FP Tyndall Global Fund Commentary – November 2018

"When the world changes around you and when it changes against you, what used to be a tail-wind is now a head-wind, you have to lean into that and figure out what to do, because complaining isn't a strategy." – Jeff Bezos

The FP Tyndall Global Fund (B Inc) rose ahead of the wider global market during the month, gaining 3.55% and increasing year-to-date returns to 8.50%.

> Global equity markets continued to struggle during the month as the growth rate in the US appeared to slow, and economic data from Europe and Asia was significantly weaker than earlier in the year; Germany posted it first negative quarter of GDP growth since early 2015 and is showing signs that it may result in being in a technical recession.
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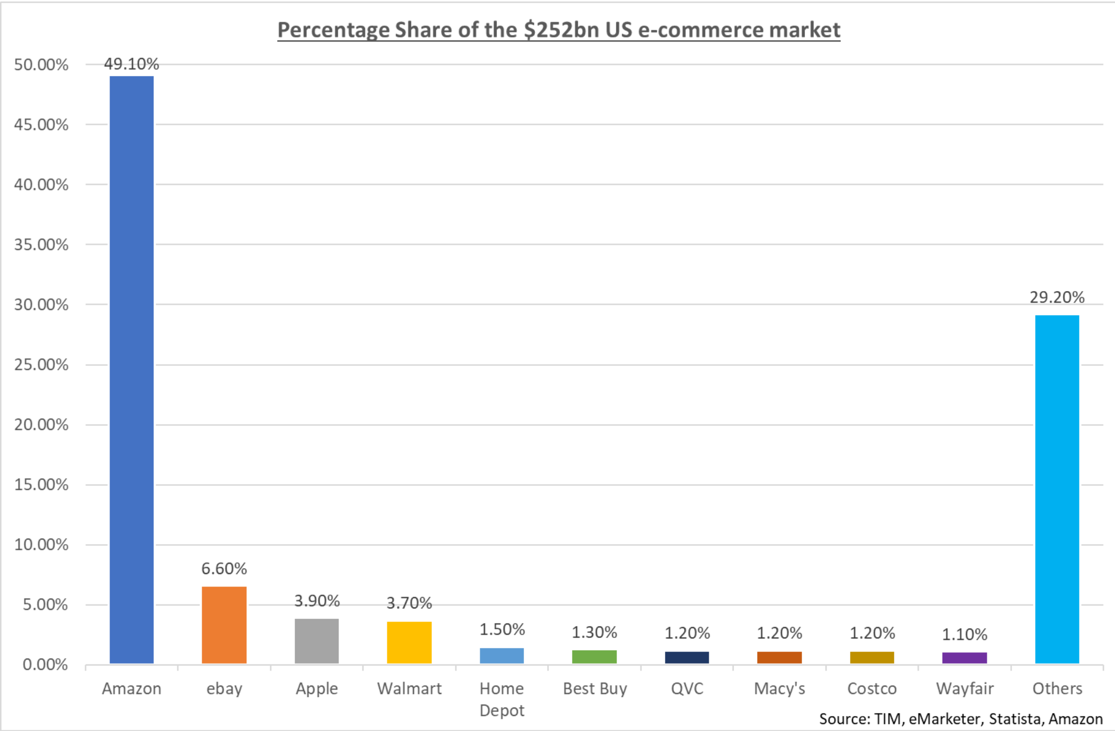
> Politics will be to the fore in December. Donald Trump, a.k.a. Mr Tariff Man, and Jinping Xi met at the G-20 summit in Argentina last weekend, where the market initially seemed content with the 3-month postponement in reaching some compromise on trade tariffs. In the UK, parliament is set to debate the Brexit deal that Theresa May has agreed with her European counterparts, which currently is opposed by members on both sides of the aisle; only time will tell whether as the vote approaches whether the prospect of the consequences of a no-deal situation tempers views. The German CDU party are due to vote on the successor to Angela Merkel, who has led the party for the last 18 years; whether the coalition survives depends on whether her chosen successor Anneggret Kramp-Karrenbauer is successful, as if either of the anti-immigrant challengers (Friédrich Merz and Jens Spahn) set the party on a different course a deal with the Greens maybe needed for a working majority – so much for a quiet December and a steady rally into the year-end!

Despite the recent stock market malaise, consumers where once again out in force on Black Friday, breaking the previous records by quite a handsome margin. Mastercard reported that sales on Friday alone amounted to $23bn, and Abode Analytics+ estimated that the online amount of sales grew 24% to $6.2bn, which equates to 27% of all sales; well above the normal US proportion of e-commerce retail sales, which stands at 13%. Cyber Monday sales also surpassed all records with a further $7.9bn spent online.

The percentage of sales captured by Amazon over the weekend is yet to be released, however their dominance of the US e-commerce market continues to increase. Having accounted for 38.1% of sales in 2016 and43.5% in 2017, it stands just shy of 50% this year. Over what Amazon terms the "Turkey 5" (so including Cyber Monday) the company amassed worldwide orders for more than 18 million toys and fashion items surpassing 13 million items. Sales by small and medium size enterprises through their platform increased by more than 20% as Cyber Monday became the largest single shopping day in the company's history to date. Although these headline numbers are impressive, we will look to analyse the amount of sales driven by promotion, and the corresponding effect that this will have on margins.



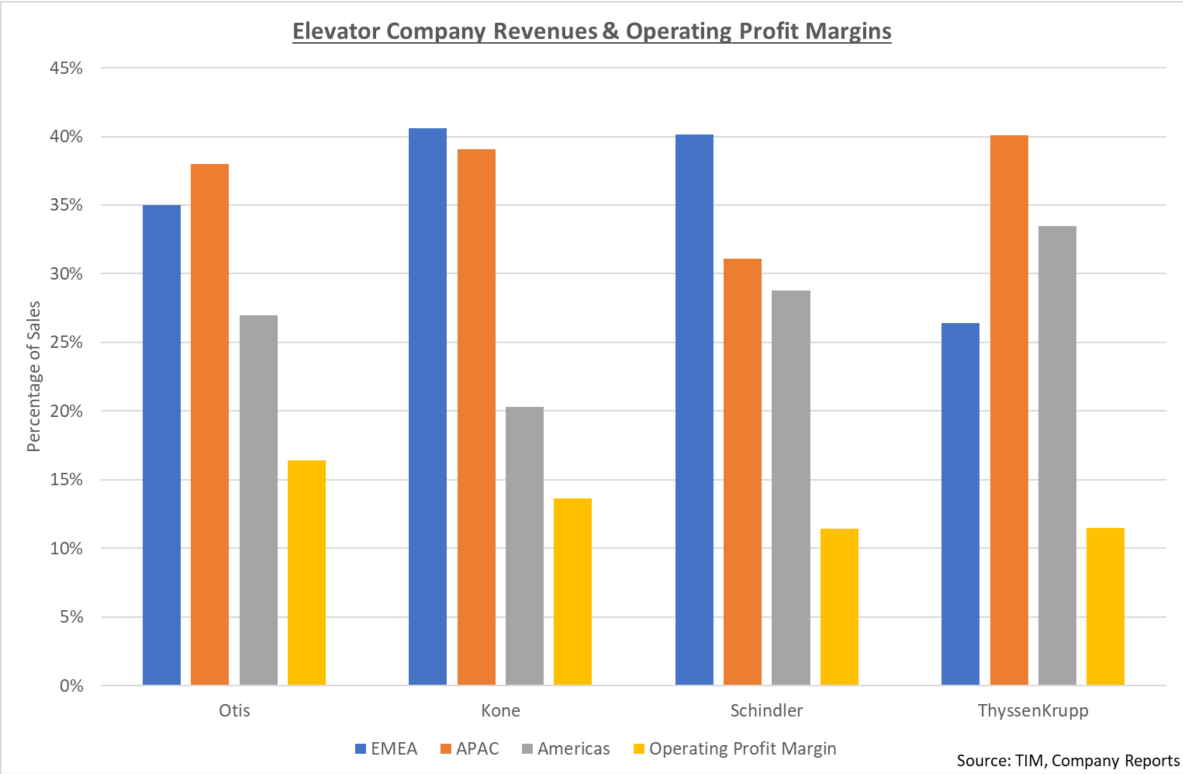
According to Statista Amazon only ranks second in global e-commerce sales with a 15% share by market value; the Chinese giants of Taobao.com (17%), Tmail.com (14%) and JD.com (9%) along with ebay (4%) make up the remainder of the top 5. Despite the European Union's protests, and subsequent fining, of Google's dominance in search, a recent survey by Adeptmind, found that 46.7% of US internet users actually start their searches for products on Amazon, while Google is in second place with 34.6%; a reversal of the situation three years ago. Worryingly for Google is that the percentage that use Google for search and then switch to buying on Amazon increased to 28%.

Despite its recent fall in valuation, resulting from the company guiding 4th quarter revenues and operating income that fell short of market expectations, Amazon remains a holding in the Fund. Given the headline numbers reported from the holiday season thus far we expect that the company may well exceed their cautious top line guidance; this is also likely to be bolstered by the number of new clients they have reported taking up Amazon Web Services (AWS) since the quarter end. Operating income will be negatively impacted by promotions and from the firm raising wages for its employees, but as AWS outgrows the rest of the business, margins benefit from an offsetting tailwind, so we expect that this number may well also be conservative.

This month also saw our holding in United Technologies announce its intention to separate into three separate companies by 2020. Otis will come an independent company. The firm is the market leading elevator and escalator (E&E) company in the United States, which commands higher margins than its European peers given the density of its installed base in its home country, and the percentage of high-margin recurring revenues that it receives from its servicing and maintenance contracts; with over two million contacts the company has the largest aftermarket service portfolio in the world.

Given that we hold Kone in the Fund we will undergo analysis as to the benefits of holding both it and Otis once the separation occurs. Given that we have been happy to do so thus far, there is unlikely to be a substantive argument for not doing so, but as part of our factor risk assessment this position will be constantly reviewed.

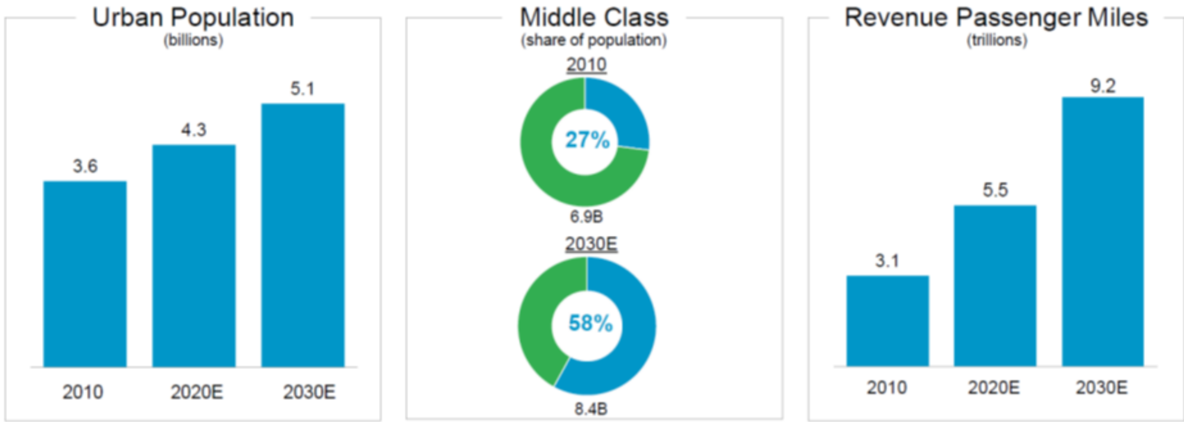
There has been much speculation that post the ThyssenKrupp split, a Thyssen-Kone merger would make strategic sense. Such a merger would make a new global leader, in terms of installed base, in the US, China and Germany, and a close second to Otis in France, Italy, Brazil and Spain. The combined entity would account for 28% market share globally. Although this combination would have the least anti-trust obstacles to overcome, the spin-out of Otis does put the possibility of a Kone-Otis combination into play. We believe that a combination of the two highest margin E&E companies would be a preferable outcome, despite the market share obstacles caused in the US and UK. We see a Thyssen-Otis merger as unlikely given the amount of overlap in their portfolios.



Returning to United Technologies, the climate, controls and security operations (which include refrigeration, fire safety and security products) will also be separated out under the Carrier brand name. The company has a large pipeline of innovative products, with more than 200 new products being released within the past two years alone.

The third company will be formed from the combination of the Rockwell Collins Aerospace systems, United Technologies Aerospace systems and the Pratt & Whitney operations, which will become the preeminent aerospace systems supplier to both the aerospace and defence industries. Combined sales of the two businesses will be in the region of $39 billion, giving it scale in invest throughout he economic cycle. Pratt & Whitney produce the Geared Turbofan™ for commercial aircraft and the engine for the F-35 Joint Strike Fighter from within its portfolio, both of which are experiencing rapid adoption worldwide and healthy aftermarket sales.

The price reaction to the confirmation of the separation appears to suggest that it was better travelling than to arrive; management projections of Free Cash Flow from Collins appeared conservative and this spooked investors. Although the costs of separation are estimated to be in the region of $2.5-$3.0 billion, we believe that the overall value of the three standalone companies will be greater than that currently ascribed to the combined entity today; The activist investor, Dan Loeb of Third point, ascribed a value of $190-$200 per share in his letter to shareholders compared to the current share price of $120, although we think this is a little over-optimistic. All three companies should benefit from the global megatrend of urbanisation as the global middle-class population increases despite the current weakness in the Asian markets.



Source: United Technologies

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