VT Astute Funds

Quarterly Commentary

Q3 2022

Introduction

Thank you for taking the time to read our Q3 commentary. 2022 has proven to be a difficult year so far. A confluence of events has created a bear market in both equities and bonds, presenting significant challenges to conventional portfolio diversification. At times like this, we place ever greater emphasis on sticking to solid investment principles and on communicating these to our investors. As always, we endeavour to protect and grow our investors' wealth, and to provide the financial security you need to plan for your future.

As we have previously communicated on the drivers of current market volatility, our CIO letter this quarter aims to highlight just how unusual the losses in bond markets and why perhaps markets failed to address this risk earlier.

In our **Astute Overview** section, we look at the current bear market versus some previous occasions and look for reasons to be positive whilst others are worried.

Our regular **Astute Perspective** shows our current conviction views, while **Astute Positioning** covers 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, with 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

Scott Osborne
Chief Investment Officer

Hannah Owen
Head of Group Communications

Nathan Chan
Senior Investment Analyst

Toby Hulse
Investment Analyst

Plus ça change…

It is hard to grasp just how much change we have experienced in the last two years. The tragic passing of Queen Elizabeth II in September reinforced this sense of shifting foundations. Regardless of your views on the Monarchy, the presence of the Queen had been a constant in most of our lives. A reliable point of reference in an otherwise topsy-turvy world.

The more things change, the more they stay the same - an expression that appears ill suited to the current world, which seems to be stuck in a permanent state of flux. However, the purpose is to remind us of the immutable, fundamental facts that don't change. It is this focus which helps guide us through volatile periods. Forget the very basic facts and you can easily lose your way.

In many ways the market moves we have seen this year are not exceptional. The path of equity returns has been pretty typical when compared to previous bear markets, particularly when considered in the context of all that has happened this year (see Astute Overview). What IS exceptional, are the moves we have seen in fixed income markets. In so called "risk-free" assets, like government bonds, year to date performance is just about the worst in history, excluding some pre-war years. Furthermore, the fact that a typical equity bear market has coincided with a totally atypical bond bear market has severely undermined the foundations of portfolio diversification. Leaving few places for investors to generate returns, at a time when inflation is working hard to erode the real value of assets.

Part of the shock in bond markets, I believe, is that investors lost sight of the fundamentals. Rising interest rates was an inevitability, but low rates had become so entrenched over the last decade that people became complacent about the impact they could have. Of course, very few people, myself included, thought rates could rise this high, this quickly. So, while the impact is more severe than anybody really expected, the risk was always there to be managed, something we did reasonably well by avoiding bonds in favour of real assets across our portfolios.

Looking back, during the first quarter of the year it became clear that interest rates needed to rise much higher and faster than previously expected, and this triggered the bear market we are still experiencing. We said at the time, that markets won't stabilise and build the foundation of a new market cycle until we have clarity on where interest rates peak, and that it would likely be early 2023. This still holds true today. We may see a recession which pushes equity valuations lower, but in these circumstances interest rates would likely fall quickly and relieve some of the pressure on valuations, particularly in fixed income markets. We have recently started purchasing bonds to protect us from this scenario. On the other hand, we could also see no recession, with inflation and interest rates remaining high. In which case we think equities are pretty fairly valued and capable of capturing the growth needed to achieve our objectives.

So we remain happy with our positioning, waiting patiently for the clarity - one way or the other - that the market needs to grow again. Something we believe will happen in the next 3 or 4 months. There's always the potential for unforeseen risks, the market reaction to the "Mini Budget" being a good example (see Astute Observations). There are always plenty of doomsayers in markets, and they only get louder when markets are down. Ignore them, and remember the fundamentals: good risk management, disciplined stock selection and patience. The more things change the more they stay the same.

Scott Osborne PhD CFA
Chief Investment Officer

Astute Overview

2022: war, inflation, and a new £1 coin – will it have a silver lining?

The last quarter has certainly caused some superficial damage to equity markets, bond markets, pound sterling and the integrity of the UK economy. The twenty twenties have (so far) seen low probability "six sigma" events become ten a penny. Whilst it has been a painful year for investors so far, key data provide some cause for optimism amongst the prevailing gloom.

We all know that market drops are part and parcel of being invested, and are expected to occur over a long-term investment horizon, however, it's much harder to appreciate your long-term goal when you're in the midst of market volatility. Below, you'll see maximum drawdowns (peak to trough decline) in the main US equity index, and the same data for US government bonds, across notable bear markets. Maximum drawdown tells us what the most painful point of a market was, but tells us nothing about the longevity or recovery. You can of course calculate an average length and loss of a bear market, for the S&P 500 that is -36% over 289 days (this would make October 19th the turning point in this market if we believed in such statistics).

In isolation, this is useless information, each bear market has specific drivers and no two markets are exactly the same. Human behaviour tends to be consistent though, and we can infer from past events how people might respond to a systemic crisis like 2008 versus 1980-82, when Fed Chair Paul Volcker hiked rates to 20% to break inflation. The table highlights we are, at worst a reasonable way towards the bottom of a similar equity market, unless there is some unforeseen systemic risk, but we are way beyond any typical bear market in bonds. Interestingly, US treasuries did fall 20% between mid-1979 and early 1980 as interest rates peaked, but this was a positive period for stock prices.

Event	US Equity Return	Days	US Treasury Return
Volker Rate Rises 1980-82	-27%	622	+16%
Dot Com Bubble 2000-2002	-48%	929	+38%
Financial Crisis 2007-2009	-54%	517	+21%
Year to date	-24%	269	-26%

There are good reasons why equities and bonds are down, but let's take a brief look at the global economy and see if we can't find some silver linings amongst these storm clouds. Firstly, the bad stuff.

Currency - Cable (slang for the exchange rate between the Pound and US dollar) has tumbled steadily this year as US interest rates outpaced the rest of the world. Following the Chancellor's "Mini Budget" the drop intensified, briefly hitting a historic low of just over $1.03 before rebounding. A weak pound isn't just bad news for holidaymakers, it will sting consumers buying imported goods, damage the integrity of the UK, and squeeze margins for businesses importing from overseas. The UK is not alone is this predicament; a strong Dollar is squeezing global growth.

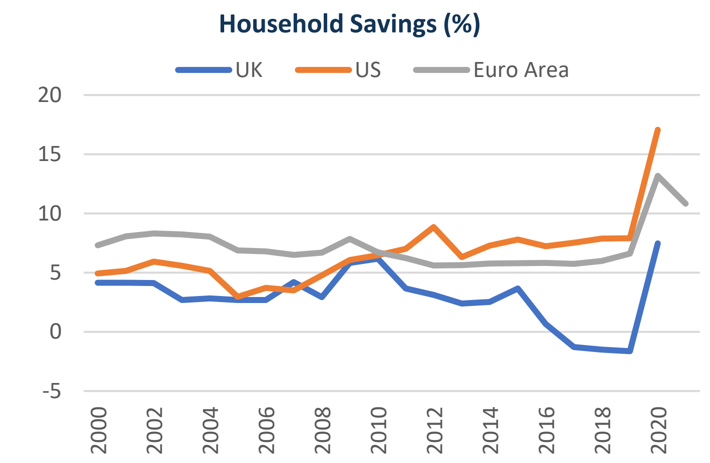
Inflation - According to Google Trends data, searches for inflation have risen sharply, and have remained elevated each month this year. And this is no surprise – inflation, globally, has remained elevated, driven initially by coronavirus induced supply bottlenecks, and then by the consequences of the war in Ukraine. Inflation remains the problem of the day, and while it may be receding, the cure is proving almost as bad as the disease.

Recession - This has been the hot topic since Q2. The US are in a technical recession, and some economists have flirted with the idea that the UK may head into a technical recession by year-end. September saw an additional bank holiday in the UK, to mourn her majesty Queen Elizabeth II, and economists have forecast that this alone will cause a 0.2% drag on September's GDP. The main question now is not if, but when do we go into recession and how bad can it get? Which is good point to start looking for those silver linings.

There is a great deal of semantics surrounding "recession". A recession is technically defined as two consecutive quarters of negative GDP growth, meaning that the US is in a technical recession (as mentioned earlier). The UK, however, is not. Q2 GDP in the UK was revised upwards to reflect 0.2% growth; therefore, in order to declare recession in the UK, we'd need negative Q3 and Q4 GDP at the least, to jump the very first hurdle of a technical recession. But let's not be pedantic - what many would consider a proper recession, would go much further than this: a sharp decline in economic activity, company and household suffering, large scale job losses. Data suggest both the UK and US are far from that becoming reality.

Inflation and Interest Rates - The most likely cause of an imminent recession is aggressive interest rate increases, supressing demand sufficiently to send growth into reverse. We have seen interest rates across Europe, UK and US increase from levels that have been so low for so long, to try and combat inflation. It is undeniable that the current high inflation is an issue for consumers and the economy alike, but inflation measures compare prices in a given month vs prices one year ago. Soon, the high prices we are experiencing will become the base effects for next year's inflation readings. For inflation to remain high, we would need to see continued sharp increases in prices, which we don't believe is plausible in a recessionary environment.

Household Savings - A key difference between the current times and pre 2008 recession, is current savings levels. Data show that the coronavirus pandemic forced savers hands. The unprecedented lockdowns and financial packages led to a build-up in household savings. In the UK and US, household and personal savings ratios have spiked, and remained elevated (above pre-pandemic levels). Healthy household accounts strengthen the outlook in the face of recession as these excess savings will act as a buffer to lessen the impact. A similar story can be seen with company balance sheets.



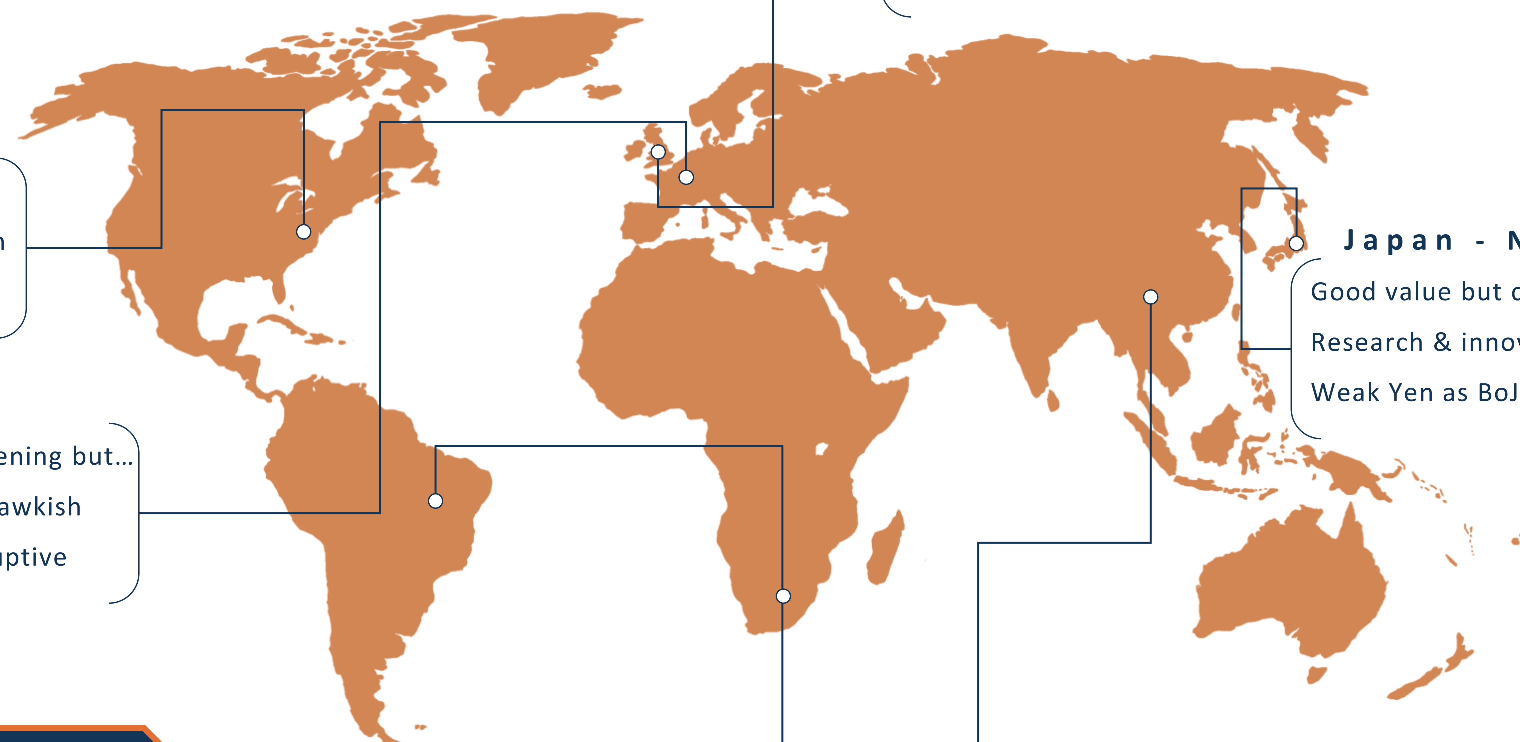
Unemployment – Typically recessions would likely spell a painful rise in unemployment. However, recent labour market data showed UK unemployment fell to its lowest levels since 1974, and vacancies remained close to record highs. The story is similar in the US. Whilst vacancies have started to ease, they remain exceptionally high, showing the labour market is tight. Furthermore, the size of the labour force has not yet recovered from its pandemic lows; many people who left the work force at that time have not returned to the jobs market since. This demand for labour will dampen the impact of job losses if they occur, as companies are less likely to fire workers they have struggled to hire, and those workers who do lose their jobs should find opportunities elsewhere.

Astute Response

While we acknowledge the impact of interest rates and a likely recession, we believe that the economic fundamentals present a better starting point than previous cycles. High interest rates also provide scope for rate cuts if growth slows more quickly than expected. Conversely, if rates stay high because inflation is persistent, we likely avoid a severe recession and valuations already look attractive versus previous cycles in this scenario.

Sources: Refinitiv Lipper, Census Bureau, EuroStat, ONS, OECD

Astute Perspective



UK – Neutral
- Larger companies remain structurally challenged
- Prefer smaller companies with growth opportunities
- Labour/goods shortages likely exacerbated by Brexit

N. America - Neutral
- Rising rates putting pressure on growth names
- Hawkish Fed pivot, committed to tackling inflation
- Recession maybe required to tame price growth

Japan - Neutral/Overweight
- Good value but corporate nationalism persists
- Research & innovation remains strong suit
- Weak Yen as BoJ committed to low interest rates

Europe - Neutral
- Fiscal and political co-operation strengthening but…
- …inflation rising and ECB growing more hawkish
- Focus on energy security potentially disruptive

Asia & Emerging - Overweight
- Long-term growth from demographics & development
- Company valuations attractive vs western equivalents
- Zero-Covid containing attempts at stimulus measures

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. Focus on Quality
   - Economic rebound will broaden growth opportunities, benefiting cyclical sectors most
   - Risks arising from inflation and geopolitics necessitate a refocus on quality, in both expensive secular growers and cyclical value rebounders.

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

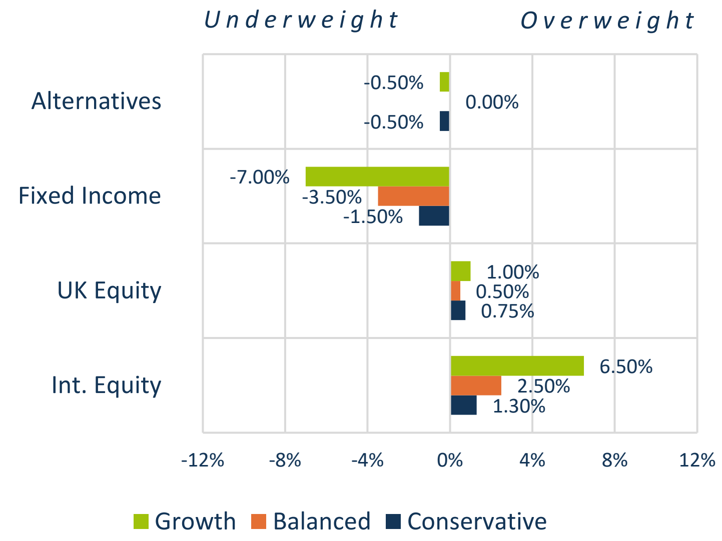
3. Invest Sustainably
   - ESG will become the default option, and the market will shift accordingly
   - If sustainable investing is the future, invest with those who have ESG way into their past

Asset Class Views

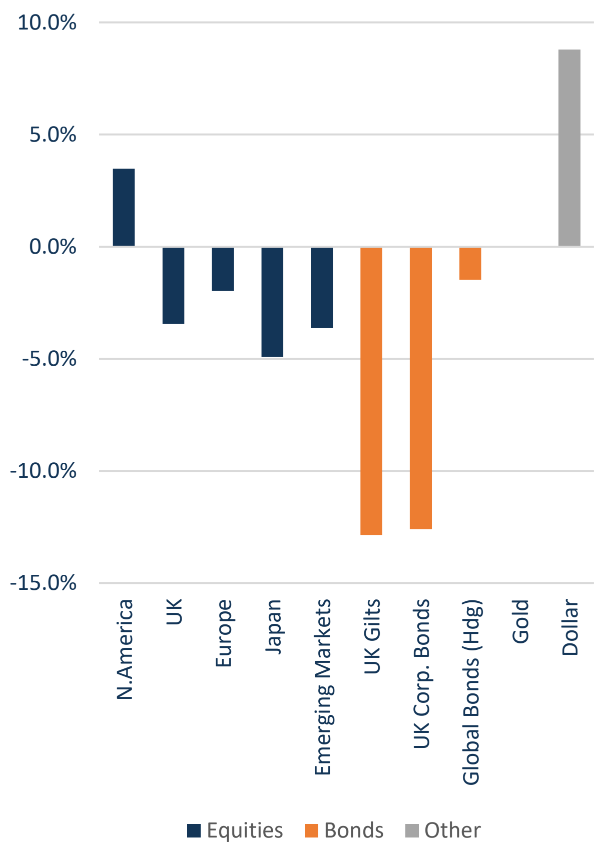
Fixed Income	Negative						Positive
Sovereign Bonds							
Corporate Bonds							
High-yield bonds							
EM Debt							
Alternatives	Negative						Positive
Alternatives							

Equities	Negative						Positive
UK							
Europe							
Asia & Emerging							
Japan							
US							

Tactical Asset Allocation[1]



Asset Class Returns[2]



Astute Positioning

Fund Activity

New Purchase	iShares $ Treasury Bond 1-3yr ETF £ H	Con, Bal
	iShares UK Gilts 0-5yr UCITS ETF GBP	Con, Bal
Top Up	iShares $ Treasury Bond ETF GBP H	Bal
	iShares $ Treasury Bond 1-3yr ETF £ H	Con
Trim	VT RM Alternative Income	Con
	Starwood European Real Estate	Con, Bal
	Real Estate Credit Investments	Con, Bal
	JPM UK Equity Core	Con
Sold	PIMCO GIS Mortg Opps Instl GBP H	Bal
	Renewables Infrastructure Grp	Con, Bal
	iShares $ TIPS ETF GBP H	Con
	Starwood European Real Estate	Bal
	Real Estate Credit Investments	Bal
	Sequoia Economic Infrastructure	Bal

Amid rising market uncertainty and sizeable swings in equity prices, portfolio activity this quarter was confined to carefully selected opportunities in UK and US government bonds. With central banks becoming ever more aggressive with their tightening of monetary policy, yields continued to rise, giving us the opportunity to rotate our real assets exposure into fixed income, where we deemed the risk-adjusted returns to be relatively more attractive. In addition, our decision to focus on debt with shorter maturity terms proved vital to reducing total risk whilst defending capital over the period.

Looking at market movements in Q3, it was really a tale of two halves. During the first half we saw a substantial rally in global equity markets, as softer inflation readings fed the narrative that the US Federal Reserve was close to pivoting on their rate hiking cycle. Rising equity prices, however, is an undesirable outcome for policymakers as it only seeks to loosen financial conditions, which will exacerbate the current inflation problem. Fed Chairman Jerome Powell used the Jackson Hole Symposium in August, as a forum to strategically reiterate his strong commitment and willingness, to tighten as much as necessary, and to bring inflation back down to target - even in the face of a recession. Unsurprisingly, both equities and bonds responded negatively, and the second half of the quarter was dominated by another leg down in markets to lows seen in June.

This meant the funds had to navigate through another challenging quarter. Whilst all three funds posted negative absolute returns over the period, they all managed to outperform their market comparator. The Growth fund was the best performer, supported by its naturally higher exposure to the US Dollar which continues to gain strongly versus Sterling. Generally, within equities, our superior stock selection in Asia, EM & Japan helped to offset losses, particularly our Japanese multi-cap core strategy. This was partially held back by our domestic UK growth managers, who struggled versus their large cap counterparts. Finally, in bonds we saw strong outperformance, again, from being underweight interest rate sensitivity, despite still suffering from marginal losses.

The trades made this quarter primarily focused on capturing the higher yields available on government bonds, which we believed to be mis-priced. We did this tactically however, through shorter maturity bonds, because we felt the yields on offer were far too optimistic, but also to reduce our capital risk if yields spiked higher. Given the current fragility in global economic growth and the rising number of potential risks (for example a further escalation in the Ukraine war, or a very deep recession in the UK and Europe), our base case remains that as monetary policy continues to tighten, corporate earnings will come under pressure, unemployment levels will begin to rise, and the looming recession will be enough to curb demand such that inflation eases faster than markets are currently expecting. This ultimately means that policymaker should not have to raise rates to the levels currently priced into markets and therefore gives us an opportunity to lock in the higher yields before they recede. With this view, as short-term government bond yields began to surpass 3%, we started to build our positions at the expense of real assets. This included the sale of our infrastructure and property debt trusts, which had provided solid protection from falls so far this year.

Within the equity components of the portfolio, activity was relatively quiet with only one adjustment made to our UK exposure in the Conservative fund. Our decision to trim back our UK core fund manager was for two major reasons: one, to realise some gains as the manager had performed relatively well, supported by a weaker currency and energy exposure, and two, to fund our positions in government bonds, where we felt the risk profile was more suitable for the Conservative fund given the increased likelihood of a recession in the UK.

Sources: Refinitiv Lipper for Investment Management & Astute Investment Management as at 30/09/2022. 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 30/06/2022 to 30/09/2022.

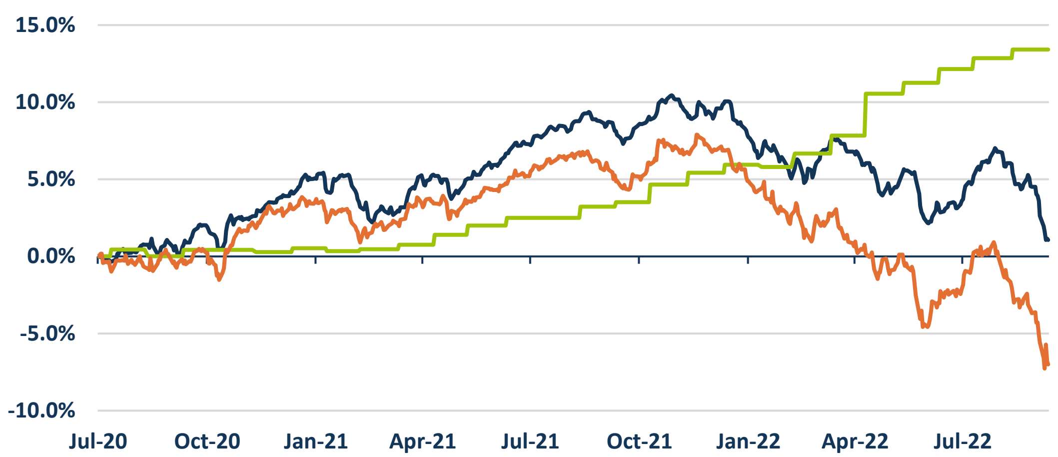
VT Astute Conservative

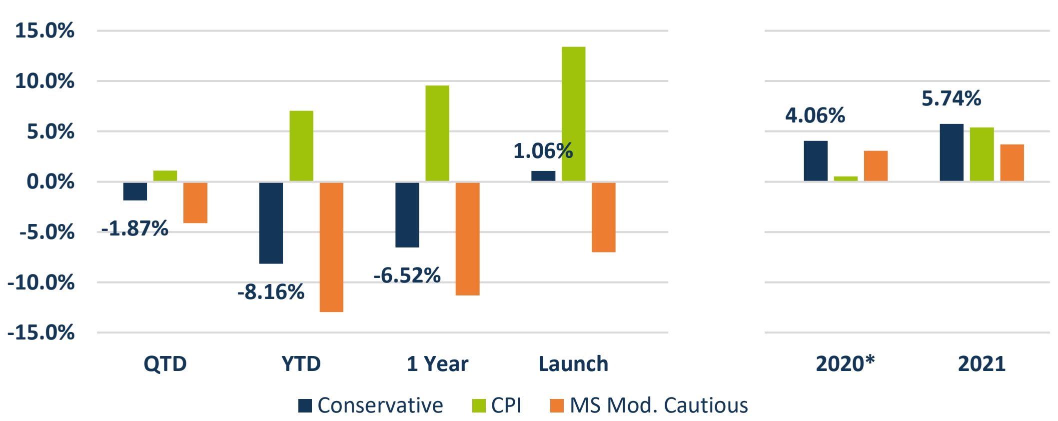
The Conservative fund outperformed its market comparator this quarter, despite the recent weakness in fixed income markets. Our continued preference to own shorter maturity bonds, with less sensitivity to interest rate movements, proved significant over the period in defending capital alongside our overweight position to cash.

During August, hawkish comments from Fed Chairman Jerome Powell at the Jackson Hole Symposium reignited the downtrend in both equity and fixed income markets. This led to yields on short-term, conventional government bonds to surpass 3%. We began to build our positions both in the UK and US bonds, where we believed the most value was on offer. Despite the current leg down in equity markets, being underweight the US was the largest detractor of returns, as the region was the best performer in Sterling terms.

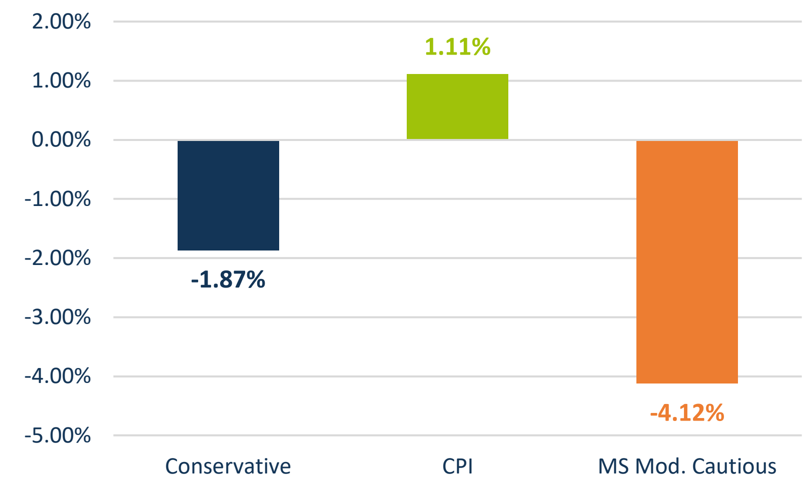
The outstanding performer was L&G US Equity, our largest core US manager, who delivered positive returns supported by the weakness in the Sterling exchange rate. Other positive fund holdings included Blackrock European Absolute alpha, who generated positive returns benefitting from their ability to open short positions, and Gresham House Energy who rose +7.32%, driven by energy price volatility.

Performance[1]





Q3 Returns[2]



Asset Classes

Asset class	Avg Weight	Return	Contribution to Portfolio Return
Cash & Equivalents	14.57%	-0.57%	-0.08%
Government	17.85%	-2.29%	-0.56%
Credit	13.87%	-3.77%	-0.50%
UK	4.85%	-7.35%	-0.23%
N. America	10.43%	0.16%	+0.14%
Europe	2.95%	-5.59%	-0.09%
Japan	2.01%	2.02%	+0.07%
Asia & Emerging	4.51%	-4.21%	-0.12%
Alternatives	25.96%	-2.35%	-0.32%

Top Funds

Fund Name	Avg Weight	Return	Contribution to Portfolio Return
L&G US Equity	5.38%	3.50%	+0.28%
Blackrock European Absolute Alpha	6.01%	2.52%	+0.17%
Gresham House Energy Storage	1.53%	7.32%	+0.14%
Jupiter Japan Income	2.01%	3.17%	+0.09%
iShares China CNY Bond	6.00%	1.57%	+0.08%

Sources: Refinitiv Lipper for Investment Management & Astute Investment Management as at 30/09/2022. Past Performance is not a reliable indicator of future results. All performance is shown net of ongoing charges. Morningstar Target Allocation indices are used as performance comparators. [1] Data for the period 20/07/2020 to the 30/09/2022. [2] Data for the period 30/06/2022 to the 30/09/2022. * 2020 data covers the period 20/07/2020 to 31/12/2020. Contribution to return may not sum to the total return due to rounding and averaging.

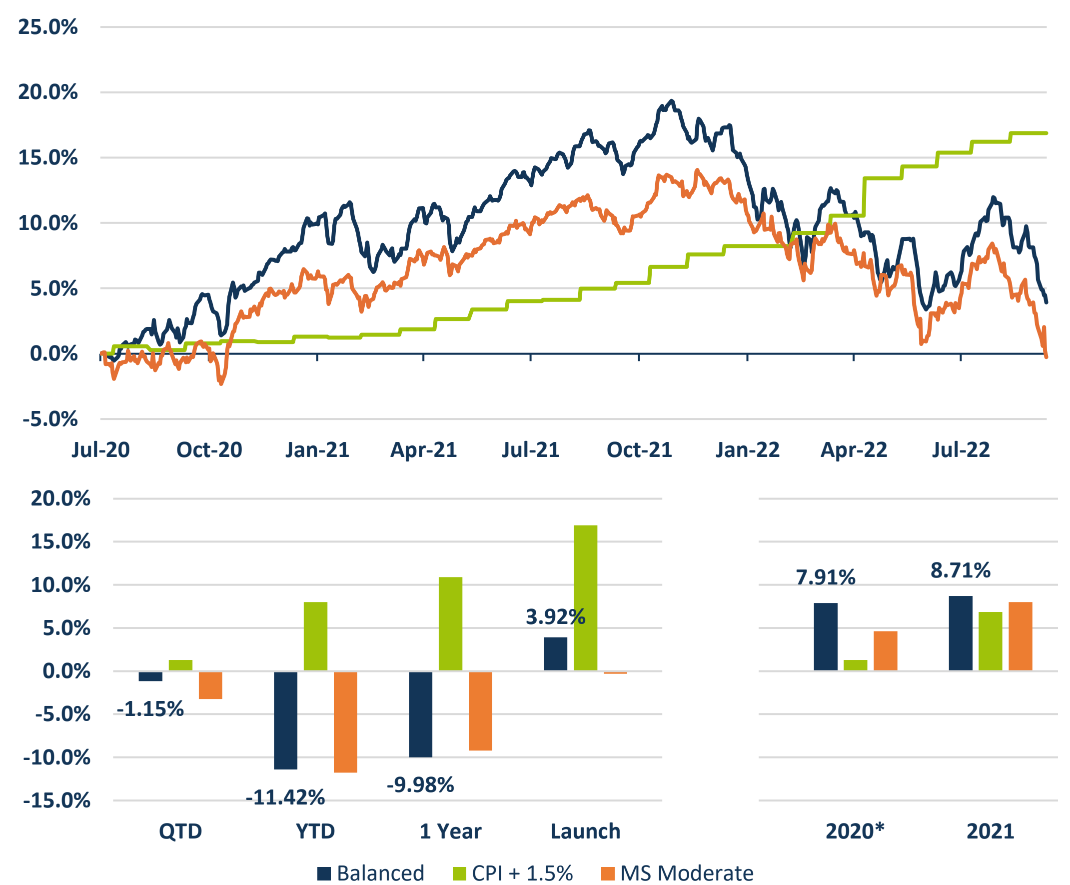
VT Astute Balanced

Over the quarter, the Balanced fund outperformed its market comparator despite the recent fall in equity markets, as policymakers reaffirmed their commitment towards tighter monetary policy. Bond prices also suffered as yields exceeded their previous peak, given the expectation that rates will be higher for longer.

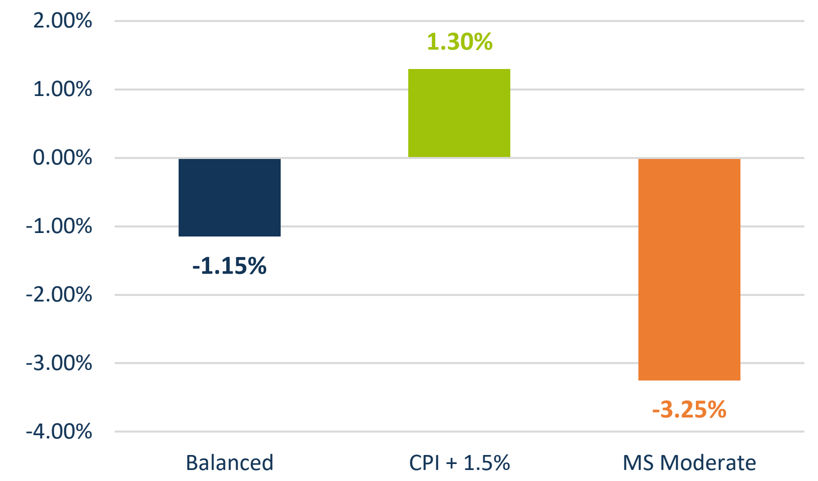
The relative gains were mainly driven by our exposure to government bonds, an area where we've continued to build tactical positions. Our preference to shorter maturity bonds provided relative outperformance, albeit with a marginal absolute loss. Being underweight corporate credit also contributed positively, our UK inflation linked credit manager continued to outperform his peers. These gains were counterbalanced somewhat by our underweight to the US, which led the regions, performance wise, on a Sterling basis.

The top contributing holding was L&G US Equity, who delivered a positive return of +3.50% in Sterling terms, supported by the relative strength in the US Dollar. Other holdings which added strongly to returns included our US growth specialists, Baillie Gifford and Granahan, who both posted double digit returns lifted by currency movements, but also finished the quarter positively in local currency terms.

Performance[1]



Q3 Returns[2]



Asset Classes

Asset class	Avg Weight	Return	Contribution to Portfolio Return
Cash & Equivalents	6.13%	-0.41%	-0.01%
Government	10.06%	-2.73%	-0.37%
Credit	7.92%	-2.77%	-0.36%
UK	7.86%	-7.05%	-0.40%
N. America	22.21%	2.62%	+0.81%
Europe	6.87%	-5.70%	-0.23%
Japan	4.37%	3.34%	+0.20%
Asia & Emerging	9.10%	-4.94%	-0.33%
Alternatives	22.01%	-3.91%	-0.48%

Top Funds

Fund Name	Avg Weight	Return	Contribution to Portfolio Return
L&G US Equity	9.41%	3.50%	+0.51%
Baillie Gifford American	1.59%	12.29%	+0.30%
Granahan US SMID Select	1.62%	11.84%	+0.24%
SPDR MSCI USA Small Cap Val Wtd	2.07%	4.54%	+0.15%
Gresham House Energy Storage	1.52%	7.32%	+0.14%

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VT Astute
Growth

Given the higher exposure to equities, the Growth fund outperformed its market comparator this quarter, as the aggressive re-pricing of interest rate expectations cut into bond prices more severely than equities. This was further supported by the tailwinds in currency movements given the current weakness in Sterling.

The outperformance was largely driven by the fact that the fund held no exposure to fixed income securities, particularly gilts, which significantly underperformed over the period as yields soared, following the announcement of the Mini Budget. Within the equity components, the fund performed broadly in-line with the benchmark, with the US being the better contributor on an absolute basis. Our UK managers with domestic growth exposure failed to compete with the larger FTSE companies that have overseas earnings.

The standout performer was L&G US Equity, who delivered a positive return of +3.50% supported by the weakness in the Sterling exchange rate. Other holdings which added contributed strongly included our US growth specialists, Baillie Gifford and Granahan, who both posted double digit returns lifted by currency movements but also finished the quarter positively in local currency terms.

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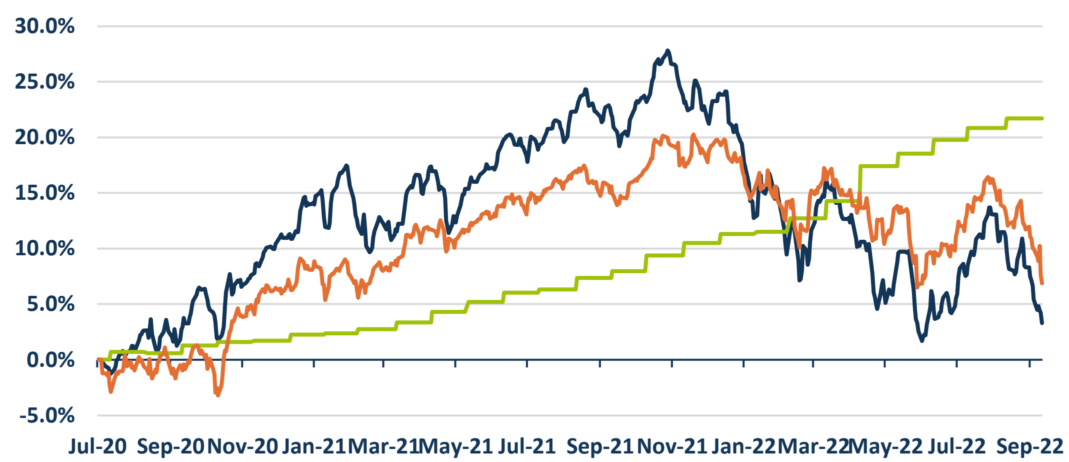
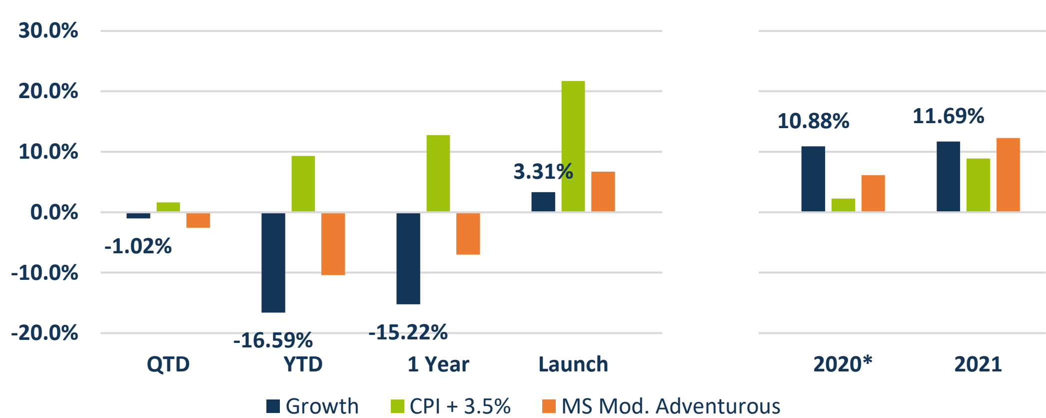
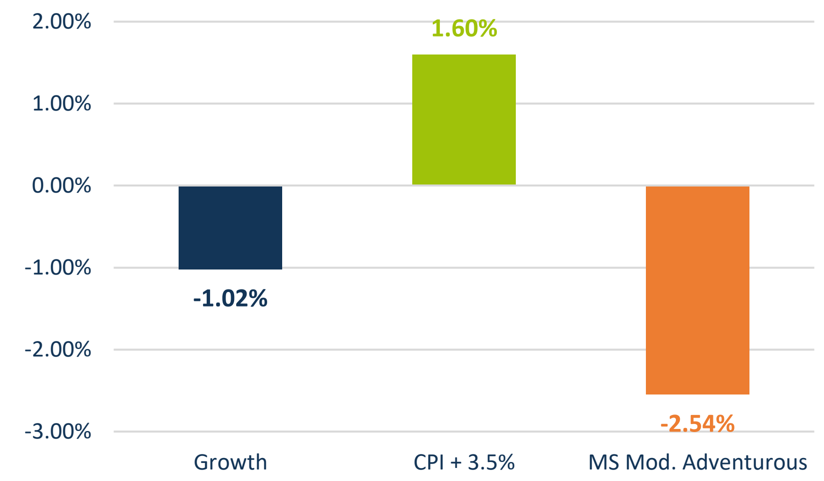




Q3 Returns[2]



Asset Classes

Asset class	Avg Weight	Return	Contribution to Portfolio Return
Cash & Equivalents	3.00%	0.00%	0.00%
Government	0.00%	0.00%	0.00%
Credit	0.00%	0.00%	0.00%
UK	12.85%	-7.51%	-0.74%
N. America	34.16%	2.34%	+1.18%
Europe	11.88%	-5.72%	-0.41%
Japan	7.04%	3.16%	+0.31%
Asia & Emerging	14.18%	-5.16%	-0.56%
Alternatives	9.40%	-13.29%	-1.05%

Top Funds

Fund Name	Avg Weight	Return	Contribution to Portfolio Return
L&G US Equity	13.12%	3.50%	+0.73%
Baillie Gifford American	3.07%	12.29%	+0.59%
Granahan US SMID Select	2.10%	11.84%	+0.32%
Jupiter Japan Income	5.05%	3.17%	+0.23%
Regnan Sustainable Water and Waste	3.03%	4.65%	+0.22%

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Astute Observations

"MINI" BUDGET
GILTY AS CHARGED

At the end of last month, the new prime minister and chancellor announced a substantial, unfunded fiscal package that will significantly increase government borrowing, ultimately offset by a hypothetical rise in economic growth. The 'mini' budget contained various tax cuts, including the now defunct abolition of the additional rate, as well as the reversal of planned tax rises (see our budget blog online for more information). Combined with "supply-side" reforms, removing regulatory barriers, this low tax economy is intended to trigger a surge in growth and innovation.

Markets, however, did not respond well. Sterling fell sharply, and - more significantly - government borrowing costs increased considerably, to the extent that the additional borrowing costs after the announcements could add another £10-20bn to the total bill. More worryingly, the day after the budget, the Bank of England (BoE) was forced to intervene in gilt markets. The speed of increase in yields had triggered a doom loop of urgent selling and falling prices as buyers abandoned the market completely. In response, the BoE committed to temporarily buying as many long-dated government bonds as the market needed to restore financial stability. Even after this calming effect, UK 10-year gilt yields still ended September at 4% compared with 2.2% at the start of the quarter. While Sterling has been sliding for some time against the Dollar, the chart to the right shows it took another leg down on the news.

Why did we get such a negative response? The key is interest rates. A low tax, supply-side growth plan might be great for an economy that is running below its potential. However, the reason we have rising prices, and the reason the BoE has been raising rates, is because we have a supply and demand imbalance. The second chart shows how tight labour markets are. More jobs sounds great at party conference, but when there's already more vacancies than unemployed people, the only possible outcome is more inflation.

Ultimately the Mini Budget put fiscal and monetary policy on a collision course, with the likely outcomes being even higher rates, to tame inflation, or uncontrolled inflation and a collapsing currency. Neither outcome is appealing and asset prices responded accordingly.

Source: ONS & Refinitiv Lipper