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## VT Holland Advisors Equity Fund

13<sup>th</sup> July 2022

Dear Investors and Friends,

I hope this letter finds you well.

*“Experience is what you find when you didn't get what you wanted”* **Randy Pausch**

The fund NAV year to date (i.e. calendar 2022) is down 19.2%. Since converting to UK UCITS fund on 21<sup>st</sup> June 2021 the NAV is down 19.1%\*.

To say 2022 has been an interesting investing year is perhaps an understatement. Coming into the year the fund was fully invested in a range of equities that I assessed as significantly undervalued and/or were poised to recover strongly from the consumer bounce back I thought was likely to follow the pandemic. In truth I thought the fund was well set for a long period of good performance when I looked at the wonderful collection of rare businesses we owned, and their modest valuations. What is it they say? *‘Pride comes before a fall!’*

I had worked hard to find both groups of stocks, i.e. either those with special features that lead to their absolute cheapness vs their quoted market valuation. Or best in class companies in sectors that looked set to perform strongly from a long overdue consumer recovery in sectors like holidays and leisure (e.g. **Ryanair**, **Jet2** and **JD Wetherspoon**). What followed next was of course a far different near term future from the one I had anticipated. This letter I hope will give you a little insight into my thinking today. I have chosen to omit the investing background section that has started many past letters. This is in part because I have recently distributed my thoughts on such matters outside the shareholder letter. Also because there is far too much discussion of macro events currently amongst investors. All I will say is that I consider multiple macro outcomes, not just the one presented by many commentators as today's fait accompli.

### **Portfolio Review**

I reflect on the funds/my recent performance. On the positive side, my approach means in recent market falls we have largely avoided the tiger traps that that might best be described as ‘fashionable tech.’ On the negative side we had no exposure to oil, gas or other inflating materials. Lack of exposure to this area, but an overrepresentation in consumer expenditure has seen us participate in equity market falls perhaps more than our value bias at the year's outset might have suggested. Indeed some of our value investments held their value pretty well (**VP Plc/ Frasers/Youngs** non-voters/ **Biglari**).

### **Oil & know what you seek**

For any readers assessing our fund vs an Index like the FTSE100 a lack of ownership of oil, gas or commodities has cost the fund in short term performance so far this year. The Ukraine crisis and the market/political interventions that have followed it have made oil/commodities wonderful short term investments offsetting large falls in almost every other assets class and sub-sector. Readers of my investment letters and research over the years will have rarely heard me discuss the investment merits of this commodity area. Why? Simply put, the best business models (brands, scale economies etc.) and the best CEOs (Owner Managers) are rarely found in these sectors.

\* All performance figures use 'I' class shares.

My goal is the long-term compound growth of your, and my own, invested capital in the fund at the best possible rate. Whilst some of the long term returns we make might come from my market timing, in truth the vast majority will not. Instead it will come from our shared ownership of small pieces of wonderful businesses, hopefully that we bought at good prices. If those wonderful businesses are also led by thoughtful, proven, aligned owner managers with high integrity then further good things can happen as:

- A) We, as outside shareholders don't need to do much
- B) These Owner Managers make good decisions about further potential growth on our behalf

Rarely are such wonderful businesses led by brilliant owner managers to be found in the commodity sector. Indeed the long term compounding charts many readers will have seen me show of book value or earning per share rising over decades are almost never from companies in such sectors. In addition the need to make numerous brilliant decisions about not just when to buy such sectors, but also when to sell, I assess as just too hard. I can see that lowest-cost commodity producers bought at cycle troughs would be wonderful investments for a while. For now I am happy to leave that opportunity to others. A short cut would be just to state that, I am just trying to fish where the best fish are. That approach is unchanged despite recent inflation and commodity trends.

#### Buy right, sit tight

I once listened to a wonderful interview of Buffett and Bill Gates sitting side by side. They were both asked if there was one driver that had led to their superior performance over peers. They both gave the same answer: 'Focus'. Over the last few years my singular focus has been on achieving a higher rate of compounding via the ownership of wonderful businesses bought at good prices. If I think I have bought one, I then try to instil a 'buy right, sit tight' mentality to these holdings. Such an approach is not only based on good sense when we look at such businesses past compounding in numerous market environments (both good and bad). It is also proven by many a wise investor that came before me. This approach is easy to say but often harder to do, as current events are showing. It requires not just patience but also endurance of some pain. In the early part of this year as the war in Ukraine started I could have sold companies such as JDW, Jet2 or Ryanair. Indeed many readers might wonder why I did not. The danger of such actions is that you are choosing to sell what you believe are long term winning businesses due to short term concerns. The danger of such thinking/actions is that you are then chasing your tail with every news story and near term trend. This is the exact antithesis of what I am trying to do. I of course can see how such companies might be adversely affected by a cost of living crisis, but I also know that:

- a) Such crisis will pass, and the extent of a current slowdown is unknown
- b) Companies like JDW and Ryanair in the past have been beneficiaries of downturns as their low cost offerings appeal to cash strapped consumers
- c) These companies are significantly outperforming their peers

On the last point each of these companies have pulled further away from competitors in recent years. They have reduced unit costs more than peers and been more reliable. Yes, really (Ryanair). They have looked after their customers far better ensuring future trust (Jet2). Or they have not profiteered at customer expense by constantly raising prices as competitors have (JDW). A time in the future will come when customers of such companies will fully reward their recent efforts and we hope to be beneficiaries of this when it occurs.

### Today's opportunity set

The above comments might imply a “do nothing, whatever happens” mindset. That is not the case. The reality is very different. Instead daily I am always looking at new ideas and also trying to be honest with myself about any truly new risks that might have cropped up in the shares we already own. I sell if we realise I am wrong or if the valuation trade-off changes significantly. Finally I sell if I think there are better things that can be done with the capital.

In the past few years I have found plenty of companies to admire, but in truth not many I was inclined to buy when I looked at the prices they were trading at. The result of this was a pretty concentrated portfolio in those I thought passed both tests. Recent share price falls of 40-60%, even amongst good quality companies with business models I admire, presents a wonderful opportunity. Using fresh capital to buy into such companies (like that generated in Buffett's ‘owned’ business) is an easy decision. When assessed vs a fully invested portfolio that I already think mis-priced the job becomes a little harder. I am using this current opportunity to evolve the portfolio. When I can I am trying to add better businesses with great long term compounding potential.

*“It is not that I like bear markets per se, but I like the prices they bring” Warren Buffett*

### Weight of Money vs Weight of Evidence

Investing markets were once famously described by Ben Graham (Buffett's teacher) as follows:

*“In the short run the market is a voting machine, in the long run it is a weighing machine.”*

Post recent market corrections this is worth reflecting on. I do so via a couple of examples of our larger holdings.

**Frasers** is a company I think I know quite well. The often large disconnect between many investors view of Mike Ashley and the reality of the business on the ground has presented us with past opportunities. The shares having reached a low of 200p were then priced at c.770p at the start of 2022 – a seven year high. At the time of writing they are 700p. It is easy (maybe dangerous?) to construct a logic as to why this is the case, making an assumption that Mr Market has finally come to his senses and seen the value that we did. The truth might be simpler. Frasers is owned by very very few mainstream institutional investors. As such there has likely been little forced selling as has been experienced in more widely held shares. By contrast the company, seeing the shares as undervalued, has been buying back stock daily. This is the voting machine in action, quietly in this case. The same voting machine that saw many other share prices rise parabolically while Frasers was falling (Peleton?). In contrast, it is the weighing machine that I am pre-occupied with. Imagine if you will, your Nan going to the high street a few years back. She carefully watched the greengrocers' scales to make sure she was getting fair value for the price she was paying. Too many investors we think lost sight of this relatively simple discipline.

In our December letter we outlined the value we thought evident in **Biglari Holdings**. We even included a copy of the company's balance sheet. Soon after our letter the company released its December 2021 annual report. Helpfully for other shareholders, and reassuringly for us, it laid out the exact logic we had been using to value the group (page 4). Whilst the shares were unlikely to reflect the full c.200-300% value discrepancy we see immediately they did make a start by rising from \$585 to \$815 in the days that followed. This is the weighing machine coming to life. Despite our and Sardar Biglari's (CEO and c.60% holder) best efforts, today the shares are back at their lows (c.\$580). Shorter term negative investing sentiment once again reigns for now.

Not only do I think Biglari a much undervalued entity, but I assess Sardar as a misjudged individual on Wall Street. Like many of our owner managers he is a complex character, but I think a very astute businessman and investor. Pre-Covid-19 Texas based Sardar used to travel annually to Manhattan to host his AGM, thinking it was the right thing to do to aid his investors. By all accounts for him it was not a pleasant experience, not least due to the fact that it brought him into close contact with the people he despises most – Wall Street’s short term speculators. The two sides didn’t get on! As such he decided to host his AGM in his home town of San Antonio, Texas. There would be no webcast, but if you wanted to come along you could ask him questions for as long as you like. You would just need to do so in person. I did just that this May.

Spending a day with Sardar and those that work for him/have sold businesses to him was highly insightful. Prior to my trip I felt I had strong insights into how undervalued this company was and my assessment on this fact has not changed since the trip. What did change is my understanding of this highly unusual owner manager and the conglomerate and culture he is creating. Biglari is a true rarity in investing. It is a company that I assess to be worth 200-400% more than the current share price, so if you will it is a dollar trading at c.25 cents. Crucially however I think that dollar will grow in value, compounding in the way we are attracted to. My best guess for a long term future rate of growth would be 15-20%pa. No less. This guesstimate is partly based on the assets that Biglari controls today and partly on my assessment of Sardar’s unconventional, but excellent capital allocation skills.

Mr Market’s voting machine has been set against Sardar for many years. The weighing machine one day will wake up, just like it did briefly this Spring. In the meantime we are delighted to let Sardar compound our capital knowing that the gap between price and value gets ever larger with each passing year.

#### Fundamental vs Momentum investing

We have used Frasers/Biglari above to outline the divergence that can exist for long periods in investing markets, particularly in its less well researched parts. The voting/weighing machine observations could easily also be used to describe the difference between fundamental investing and momentum investing. The first is solely focused on what a company is worth today and might be worth in the future based on a careful assessment of its true business fundamentals and how they are evolving. Momentum investing is by contrast largely a function of reacting to what everyone else is doing. Some investors or indeed machines are good/claim to be good at spotting momentum patterns and extrapolating them. We wish them luck. This is a game we have no interest in being involved in for a long list of reasons.

I hope that by concentrating on businesses, their fundamentals and trying to fully understand those that run them, I am building two assets for our collective future. The first is the collection of assets we own today that I believe will compound our capital at a strong rate into the future. The second asset is a skill set. I learn from each piece of analysis I undertake and each company I invest in, or pass over. Also each mistake. These skills I hope also set us up well for the future helping me make better long term decisions with our capital.

Post many years of rising markets, many investors have been successful whether they realise it or not by using a form of momentum investing. Assessing today’s investment opportunities through such a lens I think is fraught, as many participants either don’t have the skills they need or have forgotten them. By contrast assessing markets today with a long term fundamental approach is showing some amazing bargains. Some of which we already own, but a few we need to find space for. There is lots to do.

Thank you for your encouragement and continued support.

Andrew J Hollingworth, Fund Manager

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