VT Tyndall Global Select Fund Commentary

January 2020

"Oh it's such a perfect day, I'm glad that I spent it with you….You're going to reap just what you sow"- Lou Reed

With the UK General Election and the US-China phase 1 trade deal out of the way the stage was set for a benign start to the year. With an impeachment trial looming, the US administration decided to raise the tensions in the Middle East with the assassination of General Qasem Soleimani. With an abundance of shale gas, rising oil prices has more of an effect on European corporates than American ones. The rise in the oil price, however, was short lived as the spectre of war faded in the following days. Few companies will be able to totally escape the effects of factory closures and travel bans due to the recent outbreak of Coronavirus, however, it is too early to judge whether it is likely to be as widespread as the SARS epidemic in 2003 or the global actions will manage to contain its growth.

There are early signs by the leading indicators that the global economic growth may be starting to turn a corner having slowed in 2019, so we are cautiously optimistic that post the reporting season, the economic data might increase optimism. The US consumer appears to be robust and housing data remains strong. Countering this, much has been made of the Institute for Supply Management's (ISM) manufacturing report. The survey interviews 300 purchasing managers from manufacturing and construction sectors during a month as to whether they are seeing an improvement in new orders, and the recent data has been recording the worst data since 2009, which optically might suggest that the US industrial sector is entering a recession.

We argue that this is not the case as the chart below shows, the lack of improvement in new orders can often be explained by the stabilisation of orders at a historically high level. As we enter the US Presidential election year, we hope that the Federal Reserve and the Administration behave rationally, not upsetting what appears to be an improving macro-economic backdrop.

Source: TIM/ US Census Bureau

The VT Tyndall Select Fund B Inc (Total Return) ended the month higher over the month, despite of the concerns over coronavirus, rising by 1.69%

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Measuring ESG.

With increasing regularity, environmental, social and governance (ESG) topics seem to feature in the news, and this month were the key topic of discussion at the World Economic Forum in Davos. Whilst we do not actively run a fund solely based on ESG factors, we acknowledge that investors are increasingly, and rightly so, concerned on the impact of industry on the planet. In our initial screen, how management teams treat their owners (shareholders) as well as their assets (employees) forms one of the factors that we analyse ahead of considering the company for inclusion in the fund. Analysis of the corporate social responsibility (CSR) and sustainability reports form part of our further research once any company has passed the initial screens. We expect that governments and international institutions will increasingly start to penalise those companies that do not have measures in place to become more sustainable, protect their supply chains, and reduce pollution.

Founded in 2004, The Climate Group is a non-profit organisation that seeks to address climate change. Each year it produces a list singling out those companies that have committed to sourcing 100% of their energy needs from renewable sources in the forthcoming years.

While most companies detail how they are increasing the amount of renewable energy and creating products that are more energy efficient, the number of companies that have formally stated their intention to move all their energy consumption away from traditional energy suppliers is still limited. Over half of the companies in the Fund are amongst those that have done so.

Fund Holdings in RE 100 Index by Stated Year to use 100% Renewable Energy*

Already 100%	2020	2023	2025	2030	2050
Microsoft	JP Morgan	Accenture	Pepsico	Barclays	J&J
Apple	Relx		JD Sports	Kao	Nestlé
Visa	UBS Group		AB Inbev	Intuit	Roche
American Express	Novo Nordisk		Nike	Philip Morris	Asahi
SAP					Amazon
L'Oréal					

Source: TIM/the100.org/re100
*Companies in red have a stated aim but are not included in the Index

This month Microsoft went one step further by pledging $1bn towards an innovation fund with the aim of developing technology to remove carbon from the atmosphere. With this technology it has pledged to remove as much carbon as it has emitted, whether from direct or indirect (such as company travel and emissions from energy use) in the company's 45-year history.

Another measure of environmental prowess comes from CDP Global, which for the past 15 years has produced a list of corporates that are leaders, acting to address climate change and build our future zero-carbon economy. 82% of the Fund holdings receive a score of B or above on a scale of A-F and of the 179 companies that obtain an A rating, the Fund holds 18 of them.

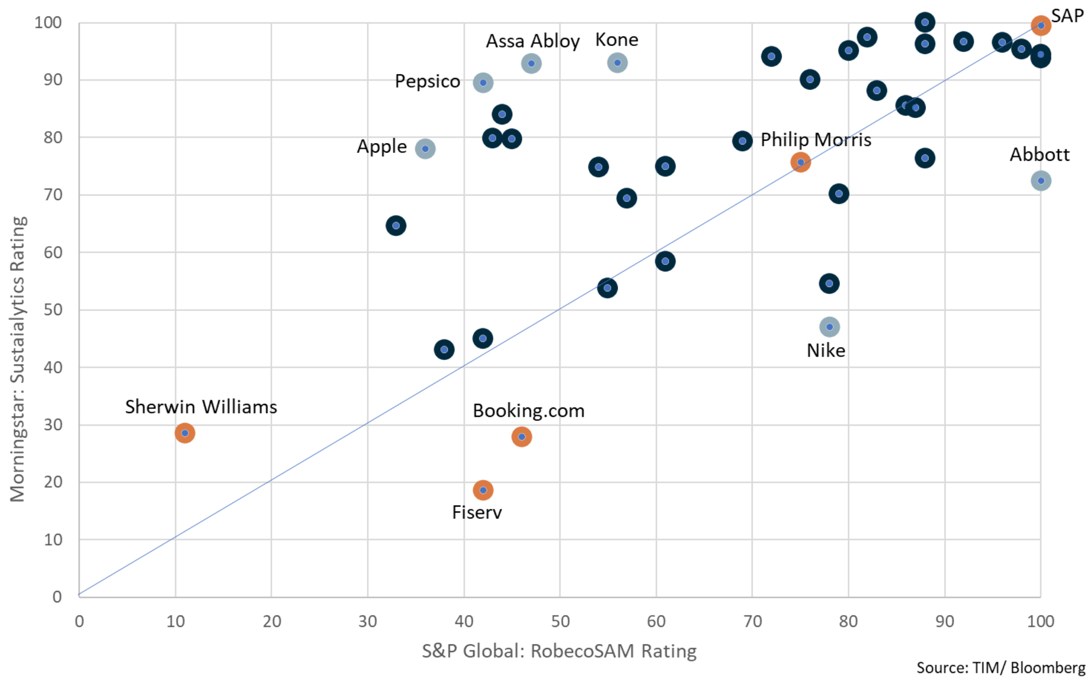
Fund Holdings with an A Rating by CDP

In the RE 100 Index			Not in the RE 100 Index
AB Inbev	Kao	Novo Nordisk	Abbott Labs
Accenture	Microsoft	Relx	American Express
Apple	Pepsico	UBS Group	Asahi
Barclays	Philip Morris		Kone
J&J	Nestlé		L'Oréal

Source: TIM/the100.org/re100/ CDP.net

Ratings agencies also now publish ESG scores, which have been developed to indicate how various companies approach protecting the environment and looking after stakeholders as well as shareholders. There are many issues in trying to create a single score to encompass various, disparate, non-financial indicators, so multiple anomalies can occur; this is often the case if the company does not actively report the factors that a specific rating agency is looking for and thus the agencies can differ drastically in their view on any particular company. We highlight in grey those companies in the Fund that suffer from this issue.

ESG scores by Provider



Source: TIM/ Bloomberg

One of the major flaws of these models is that the ratings are based on business models rather than what the company is actually producing, so tobacco and alcohol companies often score well, as do the oil majors. The Fund does not hold any oil majors but does hold Philip Morris as well as Anheuser Busch InBev and Asahi Group which we would argue would not rightly sit in an ESG portfolio.

Conversely companies can be penalised for factors such as female under-representation. Fiserv actually scores well in the 'G' category but does not score at all in 'E&S' which is hardly surprising given that it is an IT company but only has one woman in a C-Suite role. Booking.com also does not disclose in its annual report the percentage of female employees, those who are union members, or turnover rates so does not register a 'S' score. However, upon investigation, we know that 50% of the brand CFOs are female as are 23% of the board members. The company was listed on Forbes' list of 'Best Employers for Women', and also invests in employee health, fitness and mental wellbeing for all employees, so we believe the headline number does not reflect the true state of the company.

Sustainability and other Important environmental issues such as carbon emissions, are often omitted from these ratings as only half of the MSCI world index constituents reveal this data, and much of it is out of date. Most companies produce a detailed annual Sustainability Review, which we expect to become more detailed in the future, as companies realise the increasing importance of sustainability and ESG in the marketplace; a view reinforced by Larry Fink, the CEO of the world's largest fund management firm, Blackrock, in his recent annual letter to investors.

Although we believe that the measures are a help, they do not replace, and are often inferior to, investment management teams conducting deep-dives and proprietary research into the individual companies and we intend to continue analysing companies in this manner. As stated above we do not exclude companies on ESG criteria alone, but it is a useful part of building the investment case as we highlighted with Sika a couple of months ago.

Another series of sustainable aims that is closely followed by companies is the one that has been developed by the United Nations, which consist of 17 goals that it wants to achieve by 2030. These are as follows:

1. *No Poverty:* Economic growth must be inclusive to provide sustainable jobs & promote equality.
2. *Zero Hunger:* The food and agriculture sectors offer key solutions for development and is central for hunger and poverty eradication.
3. *Good Health & Well-Being:* Ensuring healthy lives & promoting the well-being for all at all ages is essential to sustainable development.
4. *Quality Education:* Obtaining a quality education is the foundation to improving people's lives and sustainable development.
5. *Gender Equality:* Not only a fundamental human right, but a necessary foundation for a peaceful, prosperous and sustainable world.
6. *Clean Water & Sanitation:* Clean, accessible water for all is an essential part of the world in which we live in.
7. *Affordable & Clean Energy:* Energy is central to nearly every challenge & opportunity.

8. *Decent World & Economic Growth:* Sustainable economic growth will require societies to create conditions that allow people to have quality jobs.
9. *Industry, Innovation and Infrastructure:* Investments in infrastructure are crucial to achieving sustainable development.
10. *Reduced Inequalities:* Policies should be universal in principle, paying attention to the needs of the disadvantaged and marginalised populations.
11. *Sustainable Cities & Communities:* There needs to be a future in which cities provide opportunities for all, with access to basic services, housing, transportation and more.
12. *Responsible Consumption and Production.*
13. *Climate Actions:* A global challenge that affects everyone everywhere.
14. *Life Below Water:* Careful management of this essential global resource is a key feature of a sustainable future.
15. *Life on Land:* Sustainably maintain forests, combat deforestation, halt and reverse land degradation, halt biodiversity loss.
16. *Peace, Justice & Strong Institutions:* Access to justice for all and building effective, accountable institutions at all levels.
17. *Partnerships:* Revitalise the global partnership for sustainable development.

Almost all the companies in our fund now refer to some or all of these principles in their annual or ESG reports, and detail how their actions have helped progress towards obtaining these goals.

The examples above serve to highlight the problems in determining what constitutes an ESG compliant company given the multitude of ways the definition can be cut and spliced. The number of sustainability indices and ETFs have grown exponentially with various nuances as to how they calculate their constituents and weightings within, showing the difficulties of refining what constitutes an ethical company and what does not. Running a concentrated Fund enables us to focus on the fundamentals of each of our companies in significant detail and' therefore, we are not reliant on using any of these 3rd party surveys in isolation to inform our opinion of how they fair in ESG terms. We believe that the Fund's mantra of 'the relentless application of common sense' applies well when judging both CSR and ESG factors.

In addition to solely assessing the factors discussed above, we believe that finding companies that are making products that help the world to become more energy efficient and reduce harmful waste and emissions is equally important to developing a sustainable future. Therefore, any strategy wishing to be sustainable should be including these companies, even if they do not tick the relevant ESG boxes at the front end; not that these are necessarily mutually exclusive. Going forward we believe all these factors will continue to attract more attention as, in the words of Larry Fink, there is going to be "a fundamental reshaping of finance".

Fund Activity

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We took the decision to dispose of our remaining holding in 3M after the company disclosed that in December, it received a Grand Jury subpoena from the US Attorney's office for the Northern District of Alabama in relation to discharges from their Alabama plant. Although 3M took steps to rectify these issues, it appears that similar issues have occurred in their Illinois plant. We already had concerns over the ongoing litigation liabilities from the historic use and sale of Per-and Polyfluoroalkyl substances (PFAS) and had been reducing our exposure to the company over the past year. The PFAS liabilities are becoming increasingly hard to quantify as the research and regulation related to these products continues to grow, but the addition of discharge misdemeanours could significantly impact 3M's cash flow.

On PFAS, the company has yet to admit that the chemicals have any adverse health effects despite producing two of the main substances found in US drinking water. The company took the substances off the market almost 20 years ago, however, as was the case with asbestos, litigation can continue for many years after their withdrawal. The US Environmental and Protection agency disagrees with 3M's view, claiming that they have led to tumours in animal studies as well as multiple side effects including reduced immune response and higher cholesterol in humans. 3M is likely to face the cost of removal and cleaning up PFAS pollution as the House of Representatives is set to rule imminently on who should foot the bill, and faces lawsuits over personal and property damages, which at present are unquantifiable.

Despite being one of the few beneficiaries from the spread of Coronavirus, as a leading producer of respiratory products, the overall company growth still appears to be facing headwinds given their end markets, which the latest round of jobs cuts will do little to assuage. As an aside the company has committed to sourcing 100% of their energy from renewable sources by 2025, so would have featured in the tables above.

Our investment in 3M has been tumultuous. Despite having booked some profit in 2019, with growing questions over the sustainability of its cash flow and incalculable liabilities for litigation, we feel that there is a risk of further downside (and the possibility of share price falling below our investment price) and thus better opportunities lie elsewhere.