VT DE LISLE AMERICA FUND

Manager's Commentary

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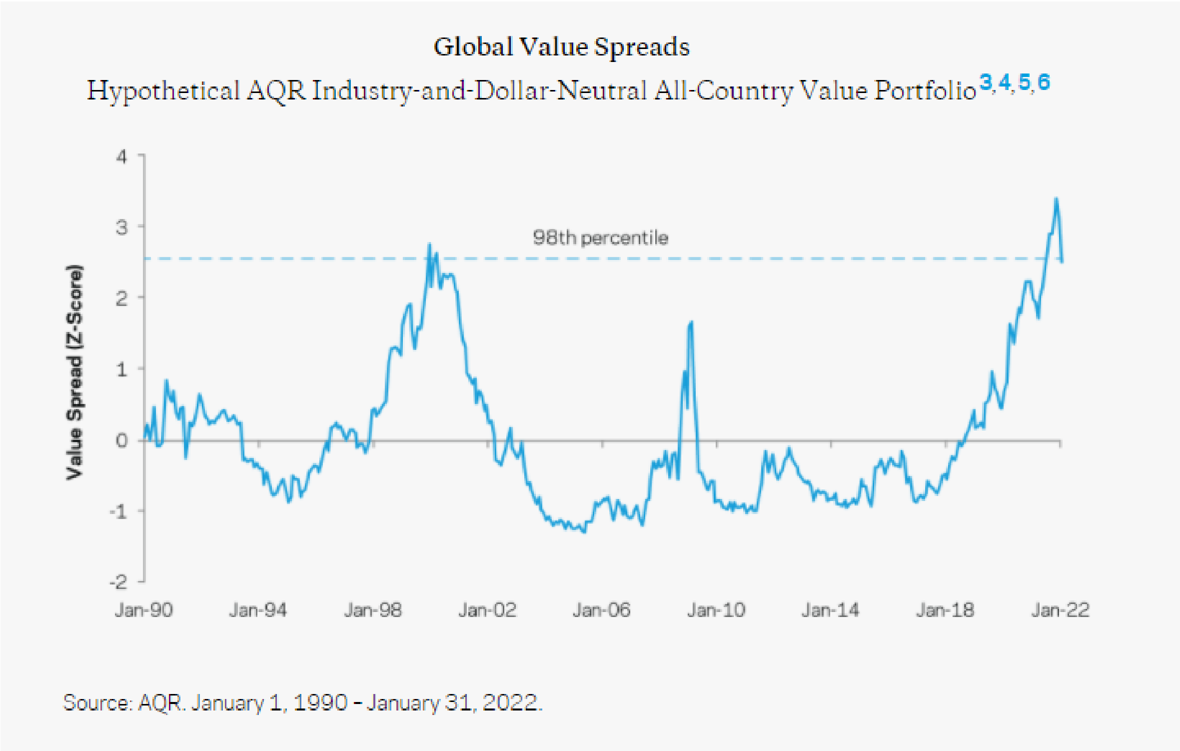
10 February 2022

Inflation came in hotter than expected again, at +7.5% for the January CPI, the highest since February 1982, 40 years ago. However you cut it, this was a disaster. The core, ex-food and energy, was higher than expected but new cars were flat. Cars had been getting the blame for driving these numbers but now it's migrated to other stuff. The 10-year Treasury went through 2% for first time since 2019, so we reach pre-pandemic yields for the first time. This still leaves the real yield, defined as the difference, at -5.5% and still the highest since 1975. Next month the Fed stops buying bonds, if you think yields stop rising here you can relax. That means we stop at 2% and the 2- year stays at 1.4%. If that seems ridiculous with wage rates racing and oil finding a new level above $90, read on...

In the pandemic, with zero rates and free liquidity, we could price any growth stock as high as we liked. These crazy valuations popped as interest rates rose from the floor and recently we've seen the further collapse in more meaningful companies which nevertheless have a fragile model. Hardly a day goes by without a new fragility being discovered. Netflix does it on debt. Who knew? PayPal and the rest of Fintech live in a rapidly changing world. Facebook has to compete with TikTok. Yesterday Ocado, today Delivery Hero. The larger household name growth stocks are now coming apart on any excuse. So far, as expected but what is more interesting is the whittling down of the FANGs which have driven the S&P 500 this last decade. It's the action when they are super strong and knocks the cover off the ball that really informs. Like Google. Massive earnings beat but just 5 days later it was back to where it started and the best quarter of all-time, so they say, at Apple has not boosted it back to $3 trillion. We have been discussing how the ones intact face a decade of sideways action as the bonds return to realistic higher yields and the highs for the FANGS are already in.

An example: the fundamentals for Adobe are fantastic. It has grown earnings at 19% average for a decade and no doubt will keep going forever. The stock is off from $700 to $500 so it's all priced in, right? Nope, it's still on 50x trailing P/E and in the 1980s you could get a 19% grower for 20x trailing. But the 1980s is where we've just referenced our 7.5% inflation rate! Sounds like a lot more P/E multiple falling still to be done here for the next few years. +19% earnings a year is an earnings double every 4 years so in 4 years time Adobe could be at the same price but on a trailing P/E of 25x if it can keep the good times rolling on.

Not a bad outcome but maybe not where you want to be? This also applies with all the other fine names, while the fragile will continue to collapse.



The above chart makes the point that even after a few months of growth stock meltdown, we're still in the 98th percentile. Notice the value high in 2006 and the lower high than now for growth at the top of the tech bubble in 2000.

Think it's all over? It's hardly begun! To hide from inflation, we need stocks with low P/Es and we need stocks that can pass on the price increases and even benefit from them. We need to avoid margin squeezes from commodity or labour costs. Our Fund is on a P/E of 9x trailing yet is growing earnings at the same rate as many of the high multiple growth funds because our commodity and industrial stocks actually like this environment. Our consumer durables are about experiences and they are growing earnings at double figure rates. We think the Fed will not raise rates until there's a recession because no one wants that but by the Fed undershooting, this inflation goes on and the 16 years of growth stocks marching to ever higher multiples are over.

Past performance is not a guide to future performance; the value of an investment and income from it can go down as well as up.

Important Information

Source: De Lisle Partners as at 10/02/2022