VT Astute Funds

Quarterly Commentary

Q4 2020

Introduction

Thank you for taking the time to read our Q4 commentary. First and foremost, I hope that you and your loved ones all remain safe and well during what we hope will be the last phase of this pandemic. We are all living through these strange times, but it is important to keep the events of financial markets in perspective.

A lot has happened in the last three months of 2020 and that means there is a lot to cover in this commentary. To the right, I explore the idea that Q4 2020 represented a pivot in market perception towards longer-term thinking and a refocus on larger structural trends.

In our **Astute Overview** section, we will look in more detail at the events of the last quarter and discuss what the implications may be for the months and years ahead.

Our regular **Astute Perspective** will cover how we currently see the world and our conviction views on markets, while **Astute Positioning** shows how those views translate into the portfolios and what changes we have made in the past three months.

Finally, **Astute Observations** highlights some of the more interesting research, data or charts we have encountered recently with a few short and, hopefully, enlightening comments.

As always, we take a long-term approach to investing our clients' assets, but success is a journey, not a destination, and the short-term views expressed herein are aimed at managing risk and making your investment journey as smooth as possible. By taking a risk-adjusted approach to your investments, we aim to deliver reliable growth in line with our stated risk profiles and provide you, and your financial planner, the consistency and security to plan for your long-term financial future.
Thank you for your continued support. If you have any further questions or require any additional information, please do not hesitate to contact your usual financial planner.

Fund Management Team

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Firmer ground for growth

In my last update, I talked about my optimism about a vaccine that would be developed but also about the difficult months that may stand between that vaccine and any return to normality. We are now in the midst of that difficult period with circumstances made only more trying by the emergence of a new, more transmissible Coronavirus strain. Before we turn to some thoughts on markets, let me firstly reassure you that lockdown restrictions have no impact on our day-to-day operations. 2020 saw a leap forward in the adoption of video communication and the first of many fund manager meetings that I attended in my slippers. As such, I have no doubts about the efficiency of our remote working procedures; it has been a fact of life for our industry for most of the last 12 months.

Just as we start to focus in our personal lives on the shorter-term challenges of lockdown, global markets have begun to look further forward, towards life beyond the pandemic. The high efficacy of the vaccines and the unparalleled manufacturing and distribution efforts means there is sufficient confidence that Covid-19 will be tamed to some degree later in the year. Furthermore, a Biden win in the US election and some final resolution on the UK-EU trade deal and investors have secured much firmer foundations on which to build reasonable expectations of the future. Many have likened the stimulus measures supporting economies through the pandemic to building a bridge over troubled water. The developments of last quarter mean we now have sight of the land at the end of that bridge. We don't know where it has led us to and we don't know how much it has cost, but at least it doesn't end in the ocean.

On a more granular level, the news of a vaccine also led to a sharp rally in unloved markets such as those in Europe and the UK, and in sectors such as travel & leisure, a large part of which is simply laggards playing catch up on the rest of the year. On a longer view however, we are seeing an inflection as investors pivot positioning towards a more conventional economic recovery. This cyclical rebound is predicated upon a healthy fiscal stimulus and the pent-up consumer demand being released following months of Covid-19 restrictions. This means growth prospects, previously limited to a very narrow group of dominant large cap names, may begin to broaden out. This will in turn create opportunities in cheaper areas of the market as companies who struggled through the pandemic start to see revenues return to pre-pandemic levels. It may also put downward pressure on valuations for those who prospered through 2020.

However, there is nuance to this rotation. Some companies emerging from the pandemic are burdened with debt, or have had to sell their prime assets, or lost ground in key markets. These may achieve their 2019 revenues but would still not merit 2019 valuations. Likewise, some trends driving high growth valuations through the pandemic are not going to disappear and have likely been reinforced or accelerated, justifying the steep valuations of the stocks that benefit. Picking apart this detail will be the key to navigating any recovery, aiming to retain the best of the secular growth names whilst selecting the companies best positioned to benefit from a cyclical recovery.

Finally, what does this mean for downside risk and what tools can we use to protect capital? This is a far more difficult question. If the recovery does take hold then the potential for rising inflation, rising interest rates and a "taper tantrum" style market correction will increase. In this scenario, traditional portfolio protection via high quality bonds will provide little help. However, a more "conventional" risk event would likely still see a flight to quality. This is a fine balancing act and while we are increasingly looking to hedge against rising inflation with quality "real assets" within our alternative allocation, we won't be throwing the bonds out with the bath water either. As ever, a diversified approach, diligently researched and consistently applied, will provide the smoothest path to reaching our investment objectives.

Scott Osborne PhD CFA
Chief Investment Officer

Astute Overview

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TAKING STOCK – 2020 HINDSIGHT

So much happened in the last quarter of 2020 it is worth spending a few column inches looking back at the key events and digesting the implications for the Astute funds. Firstly, the US election actually unfolded pretty close to our expectations. Despite pollsters once again underestimating the Trump vote, the final count was still a comfortable win for Biden. The false narrative of a close result was skewed by the late counting of Democrat votes in key states. Under normal circumstances, the election would have been done and dusted by 2 or 3am. The so called "Red Mirage" also fuelled Trump's unsubstantiated claims of election-rigging. The fact that markets did not react to a contested result was evidence enough of the confidence behind Biden's winning margin. The less said about Trump's litigation attempts the better.

With the White House decided, the Senate, and the opportunity for a Democrat clean sweep, was increasingly in focus. Disappointing results on the night made this look out of reach, with Republicans only needing to win one of the two run-off races in Georgia to retain control. Against the odds however, both Democrats won. Jon Ossoff was in fact being declared winner as Trump supporters invaded the Capitol building to prevent the ceremonial confirmation of Biden by congress. As the finger-pointing began in earnest within an increasingly divided Republican party, markets swiftly moved to price in some of the more controversial Biden policies, including higher corporation taxes, stricter regulations, and a larger fiscal spending programme.

The news of a vaccine, which swiftly followed the presidential election, without doubt had the biggest impact for the market and led to an instant relief rally in those sectors hardest hit by the virus. Whilst a vaccine before the end of the year had been our base case expectation, the high efficacy only increased the short-term exuberance. The subsequent success of the Oxford vaccine, and its substantial manufacturing pipeline, also puts the UK at the forefront of vaccination, a factor which further fuelled the rally in UK assets despite the emergence of the new Covid-19 variant.

Finally, the resolution of a trade deal with the EU removed some of the cliff edge risk around Brexit. The deal itself is 'skinny', with former Prime Minister Theresa May summing it up as "…a deal in trade which benefits the EU but not a deal in services which would have benefited the UK". January is also the first time businesses are faced with third country status, adding significant complication to trading to, or from, Europe. In reality the impact of these soft barriers may not actually be clear for many months, as temporary measures such as the simplified customs declarations smooth the road ahead. As such, the response to the trade deal was muted versus the vaccine news. Sterling wobbled slightly through final negotiations but finished the year 3% higher than where it started versus the Dollar, and around 5.5% weaker versus the Euro. These annual numbers conceal a very volatile path however, with the Pound gaining almost 16% against the Dollar since the market panic in March.

Astute Response:

In the US, we started to tilt towards mid and small cap stocks which we see as key beneficiaries of a cyclical recovery and a Biden-led administration. We also further increased our inflation protection through our bonds and alternatives, as this downside risk increased relatively versus more conventional Covid-19 risk. In the UK, we also lowered our market cap but retained our underweight. We are closer now than ever to amending our underweight UK view, but would like to see some positive earnings momentum under the new trade agreement before committing to change.

THE YEAR AHEAD – BUILDING A BRIDGE TO SOMEWHERE

The extraordinary policy interventions of the last year have done a respectable job of building an economic bridge over the troubled water of the pandemic. As briefly mentioned in our Q3 commentary, this creates a scenario more akin to a natural disaster, with limited permanent damage and potential for a faster rebound. However, the virus remains a key risk for the year ahead. Already we have seen the emergence of a variant strain and as the vaccination effort increases, this will apply more pressure on further mutations. We firmly believe 2021 will see the end of the pandemic but much still hinges on the speed and the effectiveness of the vaccination program.

Another key and rising risk is the cost of building the bridge in the first place. The Institute for International Finance estimates that over the past year global government debt increased by $8.4 trillion, approximately $16m per minute[1]. Central banks seem committed to keeping interest rates low, which helps to reduce the cost of servicing that debt, but its looming shadow could still encourage fiscal austerity; a policy which could derail a fragile recovery. Conversely, the stimulus already provided might push inflation higher more quickly than anticipated, forcing central banks to hike rates. The latter scenario seems more likely to us at this stage and given the likelihood for some wild economic numbers this year (as like for like comparisons will be versus low and negative numbers in 2020), "taper tantrums" should be considered another serious risk to manage.

Despite those risks, our base case is for the goldilocks scenario in between, with low, but rising inflation and a more stable political scene (a new German chancellor perhaps the biggest risk to the status quo). This should result in a substantial rebound in economic activity by the third quarter of the year. We are already seeing a rotation toward more "cyclical" companies that have struggled over recent years but who typically generate their best returns in the early part of a new cycle. It pays to be discerning however, as some cyclical companies, such as oil and gas, still face long-term structural headwinds. Likewise, some of the structural trends accelerated by the pandemic will not disappear either. So, while many of 2020's losers will likely perform better in 2021, shrewd stock selection, even in a buoyant market, will be necessary to avoid the pitfalls should sentiment turn negative.

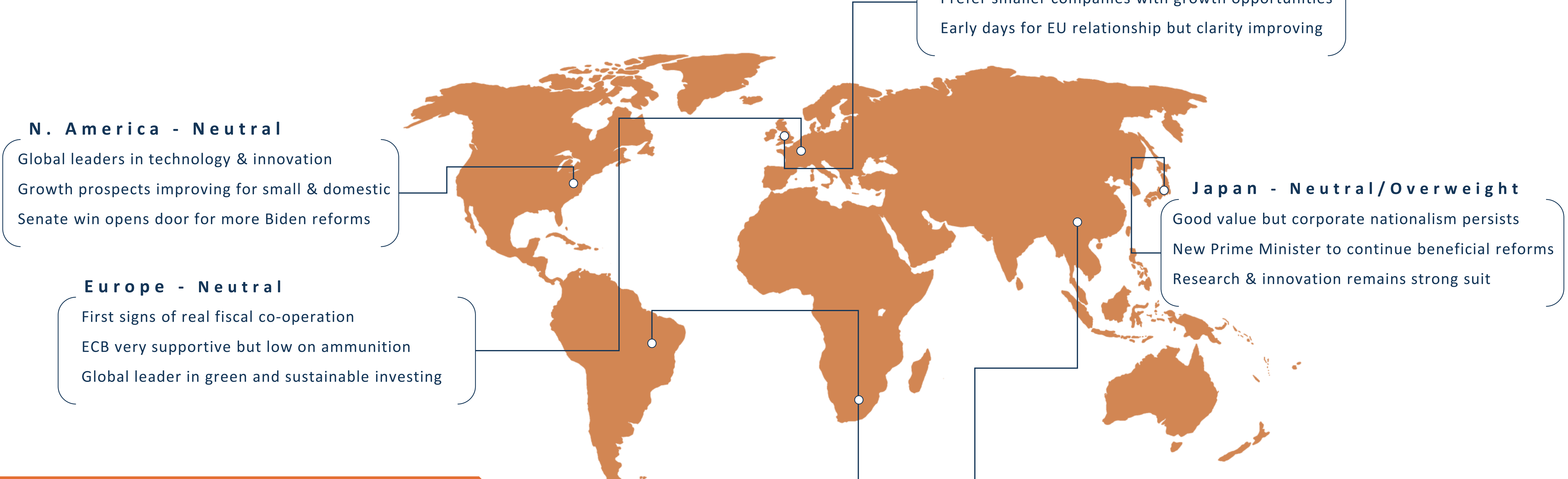
On our thematic views, we retain our positive view on technology but remain wary of some bubble-like behaviour. China's continued emergence as a global power will accelerate the "cold war in tech" and likely lead to heavy investment to keep pace in the development arms race. In the context of increasing data consumption, the roll out of 5G technology and the persistent drift in consumer behaviour to online (see Astute Observations), we continue to see this as an attractive area. There is certainly some irrational exuberance in the sector however, and if the market tide generally ebbs towards other areas, we may find the proverbial naked swimmers. Finally, Biden's election victory should also accelerate another existing trend, the shift towards sustainability. With many nations looking to direct their stimulus packages toward green type investment, momentum will likely increase. Focus will turn to the quality of growth, and companies aligned will prosper.

Astute Response:

We retain our thematic views in technology and sustainability. The market rotation increases valuation pressure on some large cap growth names and we will moderate our exposure to manage this risk. Looking forward we will tactically position the fund to exploit regions where the recovery is accelerating more quickly or where valuations look most attractive.

Sources: [1] Institute for International Finance global debt monitor

Astute Perspective



Asia & Emerging - Overweight

Long term growth from demographics & development

Prefer Asia, stable regimes and regional synergies

China/USA decoupling creates two-track global economy

Conviction Views

A key part of our process is building conviction ideas which are then expressed across each of the portfolios. While asset class and regional views are an important input into this process, the opinions outlined below will be the driving force behind any potential future returns.

1. Bias to Quality Growth – Pivot to Cyclical
    - A small number of excellent companies deliver the lion's share of market growth – growth to broaden out to include more cyclical sectors
    - Reliability of long-term growth is worth paying a **reasonable** premium for – cyclical growth at more attractive valuation but cautious on value traps

2. Overweight Technology
    - Technological revolution will continue, lean into disruptive areas, the strong get stronger
    - Look beyond current global leaders and use specialists to stay ahead of the curve

3. Invest Sustainably
    - ESG will become the default option, and the market will shift accordingly
    - If sustainable investing is the future, invest with those who have ESG way into their past

Asset Class Views

Fixed Income	Negative						Positive
Sovereign Bonds							
Corporate Bonds							
High yield bonds							
EM Debt							
Alternatives	Negative						Positive

Equities	Negative						Positive
UK							
Europe							
Asia & Emerging							
Japan							
US							

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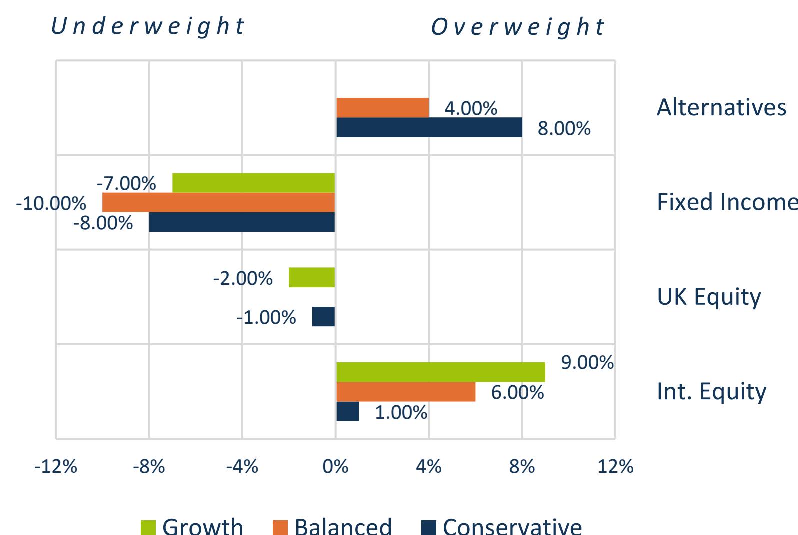
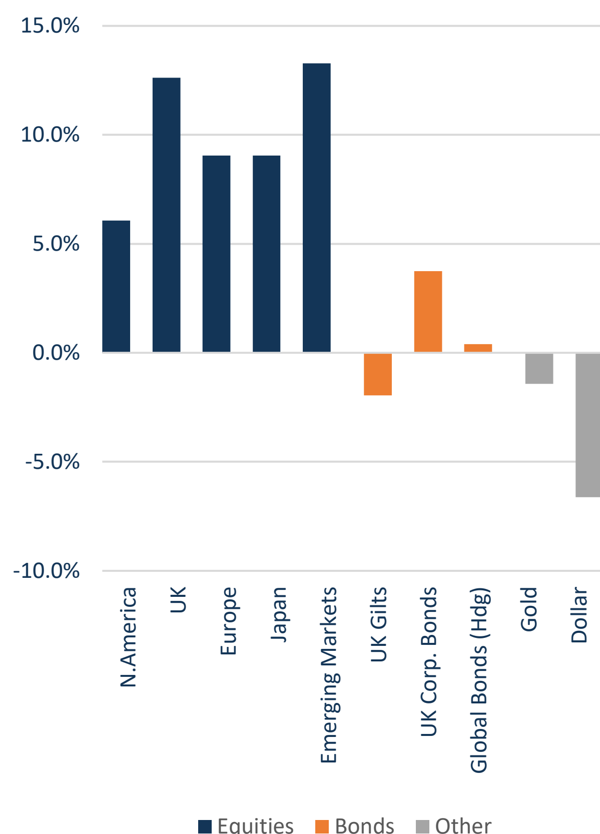
Astute Positioning

Tactical Asset Allocation[1]



Asset Class Returns[2]



Q4 saw strong returns across markets as the vaccine announcement buoyed investor sentiment. While our overweight equity position generally benefitted performance, it was the laggards that led the rally and so equity selection mostly underperformed broader markets. It was always likely that some markets would deliver a catch-up rally on good news, but timing these announcements is a fool's errand and we much prefer the smoother path to gradual growth than the boom and bust of market timing.

From a regional perspective, the strength of the Pound proved to be the biggest headwind. While US market returns rivalled the UK, the weak dollar reduced Sterling based returns by more than half. Our overweight to Asia and emerging markets continued to deliver. With few, if any virus restrictions in place throughout Asia, this area remains well-positioned to feel the global rebound first.

In contrast to equities, fixed income struggled, with higher risk corporate credits the best performer. Most traditional market hedges fell in value, including gold and high-quality government bonds. As risk appetite returned, these intrinsically defensive assets were being sold and capital recycled into equity markets.

Our asset allocation remains unchanged, which is overweight equities and alternatives with a preference for non-domestic markets. While we made no changes to our high-level asset allocation during the quarter, there were several changes across the funds which represent the first steps towards re-positioning the portfolios for the year ahead (summarised in the table below).

In our equities we made a number of trades following the US election and vaccine announcement. Firstly, we introduced some small and mid -cap companies in the US through the Hermes fund. This is the first step towards a more cyclical profile for that region and should provide more upside to fundamental economic growth, more Main Street than Wall Street. We also increased cyclicality in our emerging markets positions by switching our defensive Minimum Volatility strategy for a Socially Responsible product that is more sensitive to market movements but retains some of the same quality characteristics. In the UK we also moved down the market cap by swapping a mid-size company fund for a smaller company equivalent. In bonds we continued to build inflation protection by swapping nominal bonds for inflation-linked in both the Conservative and Balanced funds.

Finally, we have been taking advantage of some capital raising by infrastructure investment funds to build up direct holdings in the 'real assets' bucket of our alternatives allocation. These trades aim to build in some inflation protection, whilst also underpinning the portfolio with physical asset values. This quarter included subscriptions to Gresham House Energy Storage and The Renewables Infrastructure group (TRIG).

The Gresham House fund is a network of battery storage facilities that charge when power is cheap and sell back to the grid when demand is high. As the proportion of national electricity supply generated from solar and wind increases, so does the unpredictability of day-to-day supply due to weather. Battery storage is seen as an essential tool for equalling out that supply by plugging demand gaps or charging during power surpluses.

TRIG is a portfolio of renewable energy assets, principally wind and solar, which benefit from attractive government subsidies or fixed-price contracts on power generation. Both investment trusts continue to identify attractive pipeline opportunities, and generally benefit from a global push towards sustainability. The nature of the capital raises also allows us to build attractive entry points below prevailing market prices, an avenue typically only available to institutional investors.

Fund Activity

	Fund	Portfolios
New Purchase	Hermes US SMID	Con, Bal, Gro
	iShares MSCI EM SRI ETF	Con, Bal, Gro
	Baillie Gifford British Smaller Companies	Bal & Gro
	iShares $ TIPS ETF	Bal
	Gresham House Energy Storage	Con & Bal
	The Renewables Infrastructure Group	Con & Bal
Top Up	iShares $ TIPS ETF	Con
	iShares MSCI USA SRI ETF	Con
Trim	L&G US Equity ETF	Con
	Brown Advisory US Sustainable Growth	Con, Bal, Gro
	VT Gravis UK Infrastructure Income	Con & Bal
Sold	iShares Edge MSCI EM Min Vol	Con, Bal, Gro
	Liontrust Special Situations	Bal & Gro
	Vanguard US Government Bond	Bal

Data sourced: Refinitiv Lipper for Investment Management & Astute Investment Management as at 31.12.2020. Past Performance is not a reliable indicator of future results.
[1] – Relative positioning is expressed versus Astute's long term strategic weights. [2] – Total returns in GBP. Broad market indices are used to represent the performance of different regions over the period

Astute Observations

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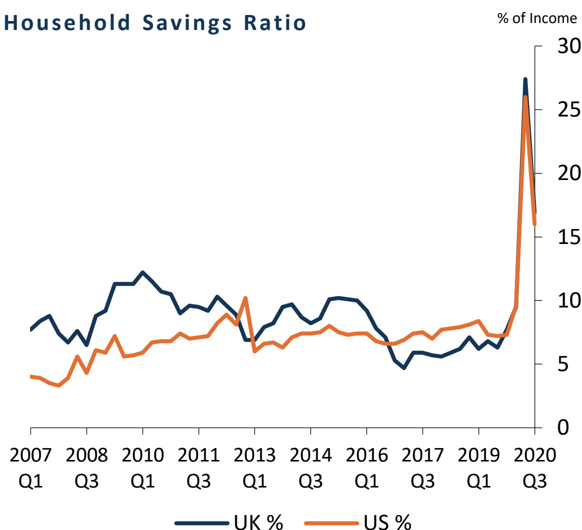
Creatures of Habit

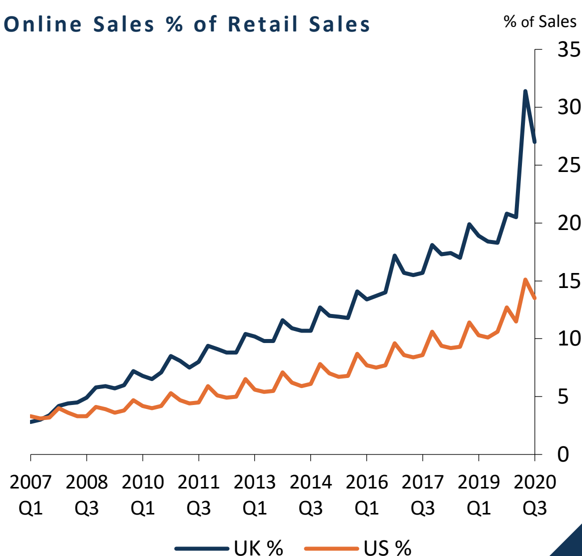
In 2020 we saw household expenditure fall dramatically. With lockdown restrictions, often those who wanted to spend could not. Meanwhile the impact on earnings was blunted by government support. In fact, JP Morgan estimates that 75% of workers in the US who lost their jobs found they were actually better off from enhanced unemployment benefits than they were in work. As a result, we saw household savings ratios, or savings as a proportion of disposable income, skyrocket through the summer.

Any spending that occurred was increasingly happening online. The second chart shows online sales as a percentage of all retail sales (this includes many things you are unlikely to ever order online, such as petrol). Lockdowns in the UK and US forced an acceleration in an already rising trend. Whilst the trend may not continue to grow at the same rate post Covid-19, it is possible that the increased ease, reliability and speed of online shopping will have changed the mindset of consumers, some of whom may have never bought anything online prior to the pandemic.

Both charts show the speed of change in consumer behaviour. While we expect that once lockdown rules relax, we will observe a reversion to a more typical spending behaviour, some change is permanent. Saving ratios are likely to depend on the speed of the vaccine deployment and more generally 'animal spirits' but will likely revert to typical levels. Meanwhile, retail sales may see a splurge of pent-up demand on things like travel and leisure, but we do not believe online sales will fall back to pre-pandemic levels. The habits formed during the pandemic will be hard to break.

Sources:
ONS (UK) & U.S. Bureau of Economic Analysis (US)





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