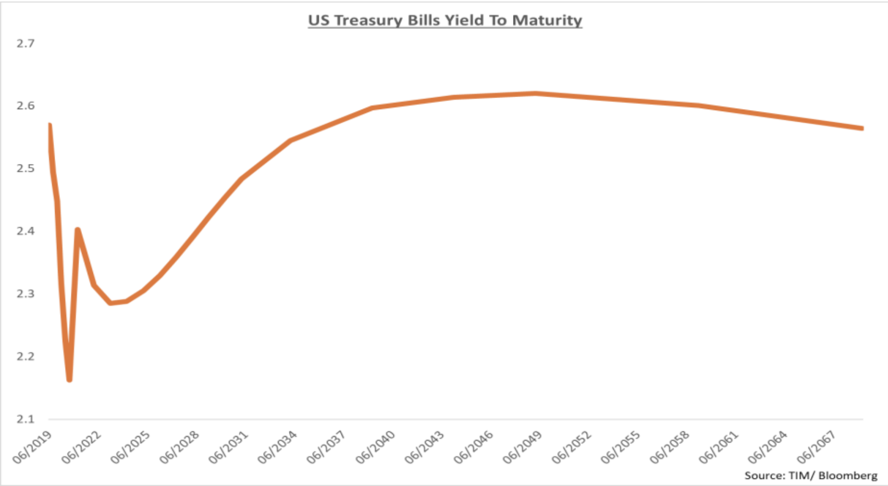
VT Tyndall Global Select Fund Commentary

March 2019

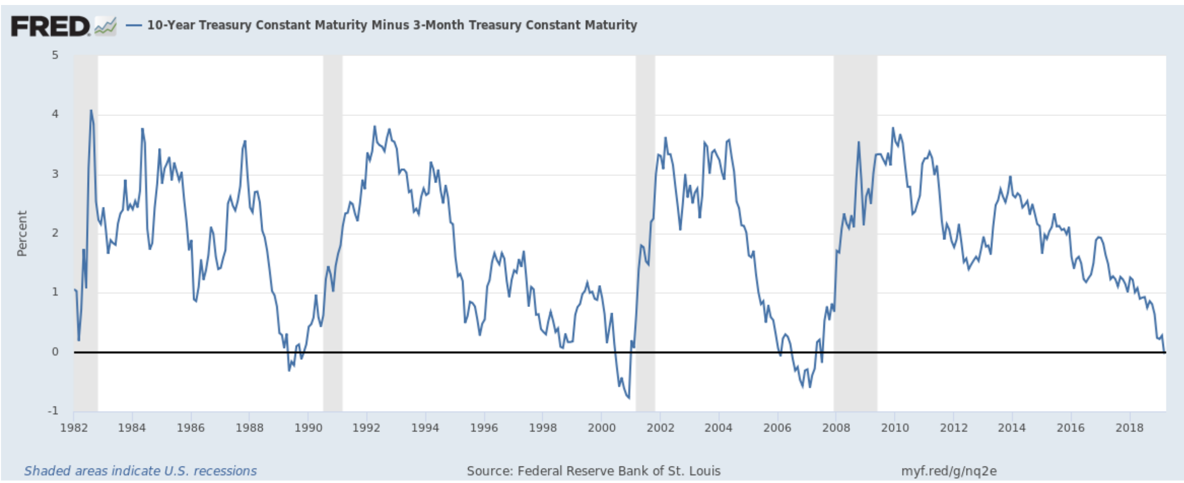
"I love deadlines. I like the whooshing sound they make as they fly by."- Douglas Adams

With the February deadline for a China-US trade deal apparently being pushed back to June and the Brexit deadline of 29th March now being either April 12th, May 22nd, or perhaps even later; it would appear that deadlines are more akin to flexible guidelines than cliff edge. Global equity markets appeared to be unperturbed by these turns of events, however rapidly falling bond yields tempered market spirits somewhat.

The VT Tyndall Global Select Fund (B Inc) followed the rise in global equity markets ending the month up 3.30% and 9.90% higher than at the turn of the year.

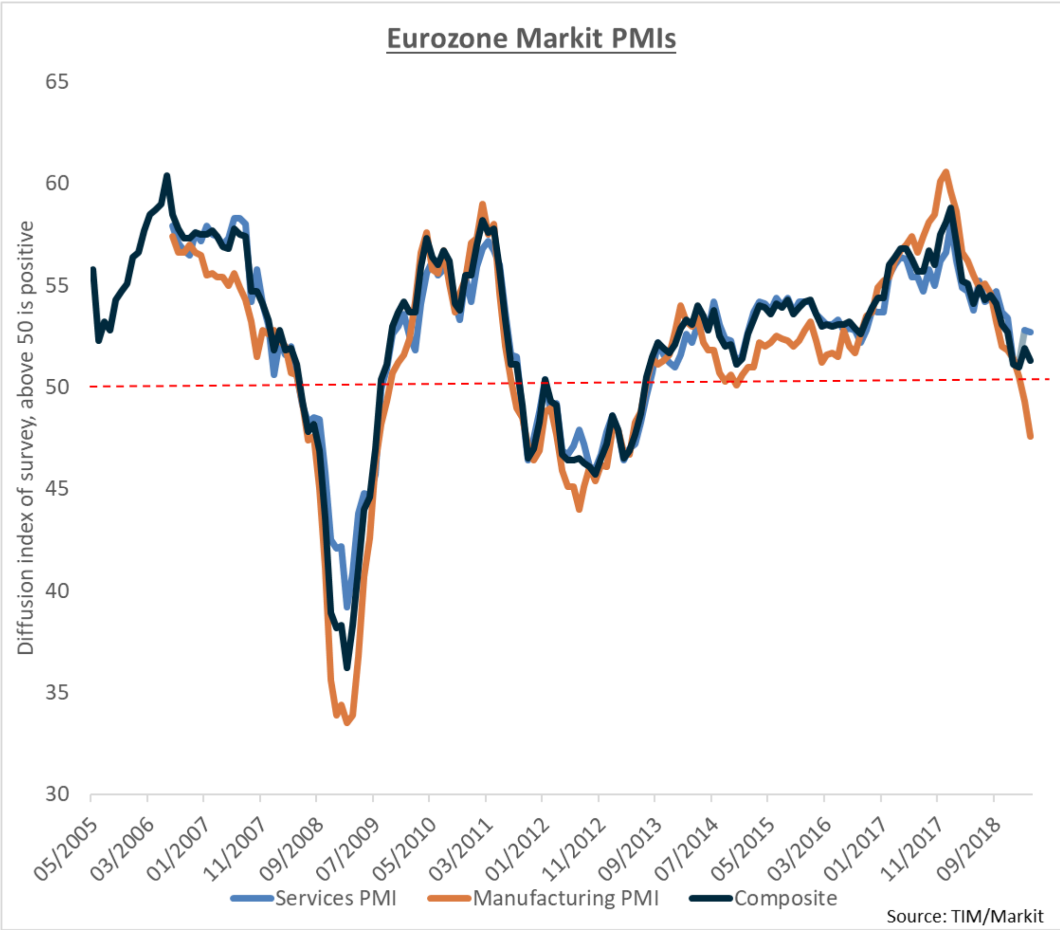


The third dovish tilt by the US Federal Reserve finally saw Mr Market express concern over the Global economic outlook. By indicating that it is unlikely that we see any more interest rate rises this year and that the tapering of the balance sheet is likely to stop at $3.8 trillion (September) has led to the most inverted yield curve since 2007. The odds for the next move to be a rate cut have risen (intensified by rumours that President Tump is to nominate Stephen Moore to the Fed Board) from an expectation of four rate hikes six months ago. The US 10-year yield has fallen from 3.24% in November to 2.36%; a long way from the 4% that Jamie Dimon and Bill Gross where predicting in 2018.



Every US recession in recent times has been preceded by an inversion of the yield curve in the previous 12 months, however, there have been many false-positives too. With a similar set-up to 1998, which proved to be a false-positive and resulted in the Fed cutting rates by 75bps, we do not expect the recent inversion to necessitate a recession. We prefer to invest in those companies that have reliable cash flow generation and higher than average ROIC and are thus not reliant on the credit markets when times are hard, as being self-financing, they can take opportunities as and when they arise, while their peers cannot.

German 10-year yields dropped below zero for the first time in over two years as March's Markit Manufacturing survey indicated a deepening contraction, increasing fears that Europe was facing a greater slowdown than originally thought. Given the weighting of Germany towards European GDP the Eurozone survey also dropped significantly.

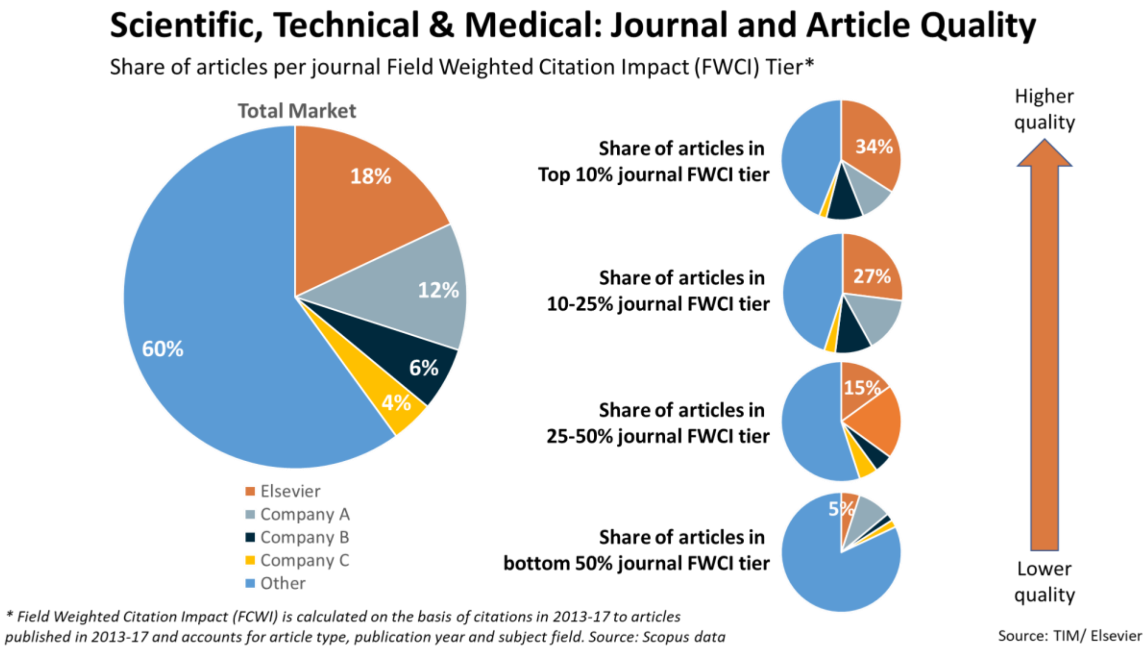


The reliance of Germany GDP on export orders (47.3% of GDP) makes it particularly susceptible to a fall in global trade. China accounts for 7.1% of total German exports, behind only the Unites States (8.6%) and France (8.0%), and thus Germany is particularly susceptible to a drop in Chinese consumption. Although the Chinese economy is struggling in the eye of a US trade war storm, the authorities are moving to stimulate the economy. Li Keqiang, China's premier and No2 to President Xi Jinping is planning to cut corporation tax and regulation rather than revert to the former strategy of printing money and ramping up government spending, which should eventually feed through to the German economy, however we expect that this might take some time until it does.

We made no new positions this month, however, we increased our position in the RELX (formerly Reed Elsevier).

The decision to increase our position in RELX occurred in the immediate aftermath of the announcement that the University of California was terminating its relationship with RELX's Elsevier division. The market took the news poorly; however, we believe that the understanding of Elsevier's business model is misunderstood and the trend towards open access is not as detrimental to the Returns on Invested Capital or the long-term profitability of the business.

RELX's Scientific, Technical and Medical division (Elsevier) has over 12,000 clients, of who c.6,000 renew their subscriptions every year. Most customers (74%) are happy to subscribe to the traditional model where for an annual fee the customer gets the right to read and submit articles to be published in one of RELX's journals, however 24% pay RELX on a transactional basis. The number of articles submitted has risen consistently since 2006 at a 5% CAGR, with 471,000 articles published in 2018 (out of 1.8m submitted). This growth is partly supported by the proportion of top tier journals owned by RELX; amongst the 2,500 journals are the gold standard STM publications, *The Lancet* and *Cell*.

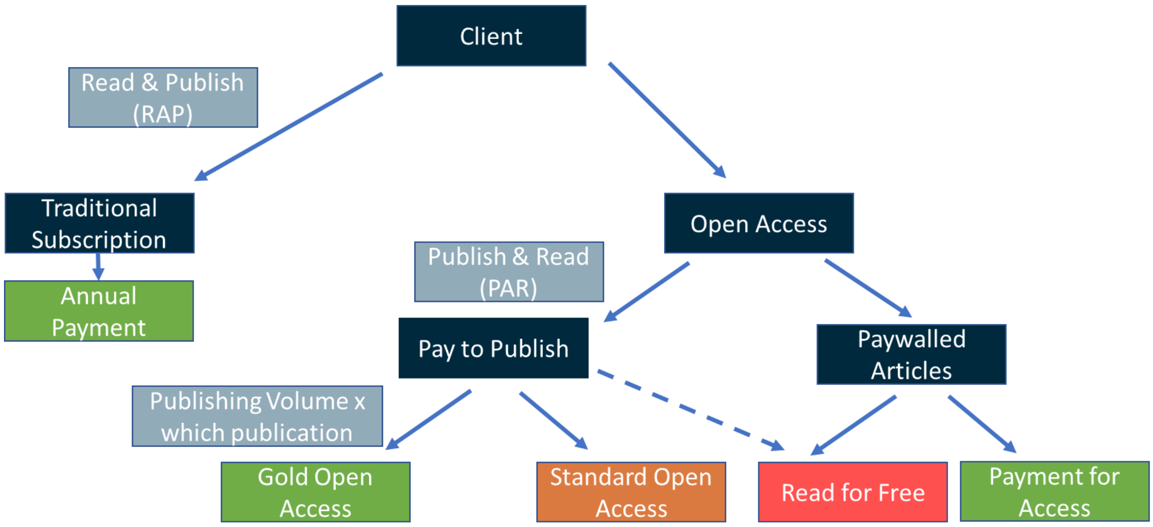


The issue of Open Access originated in Germany where the libraries and universities argued that RELX was a publisher and therefore should be paid per article published and not via an annual subscription, and that they wished their articles to be open for all to access. While on first inspection this would seem to undermine RELX's business model, we would argue that this is not the case. The agreement between Wiley and the German institutions (Projekt DEAL) is a good case study (as RELX is yet to agree terms with them) to see the dynamics of such a deal.

Within the terms of Projekt DEAL the German institutions gain read access to all of Wiley's academic journals since 1997 for an annual fee and makes their papers published through Wiley free to all; termed as Publish & Read (PAR). The annual fee will be based upon the number of papers that they publish through Wiley, at an estimated rate of €2,750 per article. There is variation in the fee dependent on the FWCI tier, with gold journals commanding a higher fee given that an article processing charge applies (€1,882 at Wiley). The institutions have also agreed not to coerce authors to publish open access and allow them to choose to publish via a paywall. Last year Wiley published 10,000 articles from these institutions and at €2,750 the payment comes out to an equivalent fee that they received under the previous RAP (Read & Publish) model; thus, if the volume of articles increases the total fee received could end up being higher than from the old model. Elsevier published 16,500 articles from these institutions in 2018.

A problem that we foresee with this model is that the institutions will face a battle between their researchers who will want their articles to be published in higher tier journals and the institution will want to keep the fees down (although the publisher also will dictate the tier in order to 'quality control' their publications).

Elsevier Research Revenue Model



Source: TIM

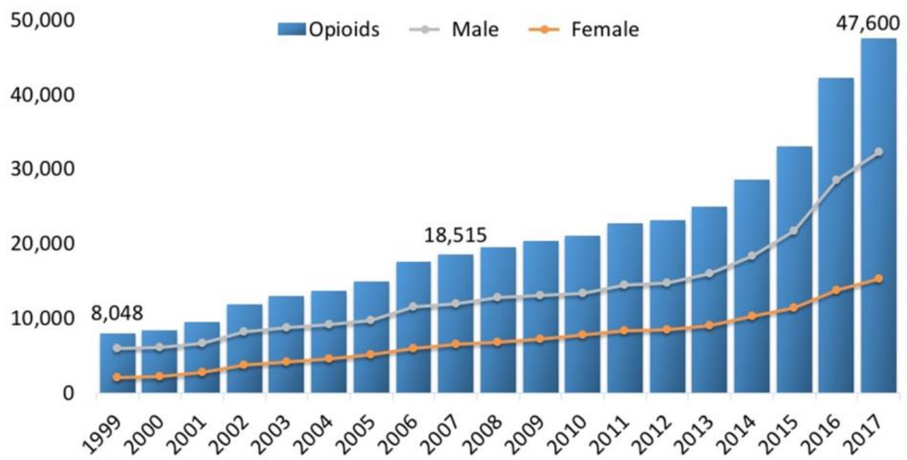
The termination of the University of California contact may have created headlines however, in 2018 the RAP contract amounted to $11m (0.3% of the division's revenues or 0.1% of group revenues) and they published 18,000 articles in RELX's journals, which is roughly 2% of the total articles published. The University claims that they account for almost 10% of articles published in the US, which would suggest that a large proportion of their articles did not pass RELX's review process and that the talks may well have faltered not only on price but also due to the University wanting more of their content published in RELX's journals whilst RELX wanting to retain editorial (and quality) control.

We believe that the Open Access PAR model will evolve to become the norm over time, however the publishers will be able to manage the transition without a decline in returns on invested capital. The upper hand retains with those who have a higher proportion of gold journals as they exhibit a greater degree of price inelasticity. As stated above we increased our holding size this month.

The actions of the Tate and the National Portrait Gallery in respect to the Sackler family's connection to Purdue Pharma has raised the British awareness of the opioid crisis in the United States- Julia Robert's latest film, *Ben is Back*, is likely to do so too. Despite one of America's most talented musicians, Prince, dying from an Opioid overdose, outside of the US awareness has been alarmingly low to date.

Drug addiction in the US has become an endemic problem and has started to draw State, Federal and Presidential attention. To put the numbers into perspective, in the United States over 70,000 people died from drug overdoses in 2017 (more annually than in the height of the HIV/Aids epidemic) and over 115 Americans die every day after overdosing on opioids. The Centre for Disease Control estimates that almost half of all opioid overdoses involve a prescription opioid.

Figure 3. **National Drug Overdose Deaths Involving Any Opioid,** Number Among All Ages, by Gender, 1999-2017



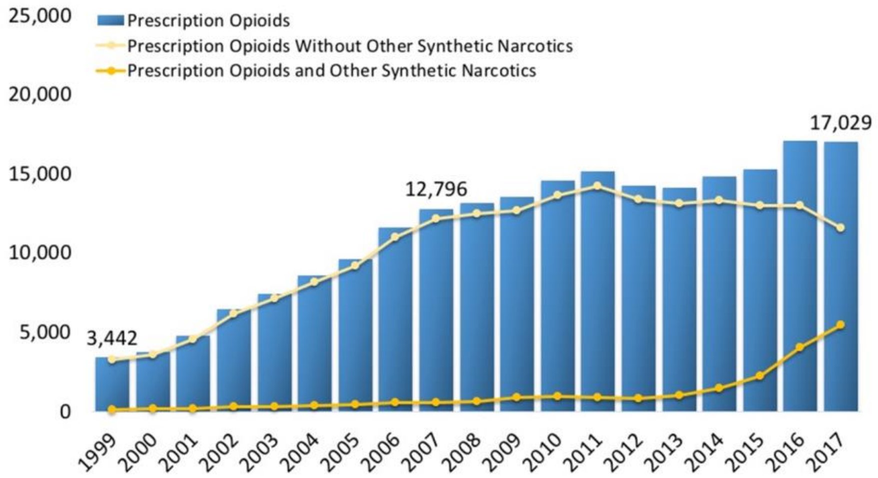
Source: : Centers for Disease Control and Prevention, National Center for Health Statistics. Multiple Cause of Death 1999-2017 on CDC WONDER Online Database, released December, 2018

Last week, Purdue Pharma agreed to pay the State of Oklahoma $270m to settle a lawsuit that alleged that opioids it sold, including OxyContin, contributed to thousands of deaths. This is the first case of its kind; however, many other American States are considering similar lawsuits.

Purdue Pharma is not alone in facing lawsuits, as Johnson & Johnson and its subsidiary Janssen Pharmaceuticals have also been named in more than 1,600 suits for the marketing of opioids including their drugs Duragesic® (fentanyl), Nucynta® (tapendtadol), and Nucynta®ER. Although the company only discloses the revenues from its top 10 drugs every year and therefore the numbers associated to

Nucynta® are not in the public domain, Duragesic® did feature in the top 10 for multiple years. Between 2001 and 2016, despite going off patent in 2004, the company earnt over $15 billion in revenues from the sale of this product. Nucynta® was divested to Depomed Inc in 2015 for a further $1.05 billion.

Figure 4. **National Drug Overdose Deaths Involving Prescription Opioids,** Number Among All Ages, 1999-2017



Source: : Centers for Disease Control and Prevention, National Center for Health Statistics. Multiple Cause of Death 1999-2017 on CDC WONDER Online Database, released December, 2018

Thus far complaints have been filed against J&J by State Attorneys in Arkansas, Florida, Kentucky, Louisiana, Mississippi, Missouri, New Hampshire, New Jersey, New Mexico, Ohio, Oklahoma and South Dakota. The company has also received requests for information from the ranking minority member of the United States Senate Committee on Homeland Security and Governmental Affairs regarding the sales, marketing, and educational strategies related to the promotion of opioids use.

Outside of the United States there are also suits filed in Puerto Rico and British Colombia; Johnson and Johnson and Janssen deny any wrongdoing.

Complaints have also been filed in state or federal courts by city, county and local government agencies in 34 states.

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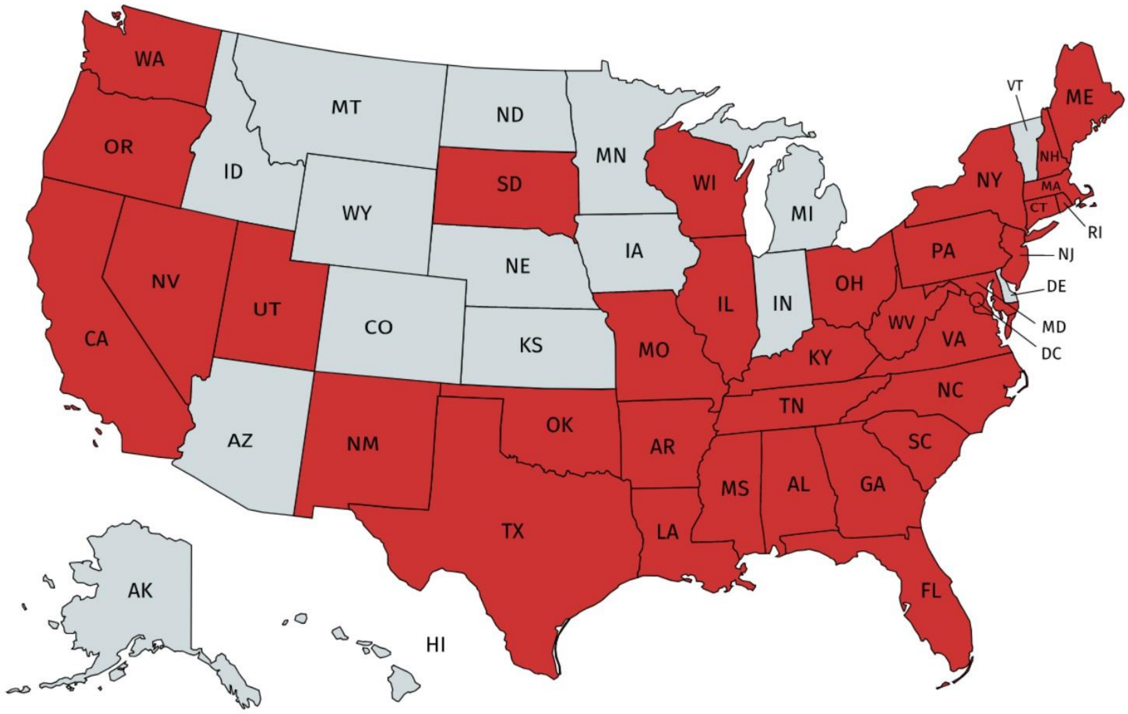
States where complaints have been filed by State or Federal Court



Although the Purdue settlement with Oklahoma would be easily digestible by Johnson and Johnson, our concern is that this is only the tip of the iceberg and the total settlements (should they been found liable and guilty of mis-selling) could run to many billions of dollars.

We continue to believe that Johnson and Johnson is a quality franchise with a diversified revenue base that is highly cash generative with a solid and rising dividend and a through the cycle Return on Invested Capital of over 20%. However, although we continue to hold a position in the company, we decided to reduce our exposure to the company given the litigation concerns, as the shares may struggle to outperform while these cases play out; it also faces litigation over talcum powder which we covered in December's newsletter. Once the dust has settled, we believe that Johnson & Johnson is likely to return to be a core holding in the Fund.

Investment Manager: Tyndall Investment Management, 5-8 The Sanctuary, London, SW1P 3JS. Tyndall Investment Management is a trading name of Odd Asset Management Limited.