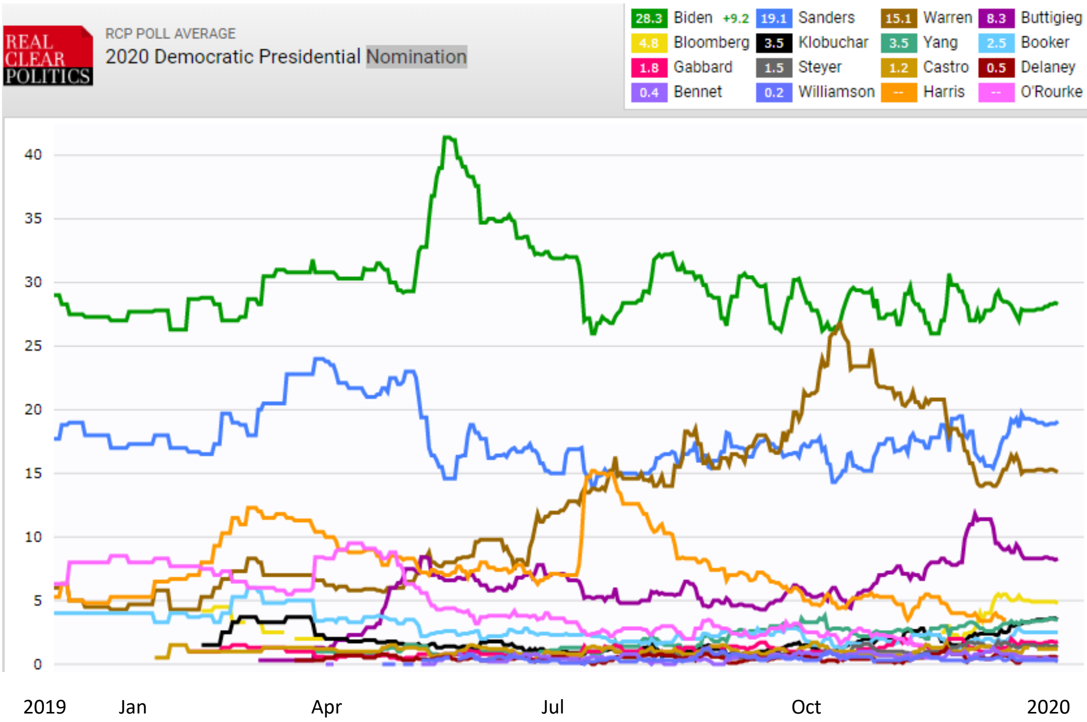
VT Tyndall Global Select Fund Commentary

December 2019

"We are often unable to tell people what they need to know because they want to know something else."- George MacDonald

Markets took the third impeachment of a sitting US President within their stride, and Donald Trump remains on course to be returned to office in next year's presidential elections. Although Joe Biden remains in the lead to run against him, Pete Buttigieg has seen an increase in popularity in key states and Mike Bloomberg is due to enter the race next year; the prospect of Elizabeth Warren becoming the Democratic nominee appears to be fading fast.



The passing of a phase one trade deal with China, that postponed the imposition of further tariffs on 15th December, also raised spirits (albeit in the days prior to the announcement the both sides sent opposing announcements multiple times a day, resulting in heightened volatility).

Sterling and UK equities caught a bid as the prospect of a quasi-socialist government diminished with the Conservative party storming home with their biggest majority in 30 years. However, subsequent announcements about amending the Brexit bill to make 31st December 2020 a firm deadline for a trade deal quickly reversed the Sterling gain as investors saw the prospect of a no deal Brexit once again. Given that the UK is already aligned in trade terms with Europe, we believe that working out a trade deal with our largest trading partner should be easier than a totally new partner as long as both sides do not try and play politics against reason. Future trade deals and the resolution of the West Lothian/Independence question are likely to keep animal spirits at bay, whilst the potential relief of no further elections for several years and the Conservative party being able to push through their longed-for constituency boundary reforms should provide some relief for the struggling UK economy.

The VT Tyndall Select Fund B Inc (Total Return) followed the market higher over the month, rising by 1.40% bringing the year-to-date returns to 25.97%

Fund Activity

We continue to believe that "*the market is a short-term mechanism that fundamentally undervalues companies that can continue to grow in the long-term*". Hence, we have remained conservative in our positioning while short-term news has driven the market.

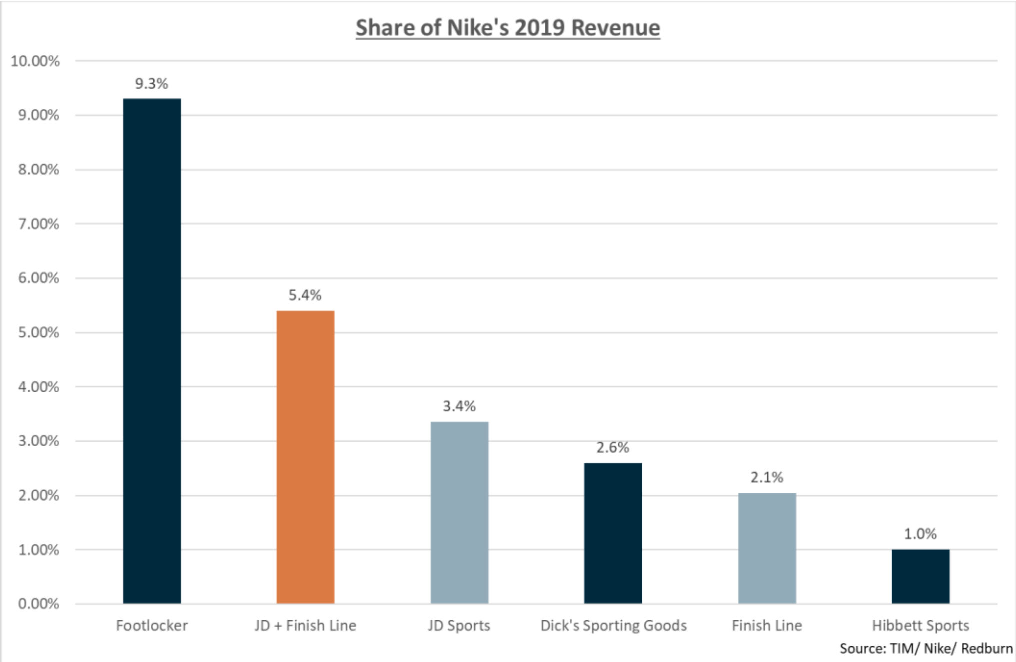
We initiated a position in JD Sports Fashion after the majority shareholder, Pentland Group, placed 4.5% of their holding in JD Sports through an accelerated book build, causing the shares to fall by over 12%. The Pentland Group remains a committed shareholder, still holding 55% of the company, and there is a floor to their holding at 50.1% due to the tax issues that would arise. The company had been doing some internal reorganisation and had already moved some of their holding in JD Sports to another company within the wider Pentland Group structure. On a positive note, the placing increases the free float in a company that has just moved into the FTSE 100 index.

JD Sports is a best in class omni-channel retailer with well-invested real estate. It is second only to Inditex in terms of store density and almost double that of its UK sporting retailing peers. The digital offering is also a key sales channel given its core demographic. Digital now represents 17% of group sales and has grown at a 38% CAGR since 2015.

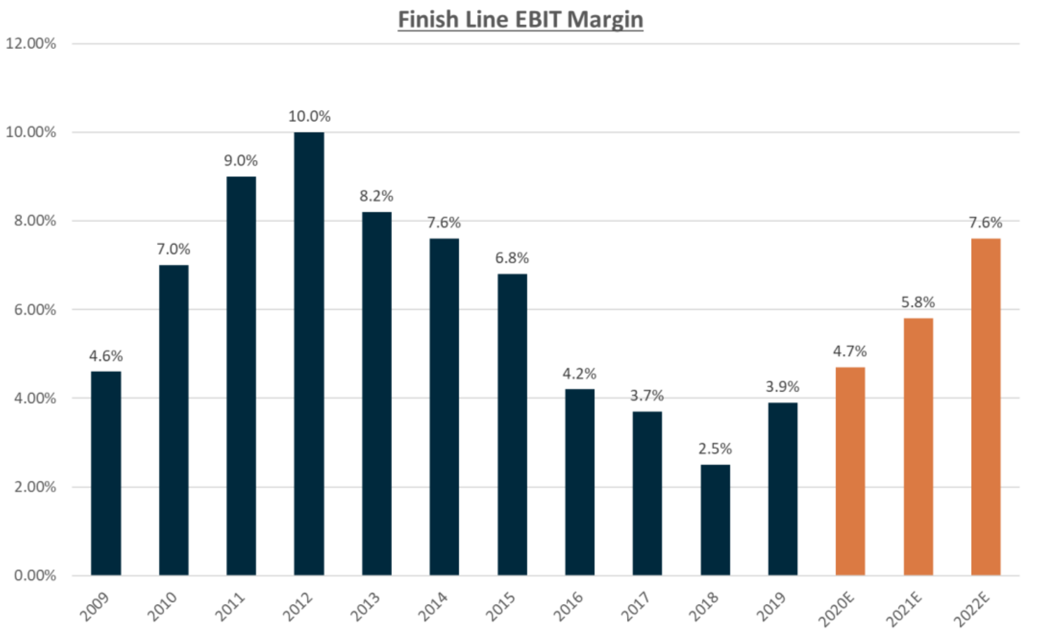
JD Sports has bucked the malaise in the retail sector, as athleisure is seen as more of a lifestyle choice, and like our holding in Nike (of which they are a core customer) is more resilient to the wider economic cycle. We recently met with the CFO who described this phenomenon in a rather brusque but effective manner:

"our *typical customer is the 16-21 year old, what they earn, they spend.... they live with their parents... that desire to remain cool will still be there even in an economic downturn, we are not immune to the economy easing clearly but our key customers don't give a toss about Brexit, they care more about who is the next winner of Love Island."*

One of the attractive points of the JD Sports investment case is that they are brand agnostic, yet key customers to both Nike and Adidas, so whichever one of the two has the latest 'in-fashion' product they can supply it to an eager customer base. Nike categorises their partners as to their importance and the offerings that they provide as a result. JD and Foot Locker are the only global top-tier partners and thus benefit not only from being in the category where >80% of Nike's trade investment is focussed but also provides services such as daily replenishment, multi-channel returns and customisation at no extra cost. Whilst Foot Locker is larger, it is predominantly focussed on footwear; JD Sports is equally split between footwear and apparel, which brands value highly given the competitiveness of the apparel market.



In 2018 JD Sports purchased the US sporting goods retailer Finish Line, and we see significant opportunity from this deal. At time of purchase Finish Line had 930 stores across 47 states in a mix of branded locations and shops within Macy's stores. JD Sports plans to re-badge some of the stores, convert others and leave some as Finish Line. It will also close c.100 stores where it believes there is an oversupply. It also has opened a flagship JD brand store in Times Square, New York. JD Sports' forte is in metropolitan centres and has a slightly younger demographic than Finish Line, which is more sports orientated and is focussed towards mid-America and the suburbs. The added value that JD Sports can bring to Finish Line is in store format and higher apparel sales restoring the group margins. Speaking to JD Sports' CFO, the company believes that a 1% improvement in margins per year for the next three years should be achievable and we are led to believe that in the long term the previous peak margin of 10% can be surpassed.



Source: TIM/ JD Sports/ Finish Line

Outside of the US, JD Sports also has operations in Western Europe as well as new ventures in Australia, Thailand, South Korea, Malaysia and Singapore. These new markets mask the true profitability of the group as a whole, owing to it not having the economies of scale that it currently possesses in the UK and Ireland, as well as higher marketing spend whilst it builds out its presence and brand awareness. We believe that, although the margins in these regions are unlikely to match those in the UK, there is considerable incremental upside when these markets mature. Margins are also diluted by the Outdoor segment (Blacks, Millets, Tiso and Go Outdoors), but the losses made by this division are mainly due to one-off costs and encouragingly the division has returned to growth, so we expect the losses to ease and turn to profits in the coming year.

The fall in the share price left JD Sports Fashion trading on a FCF Yield of 6.5%, representing a good entry point despite the performance thus far in 2019. The company remains net cash positive despite the acquisition of Finish Line and given the margin accretion opportunities that we can foresee we expect that the FCF will increase further as these are realised. Although the dividend yield is currently small, we expect that its inward investment needs will diminish and that yield should increase over time given the surplus cash on the balance sheet. Therefore, we took the opportunity of the short-term correction to initiate a holding in the company.