Woodhill

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

NEWSLETTER SEPTEMBER 2021

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

Fund value at midday 30th September was 76.5598

Assets under management: £23.8m

	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21 *	Apr-21	May-21	Jun-21	Jul-21	Aug-21	Sep-21 *
Total Return	-0.48%	7.38%	-1.09%	1.45%	0.78%	1.13% *	-0.17%	0.77%	0.62%	1.99%	0.01%	-2.36% *
*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 difficult September, and the fund went ex-dividend at the end of the month. Adjusting for the ex-dividend status of the fund September saw our NAV fall 2.4%. This occurred for a few reasons, but mainly, we sense a real change in the way that markets, governments, and economies are working. This nascent change itself partly explains our performance in the month.

We were exposed[1] to the market as the current Chinese property market drama (Evergrande) started to unfold. We remained exposed because sentiment had become negative, and markets were oversold enough to suggest that the balance of risk and reward was tilted in favour of equities. We did expect that the Chinese government would act to bail out Evergrande and to prevent a wider level of distress in the Chinese property market and in the economy itself. This is something that could still happen, but so far, it has been remarkable how little the Chinese authorities have done, so we decided to hedge the full value of the portfolio. We did hedge a little late, and this explains our negative performance in September. If the Chinese property market and economy unravels further, then protecting the portfolio will have been the right thing to have done.

The Chinese government has been encouraging other Chinese property developers to buy assets and unfinished projects from Evergrande. The Chinese government seems to be implying that a rescue should come from other developers rather than itself. This lack of government action is concerning because property prices are now falling quite sharply in China. There is the danger of a reinforcing cycle of falling property prices and rising liquidity issues in the sector.

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.

It is also worth noting that the Chinese government has recently been willing to act in a genuinely hostile manner towards the private sector, especially against media and tech companies. The Chinese government and parts of business now seem to be adversaries. This may explain the lack of government action to bail out Evergrande, at least so far. Eventually some sort of government action may arrive, but things may have to get worse before that happens.

The Chinese economy has also been having to deal with electricity shortages and blackouts. This, on top of a potentially serious property downturn, is a troublesome mix. The electricity issues in China are related to a shortage of coal and to the government's environmental commitments. Given the large spikes in gas and coal prices that the world has already been experiencing, the emergence of China as an almost "forced buyer" in the coal market is likely to put further pressure on energy prices. It is notable that while energy prices have been soaring, so too are many agricultural products including cotton and food stuffs. Unless something happens very quickly these price surges are going to feed into inflation in general.

It is not only China that has been suffering from shortages. As an example, while the shortage of HGV drivers in the UK has been on the cover of all our major newspapers it is also true that there is a shortage of drivers in Continental Europe and in the US. In the US there are apparently 40 jobs available for every driver currently working. There also appears to be a major problem with shipping and port capacity.

Even before these recent price spikes the Bank of England was forecasting that inflation would be around 4% by the end of this year. How the central banks, including the Bank of England, will react if inflation, rather than subsiding into next year remains stubbornly high, or even rises further, will be very interesting. There is now a substantial risk that Western central banks have been too loose for too long. If this is the case it could have significant, and not positive implications for equity markets. The recent moves in commodities along with generalised labour shortages could easily be the force that shifts inflation from being temporary into something more embedded.

Taking a step back from these very near-term events it is worth noting that before the pandemic hit the West was running at full employment levels. Since then, governments have, through programs like the UK's furlough scheme, made sure that unemployment did not rise significantly. At the same time governments and central banks have rolled out what has been the largest stimulus effort in history. In essence, now that covid is retreating, the situation looks as if a huge stimulus program has been introduced into economies that were in effect already running at full capacity. This itself may explain many of the shortages. It is possible that the world economy is overheating while central banks are substantially behind the curve.

Given the nature of share price-based management renumeration it is always easier for managements to buy back their own shares rather than invest in new capacity. The resulting lack of capacity right across Western economies may now mean that stimulus is finding itself impacting prices in the real economy. If this is the case the conclusions are concerning. The first is that central banks and governments would need to quickly reverse their stimulus plans, the alternative would be a genuinely serious inflation problem. The second is that the corporate world may need to invest substantially in actual capacity increases.

In our view, this is not going to happen quickly. Furthermore, from an asset price perspective, it may mean that companies will have to divert the cash flow they have used for share buy backs or dividends into capital spending. This would be a substantial change and could mean the potential deflation of an asset price bubble as money shifts from financial markets into the real economy. It could also mean upwards pressure on real interest rates as investment spending will have to be funded.

Altogether we feel that the world may be changing more now than it has possibly since the end of the Cold War. Labour rather than capital is now in the driving seat. It may mean a world that we are very unused to, one where markets and traders are no longer at the top of the tree. It is hard to be certain how all this will shake out, but we suspect that caution may well be warranted. We will do all we can to proceed with utmost caution.

TOP FIFTEEN EQUITY HOLDINGS 30th SEPTEMBER 2021

AstraZeneca	6.0%
BP	4.8%
Royal Dutch Shell 'A'	4.7%
Diageo	4.4%
HSBC	4.1%
Rio Tinto	3.6%
Ferguson	2.7%
BATS	2.7%
BHP Group	2.4%
National Grid	2.4%
Relx	2.4%
Unilever	2.4%
Prudential	2.3%
Compass Group	2.2%
Lloyds bank	2.2%

Fund manager: Paul Wood

5th October 2021

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