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VT Holland Advisors Equity Fund

18th January 2024

Dear Investors and Friends,

Year-end Investor Letter – December 2023

The fund NAV was up 37.6% in the year to 31st December 2023¹.

As I commented in our June letter, this year saw a pleasing re-assessment of the companies we own by Mr Market. I discuss the market backdrop, our investing approach and portfolio developments below. After that is a request/appeal which I would be most grateful if you would take a look at.

Investing market backdrop

In my last few investor letters, I spoke about the market cycle that I thought had ended c.18 months ago. The period 2016-2021 saw many investors reach for yield. They overpaid for income (bonds) and for the better returns they hoped some 'high-quality' equities would bring them. In short risk tolerances were high and margin of safety thinking almost non-existent. As to what everyone was thinking I cannot say, but dear Charlie, who we will miss greatly, has kindly left us with quotes for almost all scenarios. Jim Grant runs a close second!

"There is nothing worse than watching your neighbour get rich." **Charlie Munger**

"Very low interest rates distort behaviour. It causes people to go and reach for growth, for yields as if they were on their hands and knees with a flashlight looking under their furniture for some return on their savings" **Jim Grant, May 2023**

The last 18 months have seen assets and businesses that became over-valued fall. By contrast, either neglected businesses or those showing themselves to have true resilience have experienced better performance. This is the tide that has lifted our boat in 2023 if you will. With the funds NAV up by a strong amount in the year some investors might be inclined to think such a rotation is maybe over. I am of the exact opposite view. Many of our holdings have moved from derisory valuations to still very cheap ones, but these companies also have powerful, and often forgotten, compounding capabilities. I will just call out two easy to see examples in **Jet2** and **Greenbrick**. These companies in the years ahead are most likely to make ROEs of c.25-30% (as they have historically). They will also redeploy most of those earnings back into their own businesses meaning they may grow at similar rates to these ROEs. Today, despite strong price recoveries (both shares have doubled from their lows) they both trade on c.7x current year earnings.

We have found out in these last two years that our investing approach is very different from other equity managers. Whether that difference is good, or bad, is for you, our investors to judge. We only know that we are buying businesses with proven powerful compounding characteristics. These businesses are run by amazing, aligned owner-managers and yet we often can still buy them for 30c-50c on the dollar.

¹ All performance figures use 'I' class shares and post all expenses and management fees.

We are delighted to have this arena almost all to ourselves and still see a great wave of mispricing's ahead of us.

Our Investment Approach

*If you can keep your head when all about you are losing theirs
If you can trust yourself when all men doubt you,*

*If you can meet with Triumph and Disaster
And treat those two impostors just the same;*

Extracts from Rudyard Kipling's 'If'

Hopefully all fund investors by now have a pretty clear feel for the types of investments we seek². New readers (where have you been?!) might want to have a peek at our favourite Venn diagram at the end of this letter. To state that one wishes to invest in misunderstood great business is easy, actually doing so is far far harder – for it requires two non-standard skills. The first is an ability to understand the fundamentals of a business differently from the widely held view in competitive investing markets. The second is to have the contrarian streak and grit to invest when all around you are telling you are a fool (e.g. **Frasers** or **Meta** in 2022).

Sorry I don't think I know you

Many quality/franchise investment type investors like branded companies and might equate pricing power to high margins. We agree that high margin, branded businesses are good. But we do not agree that, by extension, all low margin business are bad. Some may be, but a few, **Costco** and **Amazon** as examples are outstanding.

Perchance you got invited to a Christmas drinks party. Next year try out this little observation on social behaviour: Watch closely a person's face as an old friend comes up. Openness and warmth are immediately on display as they quickly recognise the face in front of them. Now look at the same person when someone they have forgotten, or never met comes up. Many might be guarded, some even hostile to the unknown new face.

The same is true with business models looked at by many busy investors. The branded, high margin, high return on capital company is like the long-lost friend that you immediately recognise and quickly want to get to know again (i.e. invest in). Low margin/high asset turn companies in odd sectors are the unknown. Few want to spend the time to get to know them fully. At the drinks party its so easy for those first, *I'm not sure I like him*, impressions to take root. However, the same happens between many investors and our types of companies. With the right qualities such companies are very attractive to us (e.g. **JDW**, **Jet2**, **Frasers**). This is only because we have studied these business models or ones just like them in many different sectors around the world. We know the outcomes they can achieve for investors. As a result we seek them out and recognise them with a warm immediate smile. To others they are unknown, unfamiliar and just too easy to quickly reject.

This is the type of long term work that goes behind discovering undervalued great businesses that others may dismiss, i.e. a clear recognition that their business model is proven and very good.

² Introductions to how we think about investing can be found [here](#) and [here](#). Two books when combined encapsulate our approach quite well also: [7 Powers](#) and [The Founders Mentality](#)

7 Powers

We remind readers of our admiration for [7 Powers](#) by Hamilton Helmer. It lists seven different business models with Scalable Competitive Advantages (Moats if you prefer):

- Scale economies
- Network economies
- Counter-positioning
- Switching costs
- Branding
- Cornered resource
- Process power

All of these models are achieving SCA's that should result in superior returns on capital. Many will do so with high margins (Branding and Network economies) and these are sought by many investors. Not all will have higher margins though. Indeed, a Scale Economy Shared business with high margins, might be an oxymoron.

Embracing Uncertainty

Excluding low margin businesses means some investors are effectively looking for '5 Powers', not 7. We are agnostic as to what of the seven SCA business models we invest in next. What we are not agnostic about is the starting price we pay for all the investments we make vs the compounding they offer. This must offer us value and that 'value' is often derived from some sort of uncertainty. Uncertainty about the quality of a business in a poor sector (airlines or car dealerships). Uncertainty about trading that suddenly looks more fragile after a shock (**JDW or Jet2** during Covid-19). Or uncertainty created by the company trying to re-invent itself (**Frasers, Meta**). Being clear about whether such a point of uncertainty represents real risk or is an opportunity is what the job is all about. Mostly we find such opportunities in business models other investors understand less well. This enables us to have the required conviction to buy when others are selling:

"There is a big difference between high uncertainty and high risk" Mohnish Pabrai

Pattern recognition

Thirty years deep into this job I now more and more conclude that the key differentiating factor in our decision making/idea finding is pattern recognition:

- Do I recognise a powerful compounding business model I've seen be successful in another sector or geography?
- Do I recognise how investors are scared. Irrationally selling the shares of a company because they have lost trust in its owner-manager? (e.g. **JDW, Frasers, Biglari and Meta**).
- Do I also recognise the similarities between business models that go through a period of challenge and how the share price can react aggressively to recent bad news?

Most business models I admire tend to be customer focused. As such, if run with this focus and long-term goals in mind, they are likely happy to endure significant short-term falls in profits to ensure customer (or staff) are well served in difficult periods.

- If already a low margin business (say 6% EBIT) such actions might lead reported margins to maybe halve. **Wetherspoon** is a good example of such a pattern. Over recent years (post Covid-19) it did not initially follow industry pricing higher, despite significant cost pressures.
- Such a margin fall (say 6% to 3%) seems dramatic to investors, but the reason for the falls matter more.

- Most SES models require high turnover/volume relative to assets. If near term turnover falls, margins should be expected to be aggressively impacted. Indeed, if margins were maintained on lower volumes, then the customer offering likely deteriorated during the period.
- Such periods occurring post long runs of seemingly effortless growth are big shocks to investors and analysts. (See our **Meta** piece at \$112 on the ‘Five stages of grief’ [here](#)).
- This often then leads to an anchoring of forecasts at trough margins, even if such low margins are ultimately unlikely to persist in the longer-term. (This is exactly what we saw analyst forecasts do at **Frasers**).
- Good owner-managers during such periods might be positive and hopeful of a full margin recovery, but they cannot (and do not) promise as such. Good managers are also fearful and worry about downsides.
- At troughs Mr Market hears their caution far louder than their quiet optimism and therefore forecasts what is comfortable, rather than probabilistically right. (Lord Wolfson’s communications with shareholders at weaker periods in **Next’s** trading often follow this pattern).

A target rich environment

Much as some investors have seen high priced assets now fall in value, few seem to be heading in our direction. The belief to pay up for growth is well ingrained as is a desire for thematic and momentum investing. Value orientated investing in unusual places has always been a minority sport and I am delighted for it to stay that way. David Einhorn, whom I admire greatly, is one of last value investors left in the US hedge fund industry. Here is what he said c.2years ago:

“Companies can report stupendous news and have very, very minimal share-price reaction to it. It's not that the stocks are hated; there's nobody actually listening. There's nobody on the call, there's nobody performing analysis, there's nobody recommending the stock. There's nobody there to buy the stock.” **David Einhorn, Greenlight Capital, Real Vision Interview Sept 2021**

Not only did this quote exactly mimic our experience in a few companies at the time, things have not changed that much since. The result is some remarkable investment opportunities. The focus Holland has on just trying to make investors’ money compound at the very best possible rate, seems almost lost on the vast majority of institutional investors. Shortcomings in ESG policies, lack of Cadbury code adherence, less than perfect share liquidity or more often just a long held pre-conceived dislike of management by institutional investors. All have been reasons why **Frasers** and a few other companies have never been properly considered by institutions. In most of the group meetings I have ever attended with **Frasers**, I felt like one of a very small number of people actually trying to analyse and better understand the business. Whilst that situation is improving a little now, it is doing so from a very very low base. I remind readers that (post its shares trebling from the lows) this is now a c.£4bn company, but no one seems interested.

Portfolio changes

The performance of the fund in 2023 was broad based, with the value of most of the larger holdings that we owned at the start of the year appreciating strongly. This included **Ryanair**, **Biglari**, **Frasers**, **Meta**, **Jet2** and **Greenbrick**. We sold a number of smaller positions during the year. This was either where the shares had appreciated quickly (e.g. **Alphabet** and **Greggs**). Other shares sold we just thought we could use the capital better in new ideas (RCI Hospitality, Par Technology and Youngs non-voters). The only large holding we reduced significantly was **Charles Schwab**. Whilst we remain Schwab fans in the long term, we are keen to see it build higher regulatory capital which US banking regulators look soon set to demand of it. New holdings started in the year included **Netflix**, **ASOS**, **WR Berkley** and

East West Bank Corporation. In the period we were forced to make some sales to comply with UCITS diversification rules. We understand why these rules exist and of course will comply with them. We are just not sure they are being implemented as well as they could be at present. Thus early this year we took pen to paper to point this fact out to our regulator – wish us luck!

Fund development

The size of the fund as I write is c.£17m. I/my family remain its largest investors owning c.18% of the units. Whilst I do/will run the fund exactly the same whether its size is £17m, £170m or £1bn some increase in scale would benefit us all as investors. As such if you know of individuals, family offices or *suitable* wealth managers that you think would appreciate my approach, maybe just make them aware of our existence. I love the collection of existing investors we have and would dearly love a future investor base merely cloned from you all.

The UK wealth management industry is an odd place today. With the market consolidating fast and most big players wanting clients to follow model portfolios they are increasingly only looking to invest in managers that run larger and larger funds. This is an oddity that many wealth managers (privately!) admit. They realise better returns can most often only be achieved by motivated managers who control smaller sums. I cannot solve this problem for the industry. All I can do is do the best job I can for my fellow investors and make clear the type of, and scale of money we wish to run in the future. Who then turns up when is up to them.

This issue came to light in a couple of recent meetings. I was directly asked what I want this fund to become in the future. The answer, which I give here for the first time is as follows. I want the fund to remain a globally unconstrained fund known for its excellent absolute performance and admired for its contrarian stance of investing, and then holding on to unloved wonderful compounding owner led businesses. I always want the fund to have the ability to buy interesting, poorly understood companies of differing sizes. I assess that a fund size of up to £1bn would allow us to keep achieving that goal as we would still be able to own the vast majority (c.85%) of the holdings we have today. Post reaching a sum of that size I might seek ways to limit future growth in assets.

This £1bn may seem a lofty goal from our modest start today of £17m, but I like businesses with BHAG!³. It is also not a huge sum in the context of wealth management allocations to equity funds, or similar funds that are 10x this size. Indeed, the main problem we run into today is largely wealth managers who really like the approach the fund takes but cannot allocate to it because we are too small, not too large! So this is call to action. If you get to read this and you run a family office, endowment or wealth management company and think you would like to grow the assets you can deploy with us as we grow, then get in touch. Alternately if you are a manager of such assets and think you might send £25m to us when we have £1bn under management, I am telling you that day may never come.

As this is a part of the letter largely addresses new readers, I would also like to make one other thing clear. I love this job (which in truth is also my hobby) and at 54 years old I am only just beginning to work out what really works and what doesn't in investing. As such, for better or worse, you should expect me to manage this fund for c.30 years.

Claire works incredibly hard and as a result (with Valu-Trac's help) we have a very smooth running operation. We are fully FCA regulated, with the fund now listed on almost all platforms. Scaling up the sums we manage will be easy in comparison to the journey we have made so far – after all we are owner managers!

³ Big Hairy Audacious Goals – see [‘Good to Great’](#) by Jim Collins

In closing I'd like to thank all of you, my investors. Your patience, continued support and interest in the material we send to you, do not go unnoticed. In last year's letter I closed with what Buffett used to write to his partnership investors in the 1960's. This year I share the investing mottos of Lou Simpson, that sit above my desk:

"Think independently"

"Invest in high return businesses run for the shareholders"

"Do not diversify excessively"

"Invest for the long term"

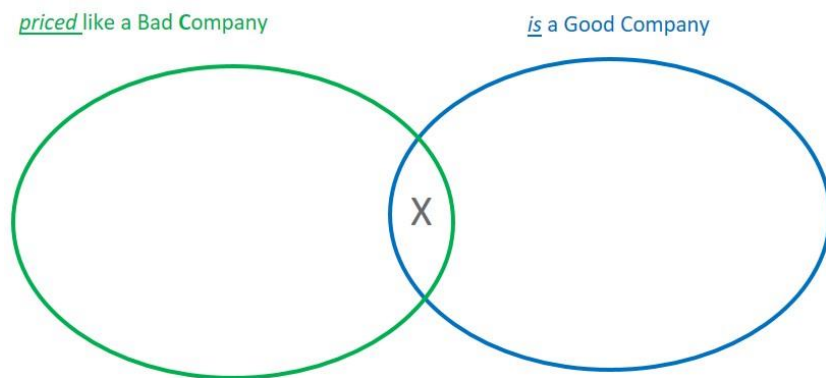
"Pay only a reasonable price, even for an excellent business"

Thank you for joining me on this journey. Others that might wish to join are welcome to get in touch.

Andrew Hollingworth

PS: An informal fund meeting will be held in the afternoon of Friday 5th April in Farnham, Surrey, UK. It is open to investors and non-investors alike. Further details will be distributed to all on our distribution list.

Fig.1: The only chart that matters



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