Woodhill

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

NEWSLETTER AUGUST 2024

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Unit price at midday 30th August was 91.0

Assets under management: £30.3m

	1 month	6 month	1 year	3 year	5 year	Inception
Total return	0.0%	2.0%	10.3%	23.8%	25.4%	27.5%

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

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

In August our fund was up very slightly, as was the UK market. We had remained exposed to equities as they recovered from the Japanese carry trade drama. We then re-hedged[1] the portfolio towards the end of the month.

We have protected the portfolio again for a few reasons. From a shorter-term perspective sentiment has recovered to being at a very positive level, and one from which equities can be quite vulnerable. Our sentiment data analysis is also confirmed by measured volatility, which spiked (a sign of fear) when the Japanese drama was at its peak and has now returned to being at a normal to low level (signalling complacency).

Longer term we also remain concerned by a constellation of positioning and valuation. In the US households that own equities has risen to above 60% of all households. The last time this level of retail stock enthusiasm and participation was seen was in 2000. In essence everyone who is likely to hold equities now holds them. Also, it is probably not a coincidence that long term measures of valuation are all pointing in the same direction – that equities are expensive. For instance, Professor Shiller' cyclically adjusted price earnings ratio is currently at almost 38x. This compares to a very long-term average level of around 16x. The only time in which equities have been more expensive than this, but have gone up anyway, was in the latter moments of the year 2000

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.

dotcom bubble. Just to put the current extreme into context, ahead of the 1929 crash the Shiller cyclically adjusted price earnings ratio was 'only' 31x.

Warren Buffets favourite measure of stock market valuation says the same thing, and this may explain why Berkshire Hathaway is consistently growing its allocation to cash. The Buffet valuation measure is to compare total market capitalization to GDP. US equities are now trading at just a little more than 200% of the value of the economy. This is at least two standard deviations above the longer-term average – and as Buffet himself has said, that at over 200%, investors are *playing with fire*. Buffets valuation tool shows US equities to be at the same valuation level seen at year 2000 bubble peaks. Then finally there is Tobin's Q – a measure of market value to replacement value. Like the Shiller price earnings ratio and the Buffet measure of value the current levels of Tobin Q are at an extremely high level – higher than at the top of the year 2000 bubble. It is quite possible to critique these valuation tools from all sorts of different angles but in our view, they are all legitimate and most importantly they are all saying the same thing. Valuations are extreme, and historically, such levels have spelled trouble for long-only investors.

One of the reasons that investors have been so committed and enthusiastic about owning equities is, we suspect, that the 'pivot' is finally officially here. Official interest rates have already started to fall in the UK and Europe, and it now seems extremely likely that they will start to fall in the US. There is some logic to this enthusiasm. Lower interest rates should act to stimulate economic growth and on a comparative basis as interest rates fall then at least in theory equities can be valued more highly (although we think investors have already more than fully front run this potential valuation uplift). However, looking back at the last somewhat normal (i.e. not covid) economic cycles (2007/8 and 2000/2002) as soon as official interest rates fell stock markets fell along with them.

In 2000 when the first cut in rates took place equity markets were already declining. Ultimately the US Fed cut rates from 6.5% right down to 1%. During this rate cutting process the S&P 500 fell by almost 40%.

In 2007 the US Fed first cut rates at almost the peak moment of equity markets in 2007. The market then ultimately fell a little over 50% while at the same time official US interest rates fell from 5.25% right down to 0.25%. The reason for these declines was that global and Western economies weakened after interest rates had been progressively increased. As economies fell into recession corporate earnings and profit margins fell and this took the stock market with them.

It is also worth noting that ahead of the 2000 and 2007 collapse the yield curve was negative (short term interest rates above long-term rates). As the Western economies started to show signs of incipient weakness the yield curve turned positive (short term interest rates started to fall) in 2000 and in 2007. This happened in both cases as the economy started to fall into recession. This is also exactly what is happening today. The US yield curve, after being negatively sloped for two years, turned to being just positive right at the end of August. There is also some evidence to say that the longer the yield curve has been negatively sloped the worse the following recession has been. For now, the yield curve has been negatively sloped for the longest period since the late 1920s.

Given where stock market valuations are currently, and how long interest rates have been held at a relatively high level, there is in our view a good chance that the same thing can happen again. The current mix of high valuation, retail enthusiasm for stocks and an economic cycle that is now quite long, means that we feel that remaining generally cautious is sensible. This does not mean that there will be opportunities ahead of us in the near to mid-term, but we will proceed very carefully.

TOP FIFTEEN EQUITY HOLDINGS 30th AUGUST 2024

Holding	%
AstraZeneca PLC	7.8%
Shell plc	6.8%
HSBC Holdings PLC	5.5%
BAE Systems PLC	3.6%
Relx PLC	3.1%
BP PLC	3.0%
Rio Tinto PLC	2.8%
Compass Group PLC	2.8%
National Grid PLC	2.7%
3i Group PLC	2.6%
GSK plc	2.5%
British American Tobacco PLC	2.3%
Unilever PLC	2.3%
Diageo PLC	2.2%
Lloyds Banking Group PLC	1.7%

Fund manager: Paul Wood

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