.

We know that interest rate increases are likely in the UK, and that in the US, the huge surge in central bank created liquidity is about to end. In much of the Western World inflation rates are at least double the level of central bank formal targets. Unlike in equity markets where things have generally been moving along relatively calmly, there has been quite a lot of activity in bonds. In the UK (and in many other places) short term interest rates have risen, signalling that formal base rates may rise soon. At the same time longer term interest rates have been falling. This combination of changes appears to imply two things. First, that base rates will rise, and second, that the result will be an economic slowdown.

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.

Normally when short term interest rates rise (especially at the beginning of a tightening cycle) longer term rates rise as well. It is only after a few increases in short term rates that long rates start to fall signalling that the central bank has done enough to constrain inflation. Now, long rates are falling before the first formal rate increase has even happened. Either bond markets are wrong about the outlook or, if not, such market action would suggest that the underlying economic picture is quite fragile. The way that bond markets have acted would normally imply that we are closer to the end of an economic cycle than its start. The same is true regarding the rise in inflationary pressure, shortages, and energy price spikes. Even before the slowdown that bond markets are predicting has arrived some large consumer facing tech companies are having to lower future expectations. If the world economy does slowdown notably then earning expectations may be too high. This itself could be the catalyst to shake equities out of their complacency.

At the same time developments in the Chinese property market indicate that there is the potential for a difficult shake out. While the ongoing drama around the large, troubled property developer Evergrande is ongoing it seems unlikely that its problems are unique. Smaller developers have also been getting into trouble and property prices appear to have lost momentum and in some cases are falling. Normally the prospect of a potential slump in what could be argued is the biggest driver of the Chinese economy would be enough to cause tremors throughout the world. So far equities appear to have ignored this issue, although as bond markets are hinting, the Chinese property market is likely to be another drag on growth.

On an international scale it is also notable that as the world has emerged from the pandemic it seems to be chaotic. The Middle East appears to be full of drama again, new wars are breaking out in Africa, China is more bellicose than ever, and Russia is moving troops to the boarders of Ukraine for the second time.

Finally, we cannot help but note how extreme the current speculative environment has become. US electric car company Tesla is now worth more than the rest of the global auto industry put together, but even this seems mild compared to some of the on-line activity taking place in the world of crypto currency. New dog themed crypto currencies have been rising in value by thousands of percent over short time periods, and post the success of the dog themed coins, the hottest speculative interest is now moving to cat themed coins.

How long this can last is hard to tell but now looks like the time of maximum speculative activity. It is almost as if the more solid, fundamental, and reasonable an asset is the less well it does and the less interest it attracts. A world in which the less substantive something is the more highly it is valued does not seem normal or long lasting.

Putting all these factors together we have remained defensively positioned for a few months. Markets are, in some places, exhibiting extreme levels of speculation while the world economy and the world itself is facing some substantial new challenges. Meanwhile equity valuations are generally high. So far equities have remained calm, but it can be the case that it takes quite a long time for bull markets to turn into bear markets. It is often easy (with the benefit of hindsight) to see the writing on the wall well before a more serious decline takes place. Bull markets tend to die quite slowly as the worrying news is resisted by ingrained and learned behaviour to always buy the dip. Looking back to the turn of the millennium the UK stock market peaked in December 1999 (and at the time bond market yield curves were flattening much as they are now) but it was not until the start of 2001 that more profound negative price action started to take place. The topping period that ended the 1990s equity bull market took around a year to take place. Even the drama around the 2008 financial crisis took time.

We feel that we may be in a similar situation today, that all the ingredients for a bear market exist but that equity markets are still enjoying the last few drinks before closing time. As ever we will proceed carefully.

TOP FIFTEEN EQUITY HOLDINGS 29th OCTOBER 2021

AstraZeneca	5.6%
BP	4.9%
Royal Dutch Shell 'A'	4.8%
HSBC	4.6%
Diageo	3.9%
Rio Tinto	3.4%
Ferguson	2.9%
BATS	2.6%
National Grid	2.5%
BHP Group	2.5%
Relx	2.4%
Prudential	2.4%
Unilever	2.3%
Compass Group	2.2%
GSK	2.0%

Fund manager: Paul Wood

8th November 2021

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