FP Tyndall Global Fund Commentary – October 2018

"An army marches on its stomach. To be effective, an army relies on good and plentiful food" – Napoleon Bonaparte

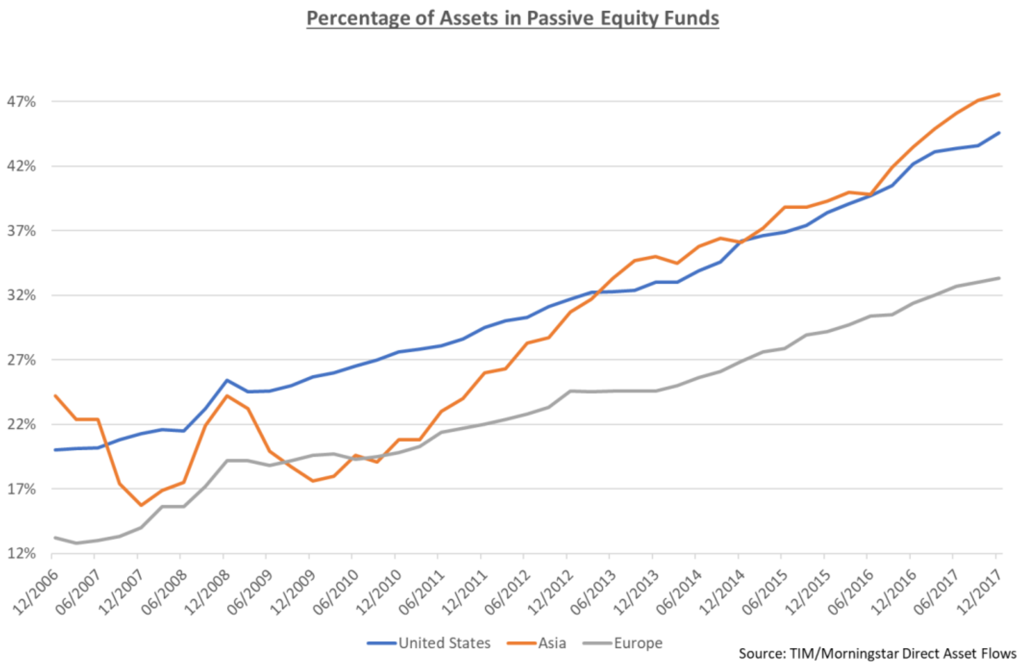
This month marks the 10-year anniversary of the Fund Manager's appointment to the Fund, during that period the Fund has risen 254.04%, compared to its peer group and the wider market's returns of 189.06% & 232.56% respectively.

The FP Tyndall Global Fund (B Inc) was not immune to the machinations in equity markets during the month and fell 5.42% over the month, reducing year-to-date returns of 4.79%.

Market participants moved from a glass half-full to a glass half-empty (or totally empty) approach to both economic and political news over the month. Having previously brushed off the interest rate normalisation approach of the Federal Reserve, rising yields now appear to be a source of concern. Although appointed by him, President Trump branded the governor of the US Federal Reserve 'crazy' and that he 'threatened economic growth', seeking to shift the blame of a sharp correction in the US equity market onto him. Mr Market is now expecting a further rise in interest rates in December and a further three in 2019. The sell-off in equity markets was indiscriminate, but those communication services and information technology stocks that have accounted for much of the rise in the Nasdaq and S&P500 over the past couple of years took the brunt of the attack. Holding Amazon, SAP, Apple and Microsoft, the Fund was not immune to this, although the later two proved more resilient than their peer group.

While there are multiple causes for concern, ranging from a slowdown in China, to dollar strength, from increasing refinancing rates to Italian budget machinations, we believe that the biggest risk to equity markets is investor sentiment and the increase in passive investing. JP Morgan estimates that $7.4 trillion of assets are currently held in passive funds. Morningstar reports that 44.6% of equity assets in the US by AUM are held in passive funds and correspondingly 47.6% in Asia and 33.3% in Europe, an increase from 20%, 15.8% and 13.2% respectively in 2007. Investors may wish to reduce their holdings due to one of the factors above, such as, for example, highly leveraged companies. Passive investing, however, means that the good get sold with the bad, and thus magnifying falls during times of falling investor confidence and also risks starting a negative downward spiral.

An example of this potential self-fulfilling downward spiral was seen in the Vanguard FTSE Europe ETF, which faced a redemption of $160bn in a single day earlier this month. Such was the move in valuations that we expect many quant funds faced stop-loss limits and thus also became forced sellers, highlighting an issue with so-called smart-beta funds.



> The latest BofA Merrill Lynch Fund Manager Survey (polled prior to this month's correction) registered the lowest net percentage of Fund Managers expecting a stronger global economy in the next 12 months since a survey in 2008, suggesting that any disappointment in the current reporting season may well lead to magnified market moves[1]. The contrarian investor in us sees this as an opportunity, because when sentiment is at its lowest, the greatest returns can be made from any recovery. We expect the next survey to be even lower given the market this month, however we may not be far off the point at which the risk/reward fan encourages us to put money back into the market as and when we find companies that fit our investment criteria and have fallen to attractive valuations.

During the month we took the opportunity of a fall in the share price of over 25% to initiate a position in the German professional cooker producer, Rational. The company was founded in 1976 and has been the global leader in its field since introducing combi-steam cookers in 1976. To date, it has sold 890,000 units globally, and it enables chefs to grill, pan-fry, bake and steam produce simultaneously in a single device. In 2005 it added a second product to its range, the VarioCookingCenter, which is capable of grilling, pan cooking and frying four times faster than conventional cookers and using 40% less energy. Together the products can cover 90% of all cooking processes undertaken in a professional kitchen and save up to 50% of the space required.

By conducting training days and seminars the company builds up consumer loyalty and knowledge (albeit that having over 95% customer satisfaction also helps), driving sales. Last year 107,000 chefs took part in at least one of the seminars, and this number is growing by 10% per year. The company also is continually updating the software and programmes for the devices, giving chefs recipes, remote connectivity and ease of programming.

[1] An open source extract of the report can be found at https://www.trustnet.com/news/844656/managers-bearish-global-growth-outlook-worst-since-the-financial-crisis

For restaurant owners the investment proposition is compelling as the payback period on buying both devices is less than five months, and as such increases not only reduces waste, but also increases productivity and profits in the first year.

Costings for a restaurant producing 200 meals per day

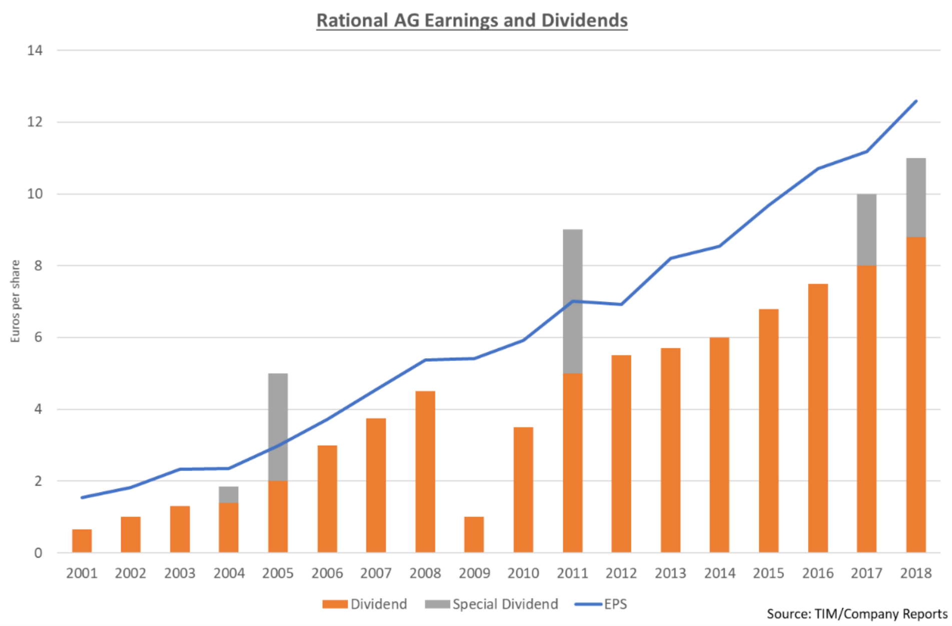
Equipment: 1 x SelfCookingCenter® 101, 1 x VarioCookingCenter® 112 Cost: c.€25,000

Average savings per month:

Raw material input (20% savings)	€1,536
Fat (up to 95% savings)	€164
Energy consumption (up to 50% savings)	€578
Savings for water/water softener/ descaler	€60
Less working time	€3,450
Total Savings per month (less monthly depreciation of €420 for five years)	**€5.368**

Source: Company presentation

Investors in the company have more than the prospect of good and plentiful food to savour. The company is cash positive and pays out 70% of earnings by way of dividend, and regularly also pays a special dividend as well. It is currently investing heavily in infrastructure and products as it grows rapidly in the US, however this should normalise over time. Despite these investments, the company has produced stable operating margins, suggesting that the current operating leverage is artificially depressed.



The company has consistently produced a Return on Invested Capital in excess of 35% over the past 15 years and holds no goodwill on the balance sheet. We like the fact that almost 71% of the company is held by insiders, suggesting that management and investors are closely aligned; variable compensation is based on employee satisfaction and the extent as to which the company has extended it quality and technological leadership, which we see as deepening its defensive moat.

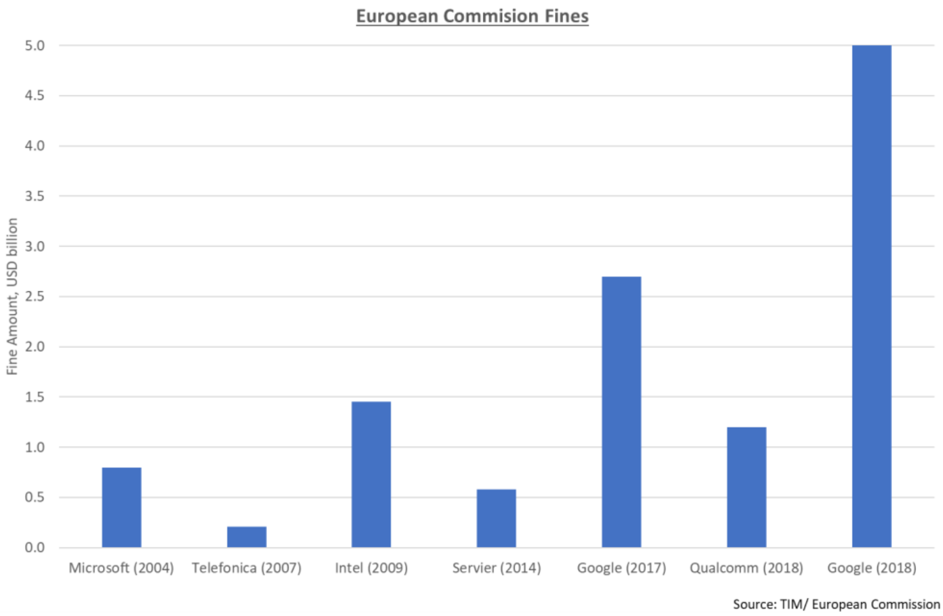
Earlier in the month, we took the decision to sell our holding in Alphabet (the parent company of Google). Our investment process applies a strict three-point initial screen, the final point of which questions whether we trust the management. Any firm that fails to pass all three questions is excluded from our investible universe.

We have been dismayed by various decisions taken by the management this year that calls into account their judgement. The decision not to turn up to the Senate hearing on foreign interference in elections alongside the executives of Facebook and Twitter, gave an impression of arrogance and disregard of public opinion, whether intentional or not. At a time when there is increasing pressure to enforce stricter regulation on digital media companies, we feel that the decision not send either Sundar Pichai or Larry Page to the hearing was an avoidable own goal by the company.

Source: The Washington Post

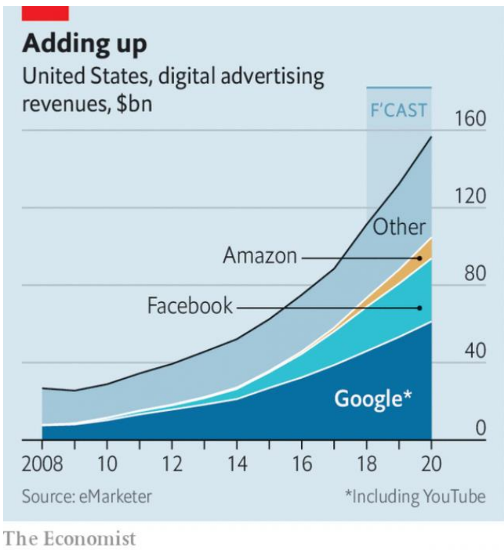
Although the company offered to send a lawyer to represent the company (which the Senate committee refused), social media outlets where awash with theories as to why the management where absent, most of which concluded that Alphabet had information that it did not want to share with the public. The company has held multiple closed-door meetings with Congress and, subsequently realising their mistake, Sundar Pichai announced that he would testify to Congress 'in due course'. We believe that this is case of trying to shut the stable door after the horse has bolted; turning up and demonstrating that they had nothing to hide would have been the smarter move. Pichai recently commented that 'user's trust is key to everything the company does'; we believe that building trust is difficult to achieve and maintain but very easy to lose and openness is a key component to building it, a trait that they have not been practicing of late.

Recent engagement with European regulators has also been sub-standard. The investigation into the alleged anti-competitive practices on the Android platform were always likely to see Margrethe Vestager slapping a fine on the company. However, had the company made to attempt to show that it acknowledged that they could be more transparent, may have led to a degree of leniency. Given that they had already incurred a $2.7 billion fine in 2017 for abuse of Google's dominant position in the internet search category suggests management must have been expecting a large fine and would have been advised to take steps to placate the European Commission. Although Alphabet has the cash flow to pay these fines, corporate image in a valuable intangible asset and worth defending.



Recent revelations that the company had avoided announcing that there had been a data breach affecting 500,000 Google+ accounts was also disappointing. Considering the leak occurred shortly after the discovery of Cambridge Analytica's harvesting of Facebook data, the company would have realised the sensitive nature of this information and that regulators are likely to take a dim view of any sign of an attempted cover up; simply shutting down the service is unlikely to be the end of the matter.

Away from management's lack of judgement, we also believe that the dominant position that the company has in US digital advertising will eventually come under threat. According to eMarketer, Amazon is set to double its revenue from this source in 2018 to $4.61 billion; a 4.1% market share. Google derives $42 billion of revenues from the same source (37.1% share) and Facebook a further $23 billion (20.6% share), and although their dominance is likely to continue in the medium term, we expect Amazon to rapidly catch up by capturing advertising monies that would otherwise have gone to the two incumbents. The same report suggests that by 2020 Amazon will have captured 7% of the market. Digital advertising is high margin revenue and therefore very valuable to those who can gain share.



We believe that Amazon's ability to demonstrate to corporates the entire value chain of advert engagement through to purchase is a more valuable model than that offered by either Google or Facebook and thus the 7% estimate may well be conservative; 56% of American's now start their product search directly on Amazon due to the ease of search to purchase. The company's CFO, Brian Olsavsky, drew attention to this source of revenue for this first-time during July's earnings call, commenting that it has now become "a multibillion-dollar business for us" and that international ad sales are growing at the same rate.

While we acknowledge that Alphabet remains a highly cash-generative company and will maintain, if not expand, its dominant position in search. We feel that Alphabet no longer passes our screen for inconclusion in the Fund, and thus we no longer hold a position the company.

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