ASTUTE
INVESTMENT MANAGEMENT

VT Astute Funds

Quarterly Commentary

Q3 2023

Introduction

Thank you for taking the time to read our Q3 commentary. As we move into the final quarter, we will pass two years of negative returns for many markets. The prolonged nature of this poor performance can feel worse than the shock of a major crash, and weighs significantly on sentiment. Nobody enjoys living through such periods, but they are part and parcel of investing, and it is exactly why a disciplined, long-term approach is the only way to consistently deliver on investment objectives. Looking back through history can help to guide us in these difficult moments, and it is always the investors who stick to their knitting and weather the storm who are ultimately rewarded.

With such a difficult period behind us, our CIO letter this quarter looks for reasons to be more positive about the future, and why the bond market can be a big contributor.

In our Astute Overview section, we look at why cash may not always be king when it comes to investing, even when rates have been as high as they are today.

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

How I Learned to Stop Worrying and Love the Bond

I expect we will look back on the two-year period stretching from Q4 2021 to today and liken it to something like the dot com bubble or global financial crisis for the bond market. In fact, this period of poor returns is already worse than the financial crisis for lower risk investors, not in terms of the size of the drop, which was worse in 2008, but because of the prolonged nature of the drawdown and the simultaneous sharp acceleration in inflation. Since the bond market sets the price for risk, assets have struggled across the board.

There are no rolling news headlines or Hollywood movie adaptations explaining why, who would want to watch a 3-hour epic on inflation and interest rates anyway? These slowly grinding markets are the worst kind and can seem unrelentingly grim, but there is hope! We are more positive about the future today precisely because of the last two years. Whenever we have had prolonged periods of poor returns in the past, the subsequent 12-month period tends to be positive most of the time (see our Astute Overview for a more detailed look at this).

What could a more positive future look like? We see three broad scenarios, none of which will be a walk in the park, but in all we see a path for positive returns. The first, and least likely in our opinion, is even higher inflation and interest rates. With inflation already on its way down we don't believe this will happen, but we retain some income generating and inflation linked assets which are designed to generate their best returns in that environment.

What we expect to happen, is that we get short, shallow, recessions while inflation and interest rates drift lower over several years. Not sunshine and rainbows by any means, but we think equities can do the heavy lifting here as valuations in some areas, particularly in smaller companies, are priced for a much more negative environment. Finally, we could end up in a much more negative environment, in which case we would expect inflation and interest rates to fall rapidly and the bond market to provide a significant cushion. Hence the nod to Stanley Kubrick's classic satire in the title of this piece.

While it's a lie to say I have stopped worrying (worrying is a large part of my job!) we are increasingly in love with bonds. To demonstrate why, let's take a simplified example of lending money to the UK government. First let's assume they don't default - default hopefully isn't a huge risk even with the parlous state of our politics. So, we are going to get our money back, but how much profit will we make? The yield that UK plc will pay me to lend them money for 10 years is around 4.5% as I write. This is about 1% lower than the best cash ISA rates, so why bother? Well, the bond pays 4.5% for 10 years while the cash account only pays 5.5% for one or maybe two years. This is why the value of that bond will move up or down in line with interest rates, something we rather boringly call "duration". If rates go down, that 10-year cashflow is worth relatively more and vice-versa.

So, what could we make or lose on this 10-year bond if interest rates move? For every 0.5% that yields fall the bond will increase in value by around 4%. That's 8% return on top of your income if yields move back to where they were at the start of the year. They could also go up another 1% (in which case you will lose that amount), but we firmly believe the upside is much greater than the downside from this point, and that's the sort of asset we like to hold in our portfolios.

As humans our innate behaviour puts much greater emphasis on recent events than historic ones. We are all scarred by recent experience, but as we exit what is certain to be regarded as one of the worst periods in market history, particularly for fixed income assets, it's easy to lose hope and forget the lessons we know from history: markets recover, things will get better. If we keep our discipline, stick to our process and trust that the last 30 years has more useful information than just the previous two, it's not difficult to see a more positive road ahead.

Scott Osborne PhD CFA
Chief Investment Officer

Astute Overview

History Tells Us Why Cash Isn't Always King

Last quarter we took the time to discuss mortgage pain, and how increasing interest rates were feeding through to debt and stinging those with mortgages. This quarter, we're looking at the other side of the coin: deciding whether to hold more cash or stay fully invested in the same environment.

After the Global Financial Crisis (GFC) era of on-the-floor-rates, it's a good feeling to see meaningful, reliable interest paid on your cash. But by what standards would a return on capital given by today's interest rates be considered high?

By historic cash rate standards? No. As long-term investors, we must delve back into history to put today's interest rates into perspective: the average base rate from 1994 to 2023[1] was around 3%. If we look before the unusually low rates of post 2008, the average is closer to 5.35%, slightly higher than today's 5.25%.

By the standards of investment markets? No. Given that interest rates have been unusually low since the GFC, it has been a low hurdle for equities to jump in order to beat cash over the last 15 years. However, let's look at the return on cash vs investments in an interest rate environment similar to today's - the last time that we could obtain a meaningful return on cash.

In that higher rate environment (1994-2008) we can see that the average 2-year return of a balanced portfolio was 15.7%[2], and the average money market (or cash) return was 7.8%. In fact, in this example, a balanced portfolio beats cash 70% of the time over any 2-year period. This speaks to logic given that, as investors, we require a higher return on our investment for the extra risk we take.

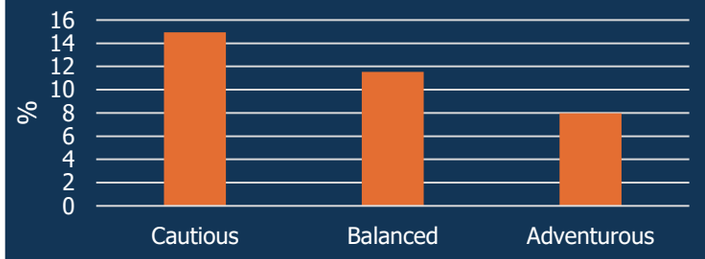
Despite this, recent poor market performance, and interest rates that are higher than recent history raise the question: should we sell out of riskier assets and hold more cash? This isn't a quandary posed only to clients, but also to analysts and fund managers, indeed to us, managing the VT Astute funds.

If an environment of around 5% returns on cash existed in a vacuum, you'd perhaps expect that we'd be shifting assets into cash within the funds, however, we are moving in the opposite direction. Where we run a level of cash as a cornerstone of the fund, then we will certainly take up a higher nominal cash return thank you very much, but as a tactical decision to hold more in cash, it doesn't add up for three key reasons.

Firstly, cash accounts are low risk by some metrics - they provide security, and certainty of return for the short-term, and won't decrease (at least on face value). However, one of the biggest risks that cash poses, is the risk that inflation will erode its spending power, which is important to consider as we are experiencing the highest inflation this century. Furthermore, the minimum recommended timeframes for our investor profiles are 5, 7 and 10 years (for cautious, balanced and adventurous respectively), and the risk that inflation will eat away at the spending power of cash is magnified over the long-term.

Secondly, whilst the last 2 years have been difficult for markets, they have created an environment of attractive valuations, giving us a strong foothold to achieve the funds' long-term goals of keeping pace with (or beating) inflation over the long-term, a goal that is unlikely to be achieved by investing in cash. Whilst earning a set interest rate on cash provides certainty of how much you will make, by disinvesting from risk assets it also provides certainty that you won't be part of the next market recovery.

Average 12 Month Return Following Negative 2-Year Performance[3]



Finally, history is littered with periods of market falls and recoveries; we looked back at 25 years of market data to find the times when portfolios will have lost money over 2 years, as they have today. For a balanced portfolio, the subsequent 12-month return was positive 85% of the time.

Based on our historical back testing, over the last 25 years a cautious portfolio generated an average return of 15% in the 12 months following a negative 2-year performance. A balanced portfolio generated an average 11.5%, with returns ranging from -14% to 35%, whilst an adventurous portfolio generated just under 8% with a much larger range of -24% to +44%. These data demonstrate that prolonged periods of poor returns bias markets towards positive outcomes. Since we know markets go up more than they go down this shouldn't be surprising, but it often is when you dig into the data.

Along with your financial planner, once you have established a cash emergency fund, you will have allocated a suitable proportion of your assets to investments with the appropriate level of risk. Your financial plan will take into account tough market conditions, and short-term periods of negative returns, and be resilient enough to stay on track to achieve your long-term goals.

What would surely knock your plan off-track, would be an attempt to time the market by moving into (and back out of) cash. The temptation to move to cash for short-term safety is a natural instinct that investors have long faced and will continue to face. We believe that the best decision you can make, is a rational and informed one. The rest is history.

Astute Response:

While high cash rates seem very appealing, we believe we can find more attractive opportunities in riskier assets. As rates increased, capital flowed away from markets and into cash accounts. In these circumstances, lots of very good companies and assets get left behind, and historically this is when strong future returns can be locked in. Within the fund we continue to invest in assets we think are undervalued - like government bonds - and where we think too much bad news is priced-in, like small and mid-cap stocks. This gives us a diversified portfolio that can generate returns in different macro-economic scenarios and helps deliver on our long-term objectives.

All data from Lipper for Investment Management as at 30/09/2023

1 – this period marks the Bank of England's modern inflation targeting mandate post the fall out of Black Wednesday and the Sterling devaluation in 1992

2 – based on Astute Investment Management's strategic asset allocation

3 – Astute Investment Management's strategic asset allocation average 12 month return following every period of negative 2-year performance in the last 25 years

Astute Perspective

UK – Neutral

UK markets biggest beneficiary of energy stock rally

Prefer smaller companies with growth opportunities

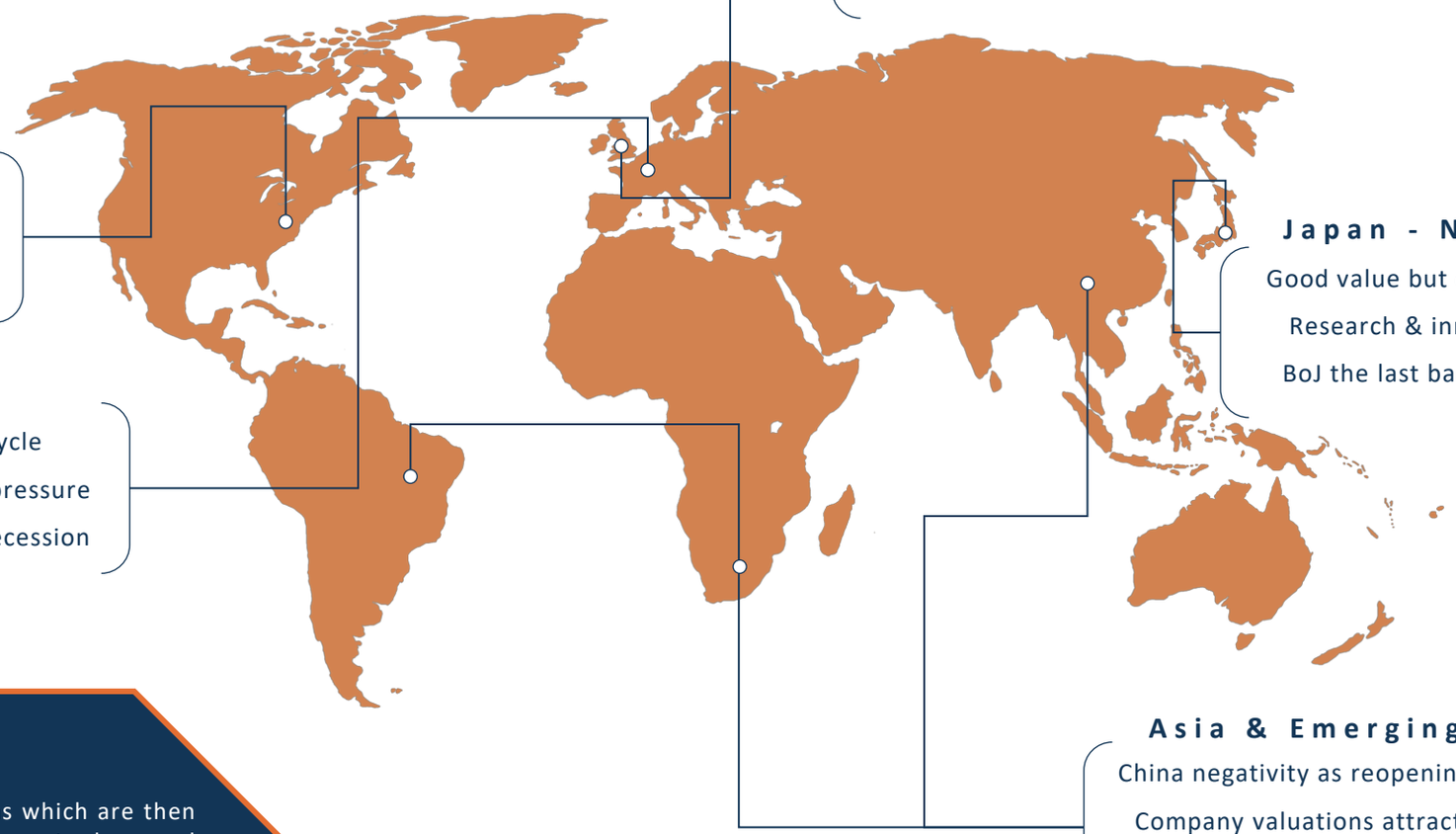
Underlying economic growth challenged but improving

N. America - Neutral

Peak in interest rates looks imminent

Fed remains worried about labour markets

Credit conditions tight but banking crisis passed



Japan - Neutral/Overweight

Good value but corporate nationalism persists

Research & innovation remains strong suit

BoJ the last bank standing with loose policy

Europe - Neutral

ECB playing catch up in rate hiking cycle

Falling gas prices easing some inflation pressure

Forward indicators now point towards recession

Asia & Emerging - Overweight

China negativity as reopening fails to stimulate economy

Company valuations attractive vs western equivalents

Geo-politics an increasing risk as election cycles begin

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.

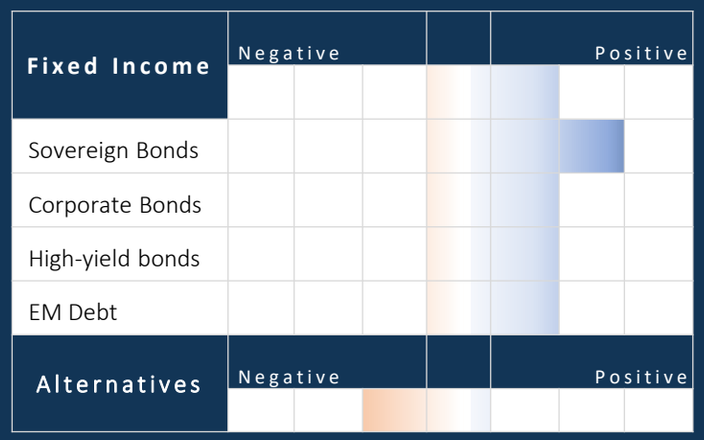
2. Overweight Technology

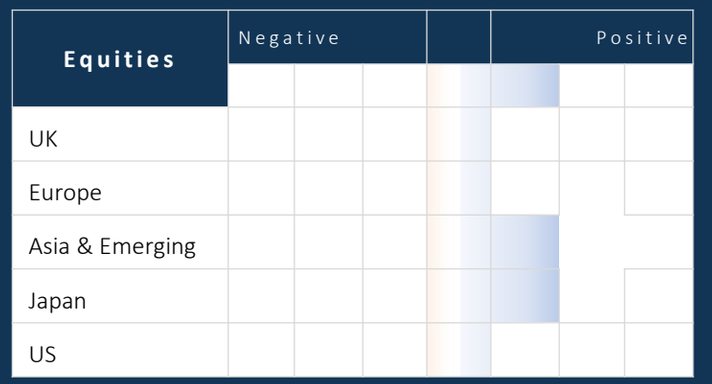
- Technological revolution will continue, lean into disruptive areas, the strong get stronger.
- Look beyond current global leaders and use specialists to stay ahead of the curve.

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.

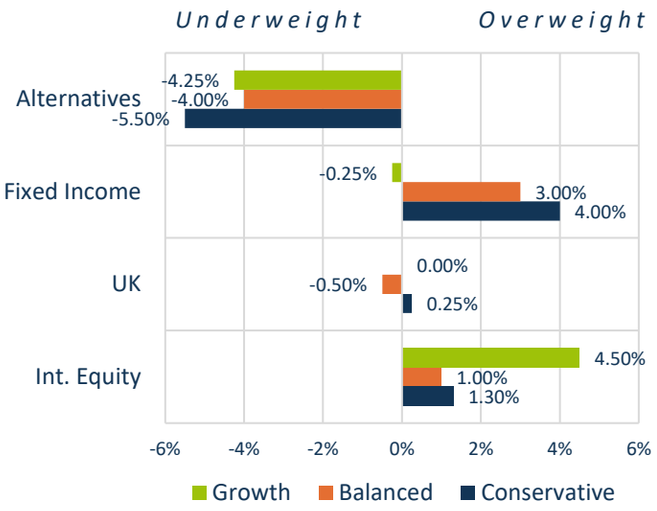
Asset Class Views



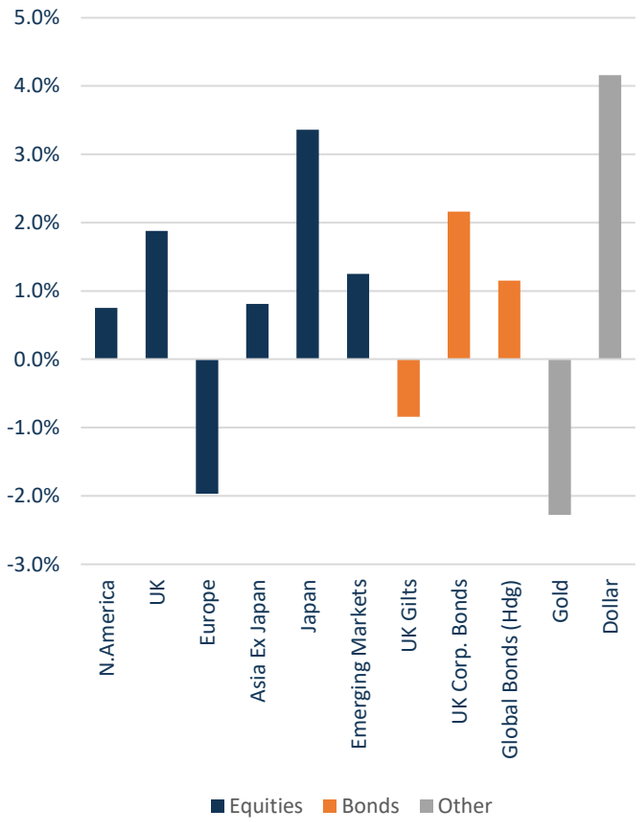


Astute Positioning

Tactical Asset Allocation[1]



Asset Class Returns[2]



Fund Activity

New Purchase	Man GLG Sterling Corporate Bond	Gro
	iShares $ Treasury Bd 20+y ETF	Con, Bal
Top Up	iShares Core UK Gilts	Con, Bal
	Man GLG Dynamic Income	Con
Trim	Tritax Eurobox	Con, Bal
	abrdn European Logistics Income PLC	Con
	Gresham House Energy Storage	Con, Bal
	LXI REIT Ord	Con
	Syncona Ord	Bal, Gro
	BlackRock European Absolute Alpha	Bal
	Protea ECO Advs ESG Abs Ret	Bal
	M&G UK Inflation Lnkd Corp Bond	Bal
	Royal London Shrt Dur Glbl HY Bd	Bal
	iShares $ Treasury Bond ETF	Con, Bal
Sold	VT Gravis Clean Energy Income	Bal
	Hermes Multi-Strategy Credit	Con

The summer started with relatively positive returns through July, as markets took solace from the approaching peak in interest rates and stronger economic data that pointed to a "soft landing" for economic growth. August, however, saw doubts re-emerge, and despite US and UK interest rates being held static in the September meetings, the focus shifted to a "higher for longer" narrative. The main signal from which was that investors would have to wait longer before interest rates come down. Markets reacted negatively to this and for the back half of the quarter, bonds and equities fell in unison.

While we didn't expect the market response to the central bank guidance to be so negative, we have for some time believed that rates would stay higher for longer. Our view remains that this higher for longer narrative is only warranted if global economic growth remains robust and recessions prove mild, if they materialise at all. However, we once again saw investors eschew anything sensitive to economic growth in favour of larger quality stocks as recession fears led sentiment. This led to underperformance in most of our equity allocations. Despite this, long-term yields rose, and thus bond prices fell, which was negative for our overweight fixed income position.

We don't rule out severe recessions, but in these circumstances interest rates will fall rapidly and bonds could rally significantly from current levels. Given the move lower in long-dated bond prices we continued to add to our positions to provide additional protection from this scenario. These trades came from two sources and represent a continuation of trades that we have been making over the course of the year.

The first was in our alternatives bucket, principally our real assets holding. These have increasingly suffered as inflation has surged. Inflation linkage in rent reviews takes time to feed through, and thus the income stream has been left lagging behind cost increases. While we have no doubts about the quality of the underlying assets, the inherent economic sensitivity means they may also suffer in a recessionary environment. As such the risk return looks better in bond markets, which will provide better protection from negative growth scenarios and are increasingly cheap. Most of the proceeds from these sales were re-invested into UK government bonds and latterly in long term US government bonds, following a spike in yields in late September.

The second source of capital for these purchases was other fixed income funds. This doesn't increase our overall bond allocation but does increase our sensitivity to moves in interest rates. We did this by trimming some of our best performing short duration strategies, which have served us well over the last two years, but now look to have less upside than conventional bonds with a greater sensitivity to changes in interest rates.

One bright spot was our corporate bonds, where good active management led to outperformance even in the rising yield environment. One of our conviction views is that markets are overestimating the damage that will occur in corporate bonds as growth slows and companies are forced to re-finance long term debt at much higher rates. There will inevitably be defaults but there are also excellent opportunities to achieve higher rates of return by taking considered risks. We added to this theme by introducing GLG Corporate Bond into the Growth fund and topping up to the Dynamic Income fund in conservative. Both strategies are managed by the same team and have proven adept at exploiting the opportunities available in the current fear-driven markets. We did completely sell our multi-strategy credit fund as part of this rotation, despite solid performance, as this fund's broader remit is less aligned with our house view.

Sources: Refinitiv Lipper for Investment Management & Astute Investment Management as at 30/09/2023. 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 30/06/2023 to 30/09/2023.

VT Astute

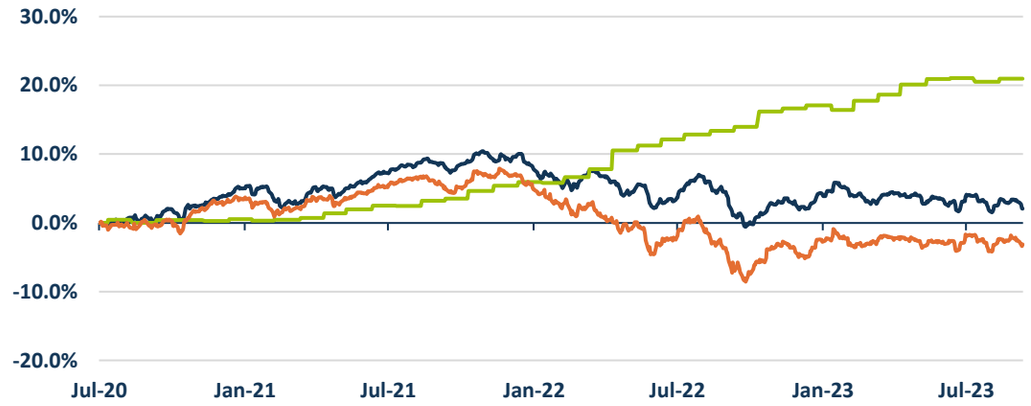
Conservative

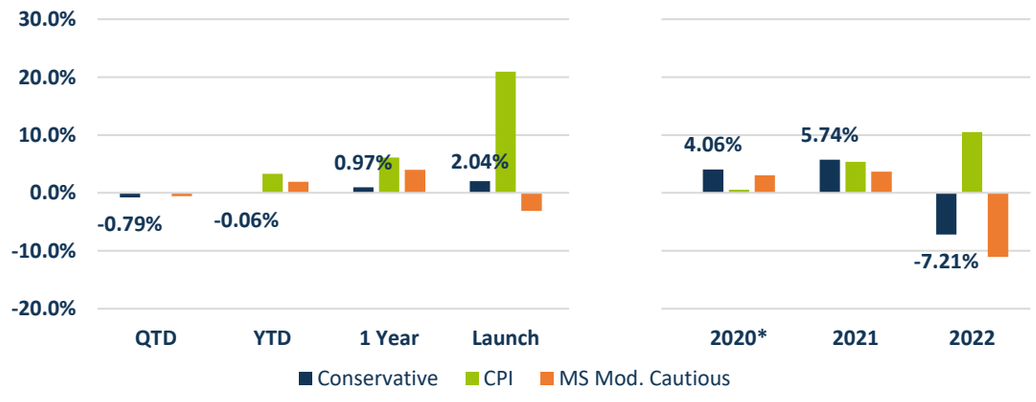
The Conservative fund underperformed its market comparator this quarter. This was driven primarily by our overweight to fixed income and some poor returns in our alternatives holdings. Growth sensitive equity holdings also fell out of favour towards the end of the quarter which held back our equity allocations. In our credit bucket, positive stock selection helped offset some losses.

As they did in 2022, equities and bonds fell in Q3, however unlike 2022 our alternatives failed to defend capital. This principally comes from our real assets positions where income has lagged behind inflation and thus investors have dumped positions in favour of bonds. This underperformance more than offset the solid returns from our structured products and absolute return funds. In equities, the worst performer was our infrastructure position which shares some of the same issues as alternatives, with rising yields hurting the value of bond-like defensive cash flows.

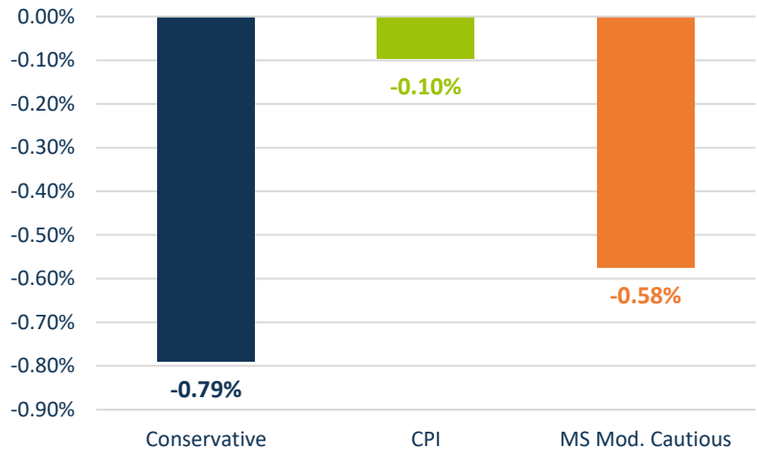
The outstanding performers have been concentrated in our credit buckets, with our Man GLG and BlueBay holdings posting stronger returns. Other strong contributors include our UK equity holdings that had less growth, and more energy exposure, such as R&M UK Recovery and JPM UK Equity Core.

Performance[1]





Q3 Returns[2]



Asset Classes

Asset class	Avg Weight	Return	Contribution to Portfolio Return
Cash & Equivalents	2.69%	1.33%	+0.04%
Government	23.06%	-1.43%	-0.33%
Credit	28.48%	1.43%	+0.41%
UK	4.04%	0.82%	+0.03%
N. America	10.00%	-1.72%	+0.14%
Europe	2.99%	-3.55%	-0.11%
Japan	2.02%	0.36%	+0.01%
Asia & Emerging	4.47%	-1.56%	-0.07%
Thematic	2.99%	-6.05%	-0.18%
Alternatives	19.29%	-2.38%	-0.46%

Top Funds

Fund Name	Avg Weight	Return	Contribution to Portfolio Return
Man GLG Sterling Corp Bond	4.06%	4.79%	+0.19%
L&G ESG GBP Corporate Bond ETF	4.49%	2.38%	+0.11%
M&G UK Inflation Lnkd Corp Bond	5.98%	1.66%	+0.10%
Man GLG Dynamic Income	1.80%	5.01%	+0.09%
BlueBay Financial Cptl Bond	2.59%	3.26%	+0.08%

Sources: Refinitiv Lipper for Investment Management & Astute Investment Management as at 30/09/2023. 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 30/09/2023. [2] Data for the period 30/06/2023 to the 30/09/2023. * 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.

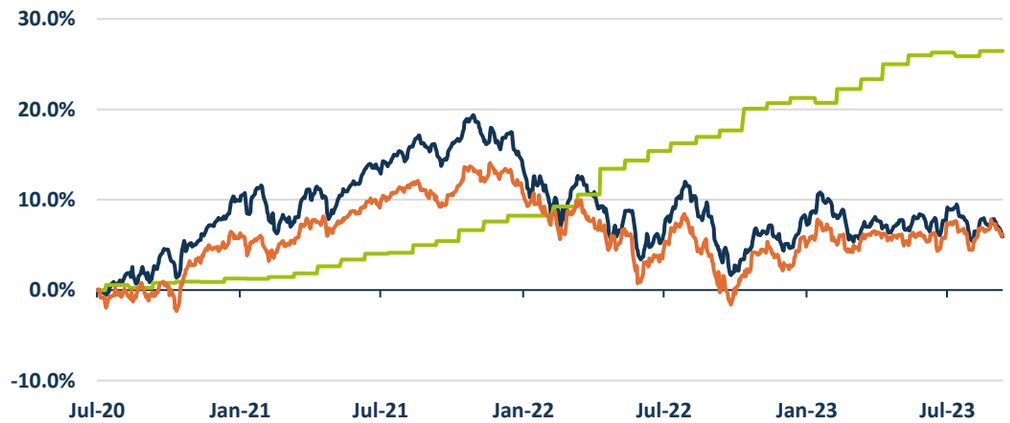
VT Astute
Balanced

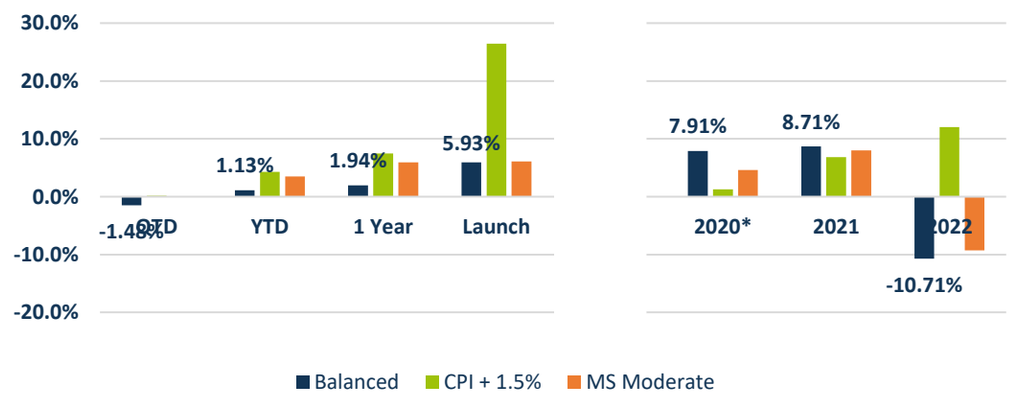
The Balanced fund underperformed its market comparator this quarter. This was driven primarily by our exposure to government bonds, some poor returns in our alternatives component as well as our growthier equity holdings being out of favour this quarter. Stock selection significantly helped offset some losses in our credit bucket and in UK equities.

As they did in 2022, equities and bonds fell in Q3, however unlike 2022 our alternatives failed to defend capital. This principally comes from our real assets positions where income has lagged behind inflation and thus investors have dumped positions in favour of bonds. This underperformance more than offset the solid returns from our structured products and absolute return funds. In equities we saw our growth focused positions underperform as yields rose. We also saw weakness in our more economically sensitive small and mid-cap positions as the market shunned everything but the largest "quality" companies. Our infrastructure thematic also underperformed this quarter as underlying companies with bond-like, defensive cash flows also felt the pain of rising yields.

The outstanding performers have been concentrated around our credit buckets, with our Man GLG and BlueBay holdings posting some impressive quarter to date returns. Other strong contributors include our UK equity holdings that had less growth, and more energy exposure, such as R&M UK Recovery and JPM UK Equity Core.

Performance[1]





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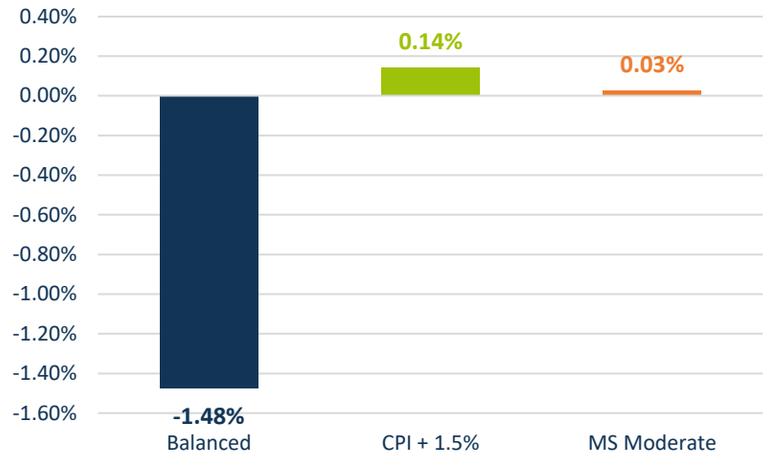


Asset Classes

Asset class	Avg Weight	Return	Contribution to Portfolio Return
Cash & Equivalents	2.43%	1.33%	+0.03%
Government	13.88%	-1.45%	-0.20%
Credit	16.64%	0.49%	+0.08%
UK	7.13%	1.08%	+0.08%
N. America	21.74%	-2.04%	-0.44%
Europe	5.35%	-2.72%	-0.15%
Japan	4.61%	0.15%	+0.01%
Asia & Emerging	8.92%	-0.86%	-0.08%
Thematic	3.38%	-4.81%	-0.16%
Alternatives	15.39%	-3.21%	-0.49%

Top Funds

Fund Name	Avg Weight	Return	Contribution to Portfolio Return
L&G US Equity ETF	9.29%	1.46%	+0.14%
JPM UK Equity Core	4.08%	3.10%	+0.13%
BlueBay Financial Cptl Bond	3.07%	3.26%	+0.10%
ES R&M UK Recovery	1.48%	3.37%	+0.05%
Man GLG Sterling Corp Bond	1.02%	4.79%	+0.05%

Sources: Refinitiv Lipper for Investment Management & Astute Investment Management as at 30/09/2023. 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 30/09/2023. [2] Data for the period 30/06/2023 to the 30/09/2023. * 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

Growth

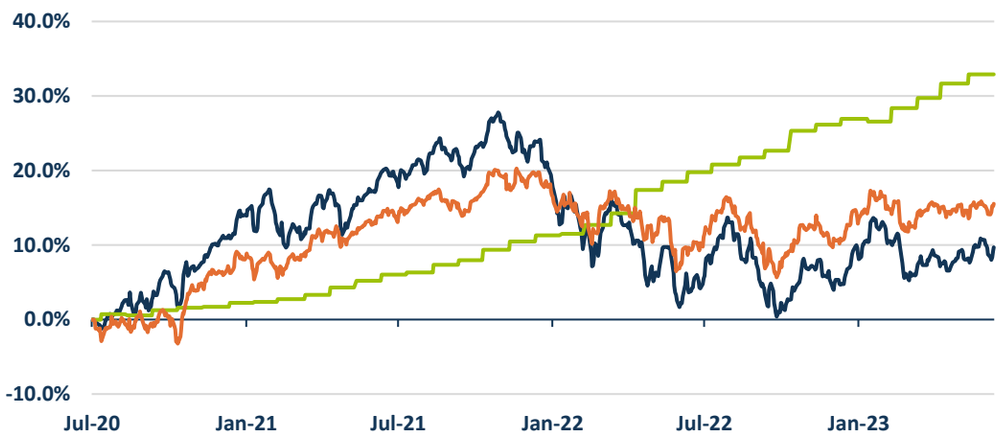
The Growth fund underperformed its market comparator this quarter. This was driven primarily by some poor returns in our alternatives component as well as our growthier equity holdings being out of favour this quarter. Stock selection significantly helped offset some losses in our credit bucket and in UK equities.

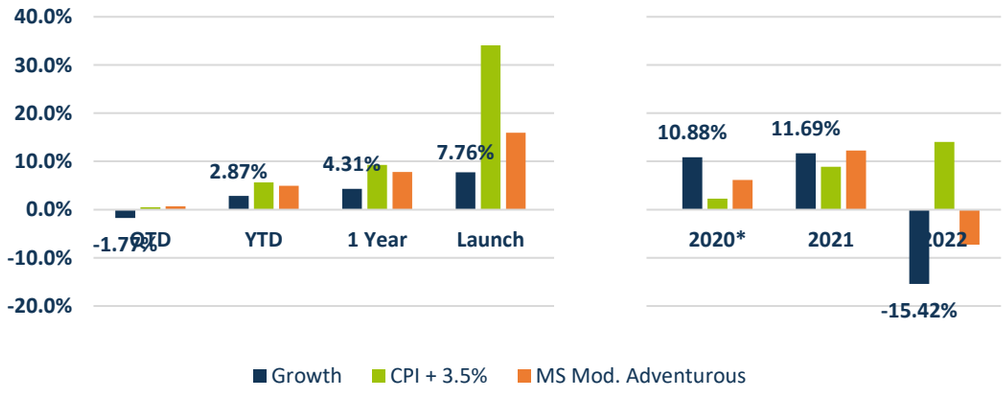
In equities we saw our growth focused positions underperform as yields rose. We also saw weakness in our more economically sensitive small and mid-cap positions as the market shunned everything but the largest "quality" companies. Our infrastructure thematic also underperformed this quarter as underlying companies with bond-like, defensive cash flows also felt the pain of rising yields.

Within alternatives our specialist bio-tech investment trust Syncona had a bad quarter after one of its portfolio companies stopped development of a key pipeline drug. The trust trades at a steep discount and subsequently announced a buyback to help support the share price. This move more than offset the solid returns from our structured products and absolute return funds.

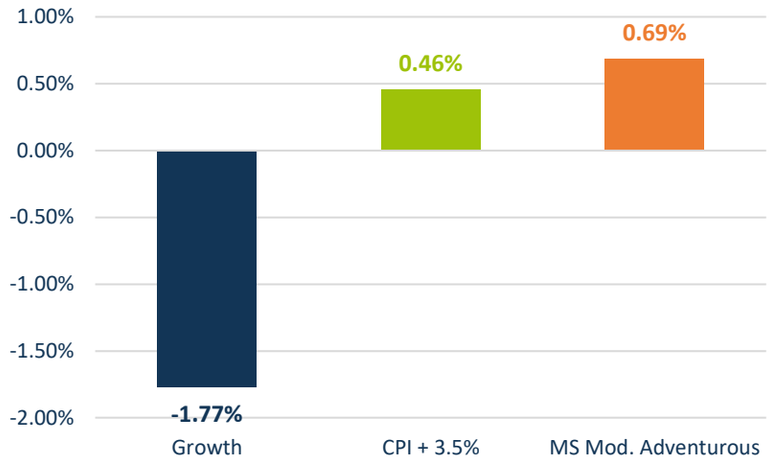
The outstanding performers have been concentrated around our credit buckets, with our Man GLG and BlueBay holdings posting some impressive quarter to date returns. Other strong contributors include our UK equity holdings that had less growth, and more energy exposure, such as R&M UK Recovery and JPM UK Equity Core.

Performance[1]





Q3 Returns[2]



Asset Classes

Asset class	Avg Weight	Return	Contribution to Portfolio Return
Cash & Equivalents	2.51%	1.33%	+0.03%
Government	0.00%	0.00%	0.00%
Credit	7.30%	2.23%	+0.16%
UK	11.92%	0.83%	+0.10%
N. America	34.76%	-2.17%	-0.75%
Europe	9.81%	-2.70%	-0.26%
Japan	7.17%	-3.96%	-0.28%
Asia & Emerging	13.88%	-0.88%	-0.12%
Thematic	7.37%	-4.40%	-0.32%
Alternatives	5.29%	-7.18%	-0.38%

Top Funds

Fund Name	Avg Weight	Return	Contribution to Portfolio Return
L&G US Equity ETF	13.50%	1.46%	+0.20%
JPM UK Equity Core	5.93%	3.10%	+0.18%
BlueBay Financial Cptl Bond	3.61%	3.26%	+0.12%
ES R&M UK Recovery	2.91%	3.37%	+0.10%
Man GLG Dynamic Income	1.01%	5.01%	+0.05%

Sources: Refinitiv Lipper for Investment Management & Astute Investment Management as at 30/09/2023. 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 30/09/2023. [2] Data for the period 30/06/2023 to the 30/09/2023. * 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.

Astute Observations

Falling House Prices – Not Worth Writing Home About

Finally getting rid of your mortgage is a milestone for any homeowner, but for most aspiring homeowners, just getting approved for one is the challenge. As recent data confirm UK house prices have now fallen for the first time since 2012, is now a good time to jump on the property ladder?

The first chart to the right puts the drop in prices in the context of the global financial crisis (GFC), when house prices plummeted. The blue line on this chart shows the number of house repossessions inverted (so repossessions increase as the line moves down). Clearly during the GFC repossessions sharply spiked as people defaulted on the mortgages and became forced sellers. However, looking at these data today, we don't see anything like a similar pattern, so why are house prices falling?

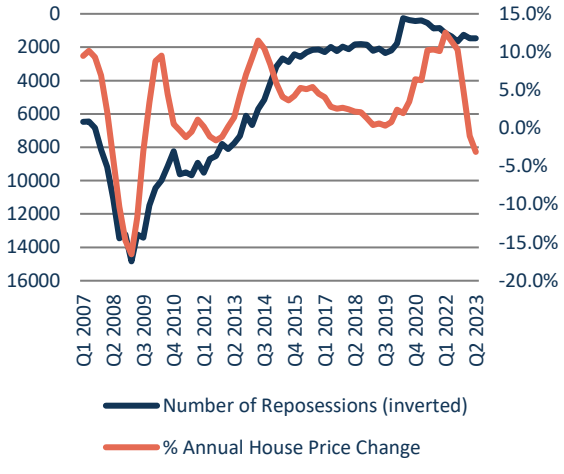
The answer is almost certainly in the second chart. This shows the same change in house prices but this time with the number of new mortgages agreed. Advancing the data by one quarter reveals a reasonable pattern, after all, today's new mortgage agreement is tomorrow's home sale. The reason new lending dipped is simply because mortgage rates were spiking, making it more costly to borrow and raising the bar even higher for aspiring homeowners.

This is another intended effect of increasing interest rates (in addition to the burden on existing mortgage payers discussed last quarter). The net effect is to slow the housing market generally by lowering demand. With no forced sellers however, there is no significant downward pressure on prices generally, so don't expect prices to fall steeply as they did in the past.

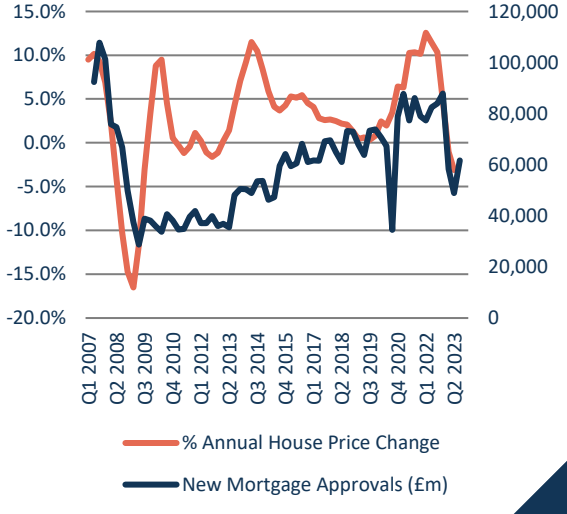
Reluctant sellers are accepting steep discounts on asking prices, estimated to be between 4-5% on average, confirming that this is a buyer's market for those lucky enough to have the finance in place. However, there is already a reacceleration in new lending as interest rates peak and mortgages rates decline. The dip may be short lived, and the property ladder likely remains slippery for those at the bottom. If you or a loved one need help with a new or existing mortgage, don't hesitate to reach out to our in-house mortgage adviser for a discussion.

Source: Nationwide & The Bank of England

Annual House Price Change and Number of Repossessions



Annual House Price Change and New Mortgage Approvals



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