VT Tyndall Global Select Fund Commentary

February 2019

TYNDALL

"If you owe your bank a hundred pounds, you have a problem. But if you owe a million, it has."- John Maynard Keynes

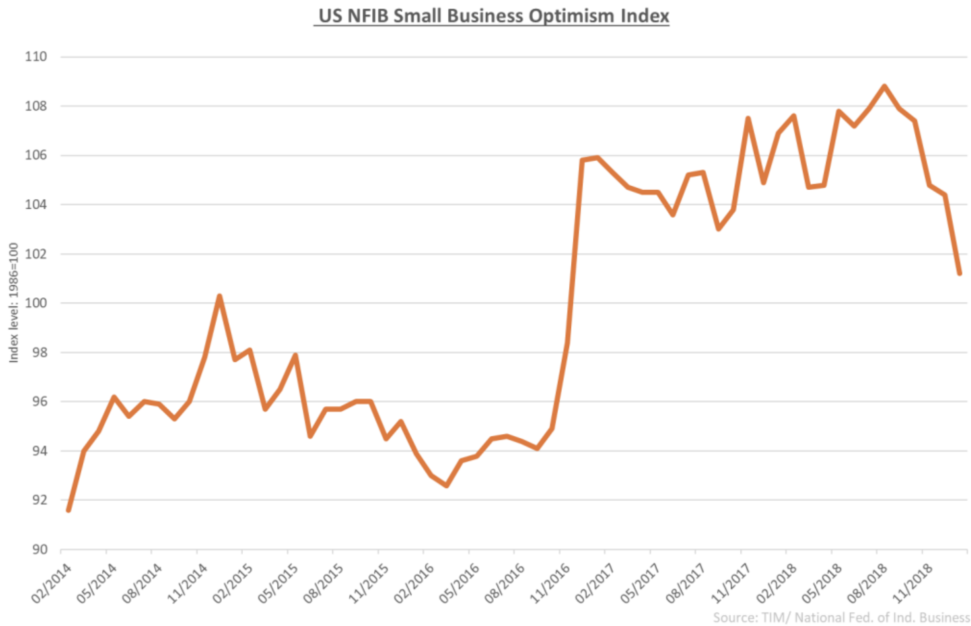
After the best January for equity markets in the past 32 years, equity markets continued their ascent in February as central banks turned more dovish and Donald Trump appeared to be prepared to offer an olive branch in the Chinese trade negotiations.

The VT Tyndall Global Select Fund (B Inc) followed the rise in global equity markets ending the month 6.39% higher than at the turn of the year.

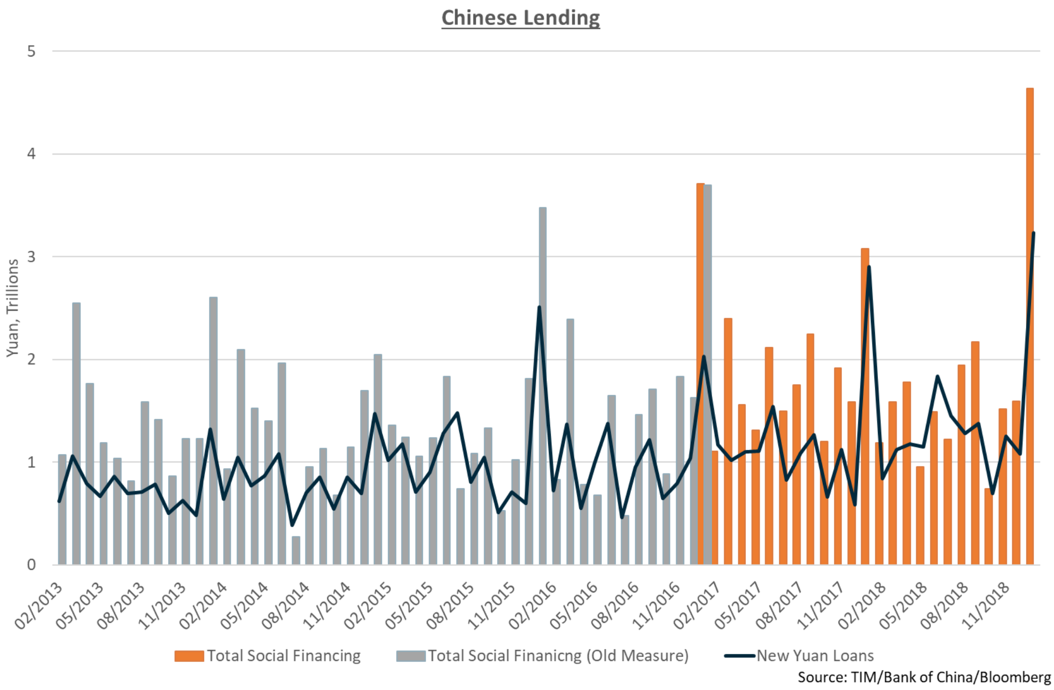
The swathe of economic data suggesting that the state of the global economy was far from being in good health had little effect on the market momentum. Data from Europe deteriorated further as Italy officially entered a recession and Germany only narrowly escaped joining them with at GDP reading of 0.0% for the last quarter of 2018. Despite this, the Italian MIB Index was the second best performing major equity index in Europe having risen by almost 12% over the month; surpassed only by Greece.

While the political parties in the UK trade blows over the reasons for Honda relocating back to Japan, a look at the recent Japanese manufacturing and export data is worth noting. The manufacturing Purchasing Managers' Index had registered above 50 (ie. growth) from the middle of 2016, but since the turn of the year the survey has fallen below 50, to the lowest level in the past 2 years, and exports have fallen 8.4% over the past year. This is partly due to exports to China which fell by over 20%, however exports to the US actually grew by 10%.

US retail sales posted their worst reading since 2001 and small businesses optimism continued to fall, but this did not deter investors; February and March's readings will be particularly interesting as they are likely to show whether these readings are as a result of the US governmental shutdown, or part of the wider reduction in the rate of growth in the US economy.



Chinese negotiations with the US are still ongoing, but the Chinese government is not standing still in the hope that economy will be able to withstand the resultant effects of a negative outcome. To try and ensure that the economy continues to function, social financing to the private sector hit record levels in January and is expected to continue to grow to almost 6 trillion yuan by April. We expect that President Xi Jingping will continue to try and prime the Chinese economy with a mixture of fiscal and monetary measures ahead of the 70th anniversary of the founding of the People's Republic of China on October 1st, which is due to see huge celebratory events including the showcase military parade in Tiananmen Square; the president will be only too aware that this year also marks the 30th anniversary of more notorious events in the same place.



We made no new positions this month, however we increased our positions in the German semiconductor company, Infineon, the US animal health company, Zoetis and Walt Disney.

Both Coca-Cola and PepsiCo reported their full year numbers during the month, with Mr Market having decidedly different reactions to their numbers and outlook despite both companies facing similar headwinds and market dynamics.

Both companies have significant pricing power and economies of scale resulting in PepsiCo forecasting $9 billion in Free-Cash-Flow in 2019 to Coca-Cola's $8 billion. This impressive cash flow enables both businesses to pay generous dividends while simultaneously investing in new products that tap into changing consumer tastes and lifestyles, such as PepsiCo's flavour pods and other low-sugar products such as Coke Zero.

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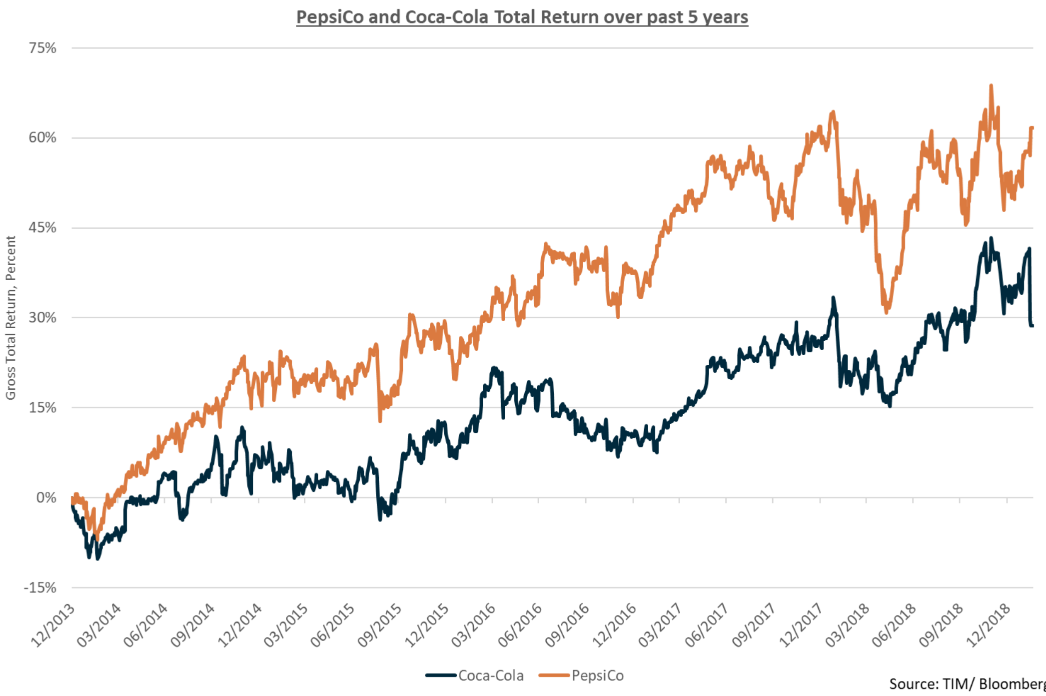


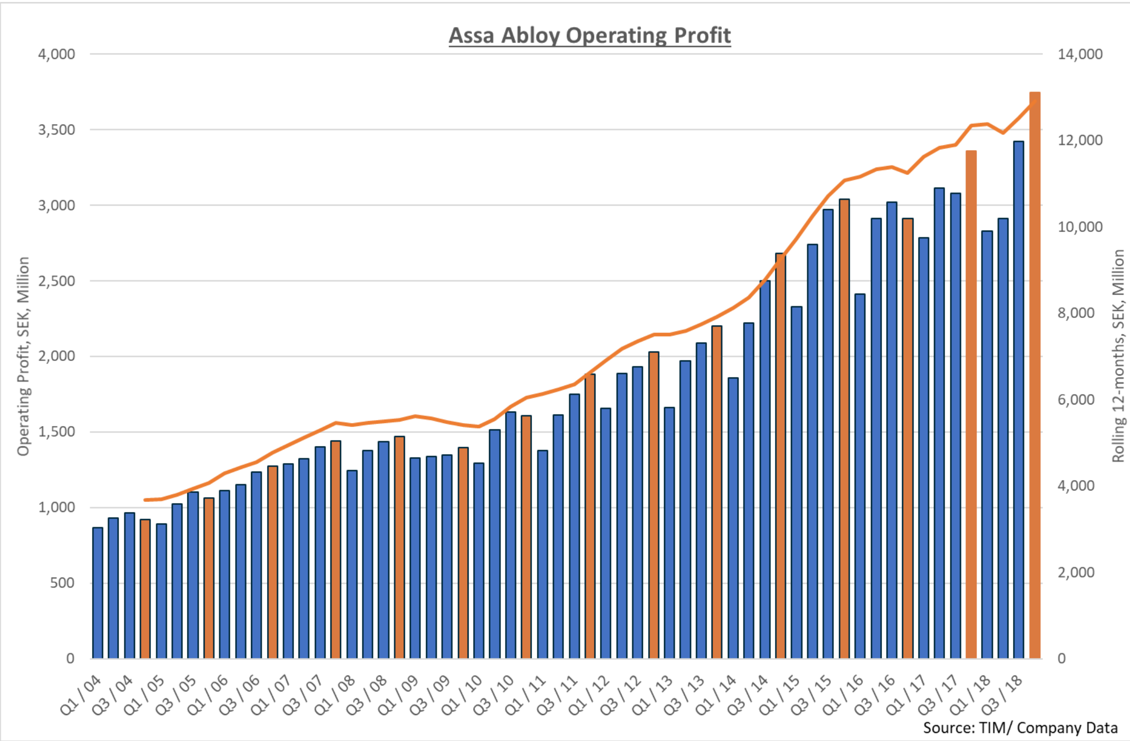
Source: TIM/ Bloomberg

Despite the structural headwind to their traditional beverage base, PepsiCo is not a pure beverage play and thus is less exposed than its rival; in fact, although North American beverages account for almost one third of revenues, only 22.5% of operating profit comes from this line while Coca-Cola generates 36.9% of revenues and 28.2% operating profit in the US. The major differencing factor is that PepsiCo also owns Frito-Lay and Quaker Oats. These products in North America account for 29.1% of revenue and 55.8% of operating profit, making the revenue stream and cash flow less vulnerable to the consumer aversion to higher sugar content products.

Source: Company Presentation to CAGNY 20/02/19: FLNA - Frito Lay North America; NAB – North American Beverages

Over the years there has been significant activist investor pressure to split PepsiCo into separate food and beverage businesses, but Indra Nooyi, who retired last year after 11 years in the CEO post, resisted any such move, arguing that the combined business achieved better terms from retailers as well as synergies from cross-promotion and distribution. We doubt that the new CEO, Ramon Laguarta, who has spent the last 22 years at PepsiCo will differ in his views, although one of his first moves has been to split leadership roles in North America between beverages and Frito-Lay. We believe that investors should see greater benefit from the company investing its cash flow in future growth initiatives and acquisitions of fast-growing niche brands; in the past year the company has brought SodaStream, the probiotics company KeVita and last week Muscle Milk, which we believe are steps in the right direction. We have PepsiCo in the Fund since October 2008, but as yet do not see the investment case for also holding Coca-Cola.

During the month we met with the management of Assa Abloy[1], which we have held since May 2011. The company performed well after demonstrating organic growth in all regions and sectors, especially in the Global Technology sector. China, which has been problematic for the company over the past three years, posted strong growth. Although management remains cautious as to whether the new structure and management in the region have actually turned the corner, but they have totally overhauled their 'go to market' strategy in the region and believe they have identified where the company was failing to capitalise on a growing market.



Although the company still has strong sales in traditional locks, it has also been at the forefront of innovation within the access and security systems market. Assa addresses the emerging Internet of Things (IoT) market via proprietary solutions for both Amazon and Google (Alphabet), effectively being

[1] Assa Abloy operates under 46 brands including the Yale, Union, Sargent, HID and Cliq.

the preferred solution for anyone wishing to tie their door opening to their Alexa or Google Nest hub so they can unlock it from anywhere or give trusted people a passcode rather having to send them a key.

Encouragingly, such is the strength of the Yale brand, it is the only product in the Nest suite of solutions that is branded with anything other than Nest, similarly the Amazon remote access solution is also Yale branded. Assa Abloy and Alphabet started shipping the Nest x Yale lock in April 2018 and given Assa's low penetration of the US residential market should provide a new growth avenue. Electromechanical (elmech) locks are currently installed in only 4% of US houses, compared to South Korea where the density has reached 75%; Europe has a penetration of 3% but Assa currently has a higher exposure to the residential market in Europe than the US where it has minimal sales. If the US was to reach a similar penetration rate it would represent an additional SKr 8 billion in revenues (Europe, SKr 6 billion) albeit that given the power of their partners the margin is likely to be lower than uplift in list price might suggest.

Mechanical locks in Europe are 5x more expensive than in the US, and thus intuitively the margin impact is more meaningful in the US, where elmech locks are 10x more expensive than mechanical, compared to Europe where the rate is closer to 3.5x.

Nest x Yale Lock

Amazon Key Yale Assure Lock

We believe that Assa is uniquley positioned to grow, through a mix of innovation and acquistion over the coming years and a concrerete resolution of the issues that it has faced in China and a turnaround in France should be seen as added bonuses.

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