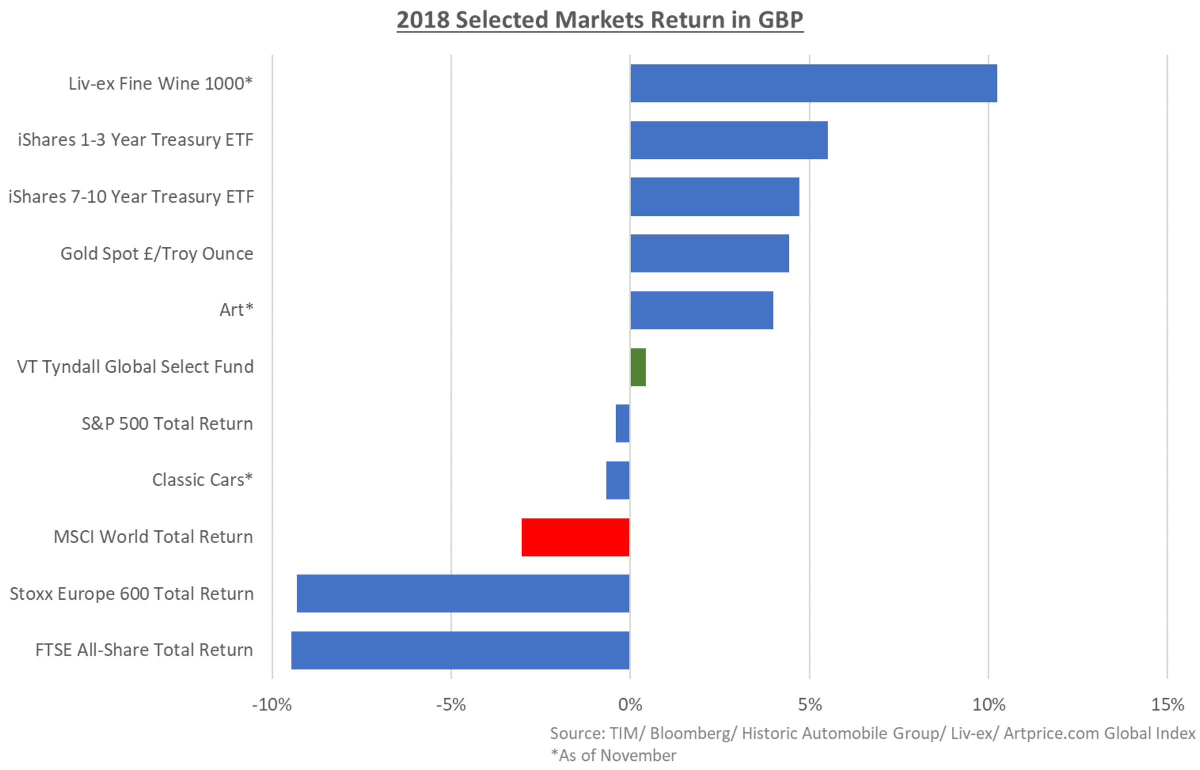
VT Tyndall Global Select Fund Commentary – December 2018

“When you see only problems, you’re not seeing clearly” – Phil Knight

The VT Tyndall Global Select Fund (B Inc) fell alongside the wider global market during the worst December for equity markets since 1931. At the month end the value of the Fund fell by 7.44%. The Total Return for the Fund during 2018 was 0.43%, outperforming the Global Market that fell by 3.04% and the peer group average whose return was -5.81%.

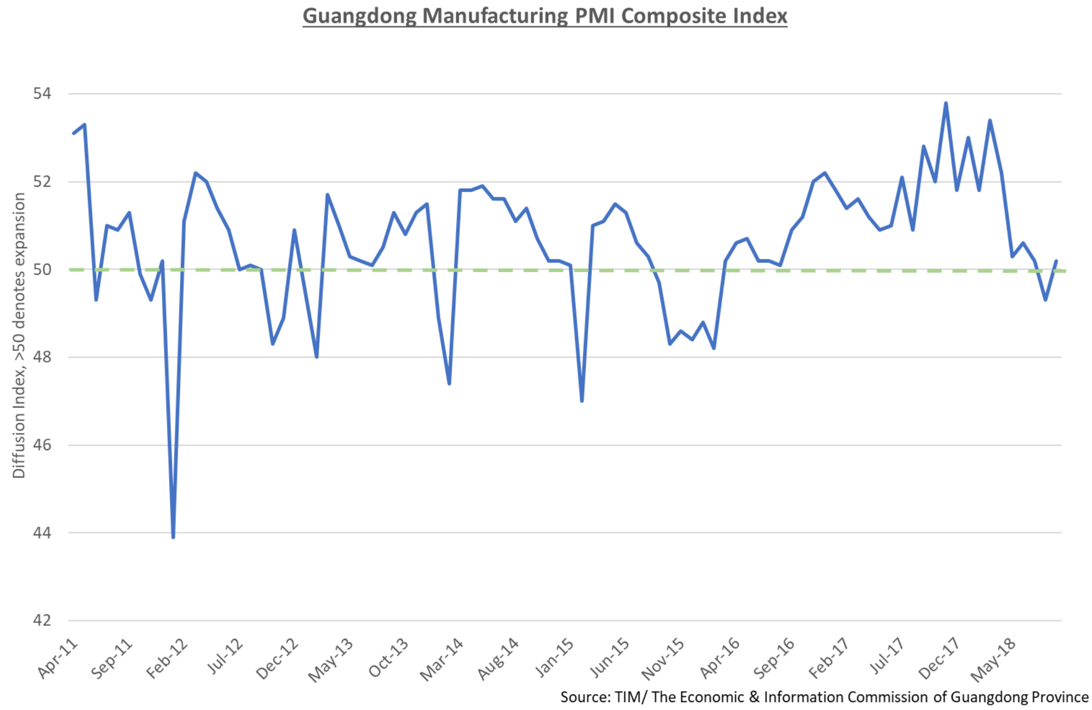


[1]

Obtaining accurate information on the actual state of the Chinese economy has become more problematic as the authorities outlawed certain economic surveys in order to control the flow of ‘sensitive’ economic data. Having ordered Guangdong (the country’s export hub) to stop producing a regional Purchasing Managers’ Index (PMI) the central government announced that the National

[1]The Liv-ex Fine Wine index components can be found at the following link: https://d17y2m6uappuyy.cloudfront.net/Livex1000_components.pdf

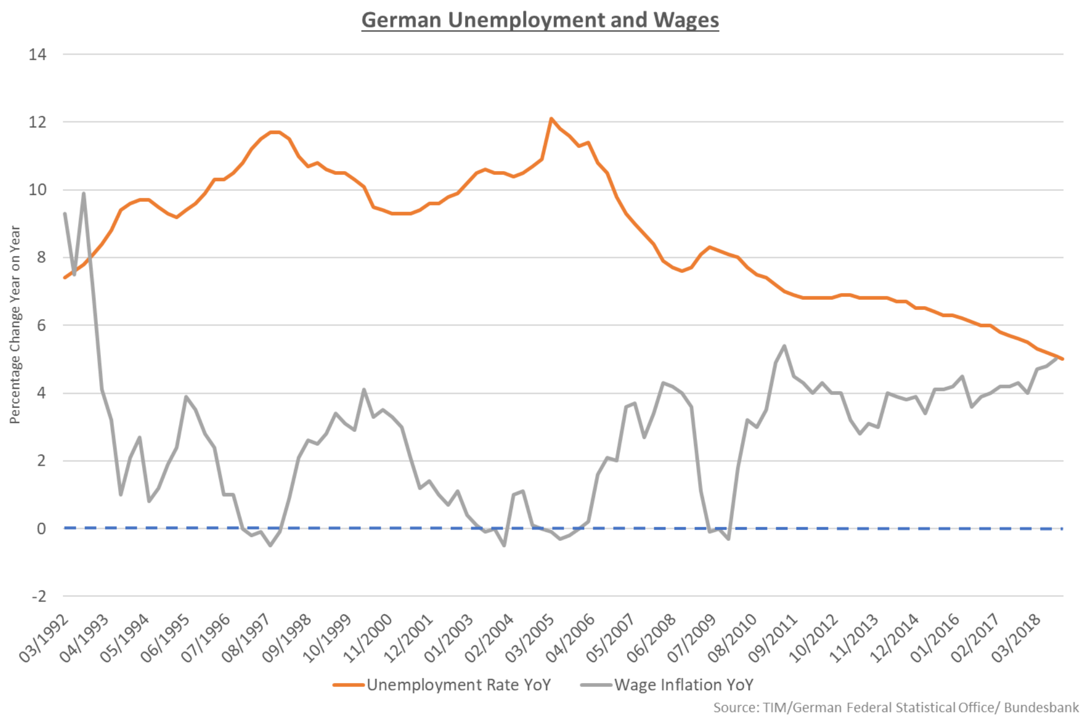
Bureau of Statistics would be responsible for all future readings; a move which causes us to believe that the region underperforming as US sanctions begin to bite.



At the recent trade fair in the capital of Guangdong, Guangzhou, the value of export orders to the United States fell by 30%. We believe that China will continue to see the rate of growth fall, despite President Trump's latest tweet *"Just had a long and very good call with President Xi of China. Deal is moving along very well. If made, it will be very comprehensive, covering all subjects, areas and points of dispute. Big progress being made!"*. China has also recently announced stimulus measures designed to boost the market ahead of the 70th Anniversary of New China; the New China celebrations happen every 10 years and this is the first under the leadership of Xi Jinping.

We met with multiple European and American companies over the month, and the topics of raw material and wage inflation were to the forefront of management concerns. One German company cited that 2018 had been difficult owing to a perfect storm. Bottlenecks in suppliers' production lines, rising raw material prices and significant wage inflation all came to a head in the last 12 months. The CEO expected that the former two would not be a significant concern in 2019, however the later was going to continue, especially as the unions have already secured a 4% increase in wages for 2019.

German unemployment is at the lowest level since unification and nearing a level of full employment. Labour shortages have led to wage inflation in certain sectors and we expect that we shall see wages increase further despite the economic backdrop that suggests Germany may enter a technical recession in the coming months. Regardless of the backlash over immigration that led to the Christian Democratic Union's share of the vote decline dramatically, and effectively to the resignation of Angela Merkel as the party head, the German government has passed a new immigration law to attract more skilled works from countries outside the European Union. We still expect wages to be a headwind to corporate profit margins, however it should also lead to increased consumer spending, notwithstanding the German consumer's propensity to save any excess earnings.



The Fund's holding in Johnson & Johnson suffered during the month owing to a report from Reuters which claimed that the company had known for decades that its talcum powder contained asbestos. They insinuated that there was a company-wide conspiracy between executives, scientists, doctors, lawyers and mine managers to cover up the trace amounts found in their product.

These allegations are not new news. Johnson and Johnson has faced claims trying to link their talcum powder with cancer over many years, and in the summer lost a case brought by 22 women, which ultimately fined J&J $4.7bn in damages. Prior to this case the company had managed to defeat most of the cases that claimed that talcum powder was connected to cancer by showing that the data and research used was flawed and showing studies to the contrary. Of the six cases that the company lost, all but two have been overturned at appeal, and one resulted in no damages being paid; unsurprisingly the company in appealing against the verdict in St Louis this summer.

The basis of this Reuter's report pulls on internal memos, FDA documents and company public statements, all of which have been in the public domain for some time. One of the pieces of 'evidence' that they cite is a 1975 joint study from the Mount Sinai Medical Center and University College Cardiff on the asbestos content in powders sold in Europe and the US. Their conclusion was that they had detected asbestos in several commercial talcum powders but go on to say explicitly that it had not been found in J&J's current products, however there were insignificant traces in their old powders. Reuters also attack the independence of this research as Mount Sinai receive funds from the Robert Wood Johnson Foundation. The Foundation, however, is independent from the Company despite owning underlying stock.

Johnson & Johnson claim that their talcum is of medical grade and therefore is not contaminated, as confirmed by thousands of tests using the most advanced testing methods. They have even opened their cosmetic and processed talc mines to regulators for testing, all of which have been shown their product to be asbestos free. The three largest studies over the past 40 years involved a total of 181,860 women, and where conducted by the National Institutes of Health (NIH) & Environmental Health Sciences, the Women's Health Initiative and the Nurses' Health Study, the longest running for 24 years.

None of these studies saw an increased risk in ovarian cancer for those who used talcum powder. The Sister Study by the NIH (2003-2009) investigated the relationship between talc use, douching and ovarian cancer. This study studied over 40,000 women who had a full of half-sister who had been diagnosed with breast cancer. The study found that douching was more common amongst talcum users, however it concluded that douching rather than talcum use was associated with an increased risk of cancer.

Major Independent Studies of Johnson & Johnson Talcum Powder Use

Name	**Regulatory Body**	**Sample Size**	**Date**	**Conclusion**
The Nurses’	US Government	78,630	1976-2000	No increase in rate of ovarian cancer
The Women’s	US National Institute of Health	61,576	1993-2002	No increase in rate of ovarian cancer
The Sister Study	US National Institute of Health, National Institute of Environmental Health	41,654	2003-2009	No association between perineal talc use and subsequent diagnosis of ovarian cancer
Miner & Millers	National Institute for Occupational Safety and Health, Occupational Safety & Health Administration	1,992	1921-1950 1946-1974 2003-2017	No cases of Mesothelioma

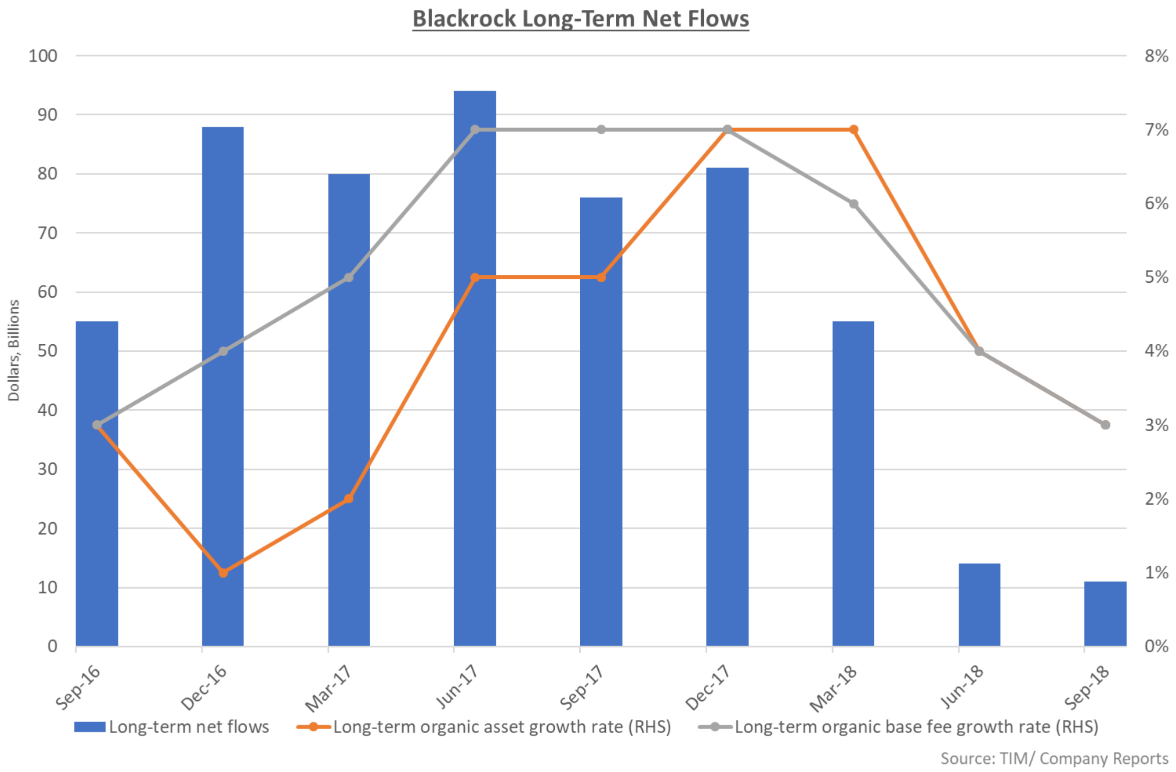
Although there appears to be no new evidence in the Reuter’s report, it served to raise investors’ concerns about the scale of damages that the company may suffer should there prove to be a history of covering up asbestos content in their talcum powder. JP Morgan estimate that if it settled the 11,700 cases outstanding for $280,000 each then the final liability would be $3.3 billion, considerably less than the $40 billion that the company lost in terms of market capitalisation on the day the story was released.

Although talcum is not split out by the company, Baby Care sales in 2017 amounted to $1,916 million which accounts for 2.5% of the company’s overall sales. The company generates over $15 billion in free cash flow each year despite spending 13.5% of sales on research and development and has little debt on its balance sheet. Johnson and Johnson have raised their dividend (currently $9bn) each year since listing and buys back significant amounts of its own stock. We do not believe that either of these are under threat and that the sell-off is overdone; a view supported by the company which announced a $5 billion buyback post the fall in the share price.

At the start of the month we sold the remainder of our holding in BlackRock. We acknowledge that BlackRock remains well positioned to benefit from the uptake in ETF investing which is still underdeveloped in Europe and Asia when compared to the US, and that High Yield and International ETFs command high fees so should be beneficial to margins as the market evolves. Our concerns, however, are a based in a few secular trends that offset these potential benefits.

Firstly, although the company claims that recent moves by competitors such as Fidelity offering zero cost trackers is beneficial to the firm as their products are on the Fidelity platform. They argue that this should result in an uplift in cross-selling and stock lending. We believe, however, that fee compression is a serious headwind to earnings. The Fidelity Total Market Index Fund and Zero International Index Fund raised almost $1 billion of assets in their first month (August-September). Vanguard has replied by announcing 1,800 ETFs would face no commission for trades placed online by investors, both of these moves are likely to force BlackRock to reduce their fees in response.

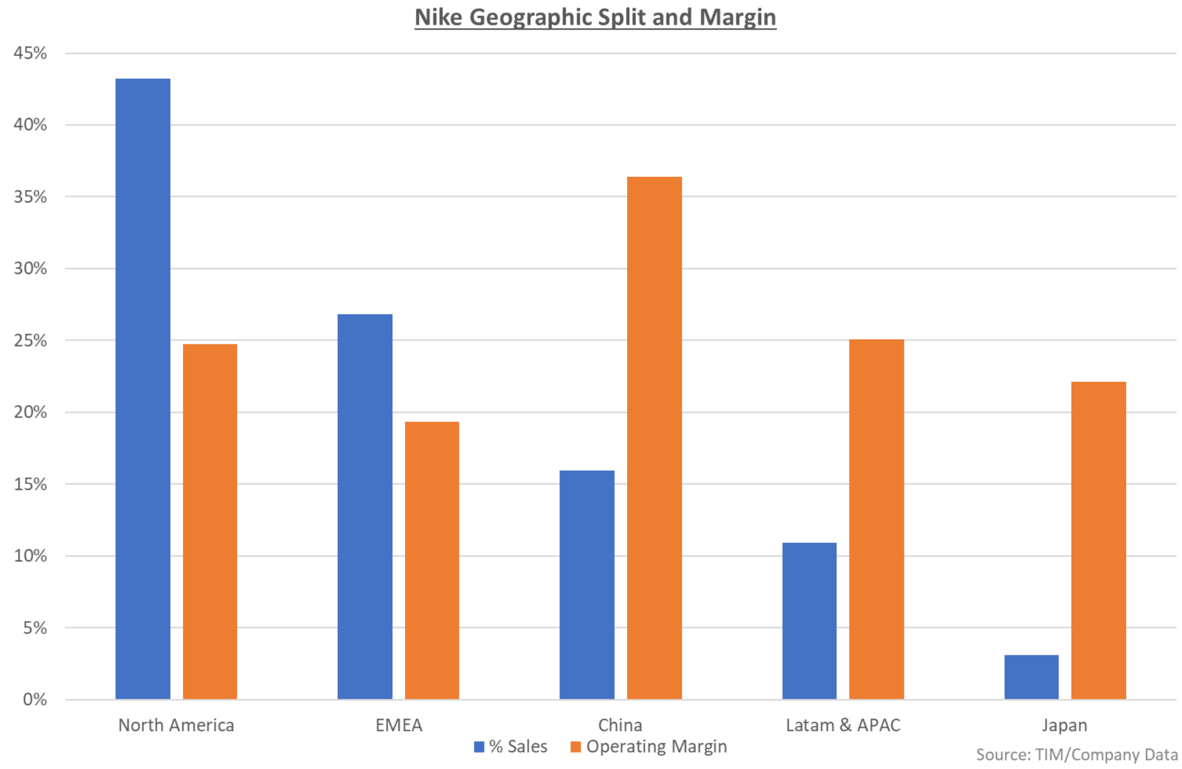
Secondly, current market trends have seen dollars come out of higher margin products into lower margin Core S&P500 and US products. Furthermore, the headwind of a strengthening US dollar is significant given the scale of the company's foreign assets and earnings. 35% of revenue and 45% of AUM are denominated in foreign currencies, with the largest exposure being against sterling and the euro. A decline in overseas AUM has a negative effect on overall fee rates and is compounded by the FX issues.



This suggests that we should see continued base fee declines and if market sentiment deteriorates then we also expect a shift to cash out of ETFs accentuating the issue. The company has recently been offsetting the decline in the growth rate in ETFs and Funds with performance fees, a trend that we believe is lower quality and more cyclical than the core business. Blackrock is not alone in facing the declining growth rate in ETF and Mutual Fund flow, according to Morningstar, in the first 11 months of 2018, net inflows for the US market as a whole fell to $237m, a 62% decline when compared to the same period in 2017, and the largest decline since the Financial Crisis.

On a more positive note, Nike gave the Fund an early Christmas present, reporting very strong numbers for the months leading up to November. The highlight of the quarter was the growth in Nike's Direct to Consumer and digital franchise which grew 41% and they expect 50% of incremental growth to come though these channels in the next five years, growing to 30% of sales by 2023 from 15% today. Innovation also boosted sales and average selling prices as the company increased investment in footwear and performance wear and there is a strong pipeline to be released over the next two years, which should support continued growth in the future.

At a time when all the economic data from China appears negative and a Trump induced trade war exists with the US, Nike reported its 18th consecutive quarter of double-digit growth in the region and reported that they had not seen any impact due to the political tensions. China now accounts for 15% of group sales.



We continue to believe that there is significant value in Nike's franchise and the company remains a core holding in the Fund.
