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VT Holland Advisors Equity Fund

16th January 2025

Dear Investors and Friends,

Year-end Investor Letter – December 2024

The fund NAV was up 21.8% in 2024[1]. (This is the net return to investors after all fund running costs and management fees). This is a pleasing rise, as not only does it follow a strong year in 2023, but more importantly it rewards loyal investors who have been patiently invested with us for many years. The fund size also increased during the year from £17m to £30m. Pride however, comes before a fall, of that we are acutely aware.

I have structured this letter in the reverse order to previous ones. I wanted to start with what is happening at Holland Advisors (Holland) and how I think about the fund. Then I cover the process we use to invest your/our monies. Lastly due to its lower importance I mention how we feel about the investing backdrop.

About your fund and your Investment Manager

We will discuss shortly our investing experience in 2024, giving insights into our investment process with examples. First, we want to reflect on 2024 from a fund development perspective. As Holland Advisors only manages one fund, the prospects of Holland and the fund are inextricably linked. A few new developments we will mention, but here first is what has not changed at all:

- We still love what we do. This is my hobby as well as my job.
- We are striving for investment excellence. We are Investment Managers first and foremost, not asset gatherers.
- The team at Holland own c.16% of the fund units, so we eat our own cooking.
- Whilst recent years' performance has been good, we are still finding ways to improve our process further. We also keep finding occasional mispriced wonderful businesses even in more buoyant markets. This gives us confidence in our ability to keep compounding the capital you have entrusted to us at attractive rates over the long term.

Here is a few things that did change in 2024

- Holland Advisors made some great hires. Stephen Heaps as COO, Matt Lovatt and Ian Colley as Fund Development Consultants. Whilst part time roles, these people bring to us very high skill and experience levels and their impact in 2024 was immediate. They, added to Claire's hard work and diligence, have resulted in a high level of professionalism in our operations. Claire and I are proud of what we achieved on our own in operations, compliance and investing. However, as we now seek capital from the world's best organisations we needed to be ready for them. With Matt, Ian and Stephen's ongoing help, we think we now are.

[1] All performance figures use 'I' class shares.

- As a result, the fund is ready to scale. We now have a team who can help to run Holland in all weathers. They can also manage the process of Holland meeting the right types of investors, but ensuring that the vast majority of my time is still committed to investing.

- At the end of 2024 Holland decided to stop distributing paid research to other professional investors as it has done for many years. Whilst this has been a great learning ground for me and has enabled us to scale the fund patiently, now is the right time to focus solely on the fund's development. Any future research we produce will be freely available to all.

- In 2024 Holland also negotiated a new long term supply agreement on behalf of the fund for Valu-Trac's (VT) services. The result of which is that the all in cost of running the fund today is 0.3%pa. Added to Holland's management fee of 0.8%pa this gives an Total Expense Ratio (TER[2]) for the fund of 1.1% pa. This is a competitive level with other actively managed funds despite our current small size. Our agreement with VT means this TER will fall as the fund grows in size to c.1.0% at £50m and c.0.95% at £100m. Outside of investment performance, investors can lose out by timing markets poorly, over trading or having high running costs. We want to see as much of our investment return accrue to fund investors as possible. That is why we work hard to try and ensure the funds running costs stay low. (Sadly those that regulate funds such as ours don't have the same cost awareness).

  A small change was also made to how the fund prices its units. A move to swing pricing from single pricing will help better protect existing holders from any small dilutions caused by fund buyers or sellers. NB: As a small UCITS fund we are forced to take industry standards. Thirty years ago spread pricing was common place, then single pricing became standard. Now the industry reverts back to swing (effectively spread) pricing. See what we mean about cost conscious regulation!

- Perhaps most importantly in 2024 I realised just how different our investment approach is from other investors. Our very different performance from peers in 2023 and 2022 showed this. But until 2024 I did not really understood why. As we discussed the fund with fund rating agencies and wealth managers during the year we realised how many other funds are run with a fear of diverging from a benchmark or with a need to invest in a silo (say UK or US). They do this so as to appeal to a great many fund buyers who like to pigeon-hole funds by geography, sector or benchmark. Here is how/why we differ:

  a. Our search criteria is very disciplined (owner managed business with strong SCA's[3]). However, our search area is very wide to ensure we don't have to compromise, seeking companies that fit all (not just some) of our criteria. Some people ask us why we do it this way. Others are even unsubtle enough to suggest we change our approach so as to appeal to more fund buyers. We find such exchanges odd and in truth a tad depressing.

  b. We use this approach because this is the way I taught myself, learning from the great investors that went before (Buffett, Lynch, Munger, Sleep). We also think it evidential that buying the best companies, run by the best managers at the best prices improves your chances of achieving excellent long-term returns. To do anything else is either defeatist or just gaming the system. Neither of these mentalities have any appeal to us.

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[2] All performance figures use 'I' class shares. The Total Expenses Ratio (TER) is also called an OCF (Ongoing Charges Figure).

[3] Sustainable Competitive Advantages

The future: More of the same

As for what happens next, we don't know. Might a long line of investors who think we have the right approach appear outside our door in 2025? Maybe. Or will the purist nature of my mindset keep many away and make us destined to remain small in size? Others' perceptions of us we cannot control, what we can control is our passion and commitment to investment excellence.

We can also control the time we spend with what types of potential investors. If you read our letters and like the idea of investing with an unconstrained, but aligned and passionate manager, we'd love to hear from you. If you love silos, benchmarks and macro-overlays there are plenty of other Equity Managers out there you can chat too!

If this comes across as blunt, it is meant to be. We are whittling down the field, so we spend our time meeting people who think like us. If none turn up, we'll spend 100% of our time analysing stocks. From studying other great investors, I have a clear view on how to succeed in this business. Only by focusing on the right companies, the right owner managers and the right potential investors will we reach our desired destination. That being a high long-term rate of capital compoundng for our investors.

How we invest your (our) money

Most readers of this letter will know the building blocks of our investment approach. We want to invest in great companies, run by great managers and invest at a great price. We want the companies we invest in to have Sustainable Competitive Advantages[4] and be run by aligned, brilliant owner managers.

The three stooges – Buying, Selling and Holding

The function of managing a collection of investments as we do requires three distinct activities, Buying, Selling and Holding. Most of the observations we make and questions we get asked are about the 'buying' bit i.e. *'what new ideas do we have?'* and *'where do we find those ideas?'* Also how are we improving our process to find better ideas in future. These are important questions which we address with examples in a moment.

However, the 'holding' and the 'selling' functions are also important areas where any investment manager needs to be clear-eyed. With good recent fund performance in 2023 and 2024, the *'when do we sell?'* question is perhaps timely to address.

Know when to hold 'em

We want to invest in great companies that have stronger for longer growth characteristics. As such we intentionally want to be very long-term holders of such investments. Charlie Munger once opined the following:

> "*investing is mostly about sitting and thinking, and of the two the sitting is the more important*"

By sitting he meant holding on to a great company for the very long term. Much of the work we do for us to decide to hold a company for many years we likely did before investing. But once we are owners a daily torrent of new information constantly emerges (new products, changing managers, volatile share prices, trade wars ++). We suspect some readers might expect us to be on top of all these updates. Clearly, we must pay close attention to some of them, but to do so daily or even weekly creates a bias for action that can interrupt long-term compounding by trading or premature selling.

[4] Sustainable Competitive Advantages – see our 2023 Investor letter

To continually hold a successful company for ten years an investor has to get through 2,600 days when the stock market is open. Each day from 8.30am-4.30pm he can decide to sell his shares and two minutes later the sale will be completed. During these 2,600 days there will be hundreds of stories and some might suggest owning such a share is unwise. Additionally, price anchoring will stop this investor re-buying at a higher price than he sold at. As successful companies continually grow their intrinsic value, lower prices to buy back in are not offered often. Aka, once sold an investor might never re-invest in such a company.

Doing nothing in a world of instantaneous dealing for 2,600 days requires a very different mindset from most other investors. We want a bias towards inaction that verges on apathy at times. Our regrets ten years from now might come from a few wonderful investments that we missed out on, but we have no doubt amongst those regrets will be a few companies we once owned and then foolishly sold.

Two instructive examples of your Manager's differing behavior in this area are Netflix (good so far) and Apple (really bad!). Links to the pieces we wrote ahead of buying each of these shares are in the company names above. The core analysis and observations we made about each have not really changed from those we expressed in these pieces 2 and 6 years ago. In both cases we invested c.3% of the funds' assets into each company, but these holdings had very different outcomes for fund investors because of what we did next.

In the case of Netflix we have not sold a share despite the company's strong share price performance. In Apple's case we sold our holding c.12mths after purchase. Explaining now why we did so I find actually very hard to do. At the time I was a little worried about the fund's high dollar exposure. I also convinced myself that I could not possibly have an analytical edge in a global company like Apple. The only consolation post reflecting on this act of value compounding destruction (Apple is up five-fold since our note/fund purchase!) is that the foolish decision to sell Apple was c.6y ago and the better decision to hold Netflix was in 2024. Hopefully that means your Manager is at least learning! Learning to sit, learning to watch and learning to wait.

Such reflections are important as they give insight into why we now pay so little attention to top down factors like sector or currency exposure. Conventional investment management wisdom suggests these are overlays to be monitored and tinkered with in a portfolio. Our real time Apple disaster however shows what the consequences of such tinkering can be.

Identifying c.20 great companies to own for c.10years and investing in them at good starting prices is our North Star. After doing so, of course we monitor them to keep improving our understanding/checking our thesis. However, influences that can hurt the long-term compounding of the fund's value by premature selling of such wonderful businesses we work hard to avoid. This includes avoiding investors who too often will ask about our top-down exposures rather than about the companies we own and why. The phrase below hangs above my desk:

"Buy right, Sit tight"

The Art of Selling

Maybe there is an art to selling shares, maybe there is even a book written about it – we have no idea. Selling is hard. Selling a share like Apple as we did, when we did, just looks foolish with hindsight. Equally not selling a share that say you bought at $10, which then traded at $50 before again trading at $15 looks dumb, really dumb.

We believe/hope that we now have an edge in how we think about a few long-term business models and the managers that run them. In a perfect world of finding 20 such businesses selling becomes an irrelevant skill as the best holding period is 'forever'. However, what if 14 of those 20 businesses turn out to be excellent and six show themselves to not be as good as we thought. This is the real art of selling. By constantly reassessing our companies and the strength of their market positions we can test our evolving thesis for each one. If we decide we were wrong in our original assessment we must sell.

In a fund with a finite amount of capital sometimes we also sell to make room for new investments. Whilst we compare share prices vs our value of a company, more often selling is a decision about business quality, i.e. which businesses in the portfolio are not as strong as we once thought.

Finally, if we assess a company as having good, but normal levels of compound growth ahead of it (11-14% say) we may reduce our holding size or even sell outright at certain valuations. However, if we think a company has supernatural long-term compounding prospects (say 20%+) we try not to sell at all. Often instead we want to add to such positions on any pull back. As we discuss below, such companies are very rare. Finding them is hard, and the long-term compounding potential they offer can be exceptional. **We must take great care not to sell them too early.**

The reason we spend so much time on what we want to buy (and when) is because this is where we think our edge is. If our investors reflect twenty years from now on how this fund has powerfully compounded their capital, it will be because of what we bought and how long we owned it for. Our ability to sell companies well we think will play little part in that compounding.

Hopefully that covers our views on selling for the next ten years!

2024 was mostly about 'Holding'

If there was theme that drove the portfolio performance during 2024 it was our '*buy right, sit tight'* mentality. A number of the shares we had bought well in the 2022-2023 period (Amazon/TSMC/Netflix/Meta) rose in value strongly. We made no sales of them, instead often adding to such holdings when pullbacks occurred. Our ongoing work on these businesses gives us greater conviction as to their quality and growth potential. Selling of other stocks in the portfolio was done for the reasons outlined above. Either due to us changing our mind on the quality/potential of businesses owned or to make way for new high quality investments we wanted to add. During 2024 the two main new holdings added were **Nubank** and **Wise Plc.**

Supernatural compounders. "In search for Nirvana"

We wrote a research piece last year using the above title. It was the culmination of many years of reflections on how we identify the very best companies. These companies have the normal traits we seek, but they have something special in addition. It is their proven high returns on capital **and** the ability (with good probability) to invest almost all of their profits for future growth at a **similar return.**

We call them supernatural compounders. If one such company makes a Return on Equity/Capital of c.25-30% and we assess it can deploy all of that into profitable growth then our investment in that company can potenailly also compound at that rate. Clearly these are exciting and often hard to find investments. As referred to above if they offer c.20-30% rates of long-term compounding we should be trying very hard never to sell them.

There are a few interesting studies which show that a high percentage of long-term total stock market returns come from the strong performance of only a few outstanding companies (think Amazon, Berkshire Hathaway or more recently Nvidia). Owning these companies, or missing out on them, will have a big impact on investors long-term returns.

When we talk about seeking investment excellence, this is the sort of thing we are referring to. We continue to work hard to try and understand the traits (financial, managerial and innovational) that truly great companies exhibit. By doing so we hope to identify some of the exceptional companies of the future. During 2024 we think (hope) we invested in two such companies. One was **Nu Holdings** and the second was **Wise Plc.**

A Word to the Wise

Wise Plc is a business we invested in during 2024. We researched the company throughout the year and as we did so our conviction level on its SCA[5] and growth potential increased. We made it a sizable fund position over the summer (our book cost is £6.83) and its subsequent share price rise has seen it become one the fund's largest holdings.

Wise exhibits many of the traits we think great businesses possess.

- It is a disrupter in its field of foreign exchange transfers.
- It is highly customer centric, offering very low and transparent fees.
- It is very focused on having the lowest unit-costs possible.

The company demonstrated its Scale Economy Shared (SES) mindset in Summer 2024 when anouncing its 3/2024 final results. It reported an PBT margin that had risen from 15% to 31% during 2023 due to the operational gearing effect a c.30% growth in sales had on its largely fixed cost base. It then went on to guide analysts that future underlying margins would be c.13-16%. The reason for this fall being Wise was palnning to heavily re-invest into its customer offer by reducing further its pricing for FX transfers. The stock market was not impressed and the share price fell.

Wise's SES model can also be seen in how it thinks about interest income. Interest income is the money banks make on unused account holder balances. It is a silent profit pool that is bigger when interest rates are higher. Wise never set out to make money this way, but fast growing account balances and rising interest rates saw its net interest income rise from zero in 3/2022 to £485m in 3/2024. Wise's reaction to this was telling. It stated that it intends to give back to its customers 80% of the interest income it makes over a 1% level. No other bank in the world does this.

We have noted in our Amazon and TSMC work that very few companies have taken the successful and powerful SES model into the B2B sector. Wise (and Nubank) are taking it into the banking sector and customers are loving it. Banking is an enormous market ripe for disruption, mostly populated by corporate incumbents who don't have a customer centric approach or low unit-costs. Almost no banks globally are lead by entrepeneurs and very few have much appetite for disputive innovation. This suggests to us Wise's potential growth opportunity could be very large.

For some years now Wise has been saving individuals that use its services c.2.5% on their money each time they make a FX transfer with Wise vs a normal bank. News of these savings have spread and as a result two thirds of Wise's new accounts now come by word of mouth. Millions of SME companies all over the world also lose c.2.5% of their money every time they do an FX transaction using their main bank. Wise's multi-currency invoicing product looks set to save such companies billions of pounds over the coming decades.

Wise has reached this point by building its own end-to-end money transfer network that is totally separate from that used by existing banks. It has taken time, effort and cost to build this network and Wise now believes this has given it an FX unit-cost base that few in the banking industry can match.

[5] Sustainable Competitive Advantage

An interesting endorsement of Wise's scale and efficiency has come from a number of global banks who have chosen to use Wise's network for their own client currency transfers rather than do it themselves. In the latter part of 2024 Standard & Chartered and Morgan Stanley joined this list. As western investors are familiar with these companies, we think the penny is beginning to drop as to the abilities of the network that Wise has built.

Wise is still run by its founder. It is obsessed with customer experience, low prices and product innovation. It also makes great returns on equity (c.30% without any leverage). All of these profits are reinvested for future growth and we suspect future returns on capital/equity will be just as high as today's. As such it has the hallmarks of a Supernatural Compounder.

<u>Win-wins</u>
Wise is also a great example of a proven disputer with a low unit-cost moat. Many venture capital start-ups have a disruptive idea behind them. What interests us is when such ideas have achieved real scale and thus possess unit-cost advantages that are hard to match. The risk of such businesses failing is much reduced, but they still have huge runways of growth ahead. There will be challenges and bumps in the road, but we think Wise has a chance of becoming world leading. Maybe it already is?

A final observation on Wise is to recall Buffett's view on looking for businesses that are a "*win-win for the entire ecosystem*". Right now, every time a small business pays a supplier or issues an invoice in a foreign currency, they only receive c.97cents in the dollar. Wise can change that to c.99.7cents. This might not sound much, but it is a huge current friction that all SME's/consumers suffer worldwide. At the same time banks whilst pocketing that c.3% maybe don't make as much money as we think in FX. They don't do much of it so are likely pretty inefficient. Soon Morgan Stanley clients will get far improved FX rates courtesy of its tie up with Wise. They will be richer and happier clients as a result. More consumers have maybe heard of Revolut than Wise, but Wise has the low-cost efficient network and the bigger banks can see that.

Lowest unit-cost wins

<u>The investing/economic backdrop</u>
There are many commentators today expressing strong views on what the economic and investing future holds. We are not inclined to enter the fray. Our mantra of wanting to invest in great companies run by great managers at great prices holds whatever the outlook. We can recycle capital if we choose to, moving freely between sectors and geographies. This means sector capital cycles or country sentiment cycles play a greater role in generating our new ideas. The only macro-observations I will make are as follows. (They do not form a macro view that drives my investment strategy however).

The business and finance world I know and the wider industries that my friends work in (medicine, engineering and property to name a few) seem to me now vastly overregulated in western countries. This I suspect could be stifling global growth - a guess, nothing more. A change/challenge to this over-regulation is overdue. Lawyers and Compliance Officers once worked in back offices and were called upon only when desperately needed by real business leaders. Now they seem to reign supreme with iron rule books that dare not be challenged. This is how the stage was set just before Trump's landslide election win.

We wonder if too many observers are so shocked by the US election result that they cannot be open minded about what might come next, both in the US and further afield. A Republican voting friend of my wife's observed on the eve of the US election.

"In Europe you take Trump literally, but not seriously. We take him seriously, but not literally."

I thought this was a fascinating insight that continues to be true today. Arguably it is now also appropriate for how many in Europe view Elon Musk.

During 2024 I read Musk by Walter Issacson. I simply cannot recommend the book enough. I am no cheerleader for him, but one important truth is evident from it. Musk abhors bureaucracy and is undeniably talented at removing it whilst keeping the lights on and still innovating. This skillset aimed fully at US Government spending at a starting point of over-regulation could have powerful positive consequences that few seem to be taking seriously. If he is successful, expect the idea to be exported.

The political change that is coming from places like Argentina and the US scares some people, but I wonder if this is just another example of confusing high uncertainty with high risk. Time will tell. If you are an incumbent regulator or politician, we can see why you might feel uneasy, but as businessman and investor I find myself optimistic.

Whilst this is interesting to observe, little of it really changes how we are investing. I still believe there are three cycles: **the economic cycle, the political cycle and market cycle.** The first two fill the airwaves and I have as little chance of sucessfully predicting them as anyone else. Sometimes political cycles can effect economic ones. Thatcher, Regan and now Milei being prime examples. Trump's impact (or not) on the economic cycle we are about to find out.

Market cycles can move all by themselves, independently from economic ones as I discussed in my year end 2022 and 2023 letters. We watch for these cycles but try not to call peaks or troughs too often. Instead we try to be ready to invest when sentiment or sector capital cycles throw up great opportunities.

Sorry this letter is long, but there is much I wanted to share with you all this year.

Thank you for your continued support.

Kind regards

Andrew Hollingworth

PS: An informal fund meeting will be held in the afternoon of Friday 11th April in Farnham, Surrey, UK. It is open to investors and non-investors alike. Further details will be shared with all on our distribution list.

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