VT Tyndall Global Select Fund

Monthly Commentary (31st May 2020)

TYNDALL

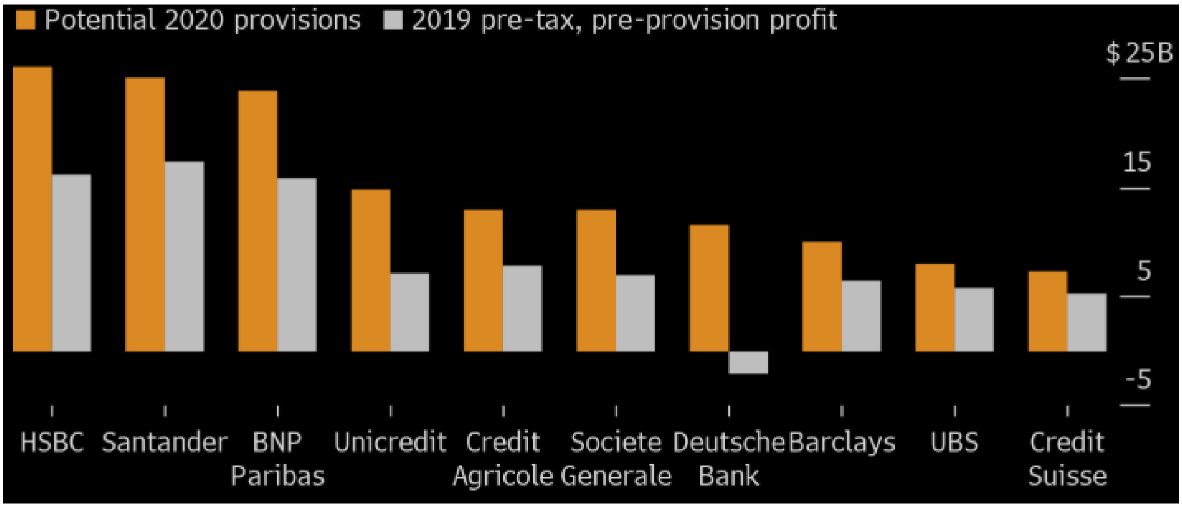
"No matter how far down we may be, we are never too far down to come back." -LeBron James

Global events have a strange case of déjà vu about them. Hong Kong has seen a resurgence of the protests that occurred last summer, this time as China attempts to renege on the 'one country, two systems' agreement, US-Sino tensions are bubbling up once more and on the UK stage the stand-off between Michel Barnier and David Frost continues over the Brexit negotiations ahead of the June 1st backstop for requesting an extension to the 31st December end date for a trade deal.

All these events have been trumped by the ongoing events surrounding COVID-19, vaccines, and lockdowns. Companies and investors have tried to look through the current lull in activity and as a result, those who followed the old mantra of selling in May have missed out on the continued rise in equity markets. Hopefully, the other line from Nike's latest advert, *"we came back when we should have been long forgotten",* will not end up applying to the virus and that countries have not exited lock-down too soon, as a second wave would be economically disastrous. We also believe that any return to lock-down will be much harder to enforce.

Concerns over a second wave may well mean that companies and households may not return to their previous spending patterns, instead opting to save more, undermining the speed of any recovery. Banks may also act in a risk adverse pattern, especially given the accounting rules that require increased provisioning, and thus tightens up lending standards. We expect, however, that central banks and governments will do 'whatever it takes' to keep the flow of money circulating and thus ensure that their QE has the desired multiplier effect.

Impact on European banks if faced with US provisioning rules



Source: Bloomberg

We detailed in last week's update the scale of governmental support as a percentage of GDP, which in many cases is a magnitude greater than the predicted impact on GDP from the lockdown, https://www.tyndallim.co.uk/is-this-enough-or-are-economies-still-reliant-on-life-support/

emphasising just how far governments are prepared to go in order to keep money flowing and both companies and individuals afloat. At the time of writing the European Commission has also just unveiled a €750 billion recovery fund, albeit that Austria, the Netherlands, Sweden and Denmark are yet to sign off on the deal without commitments for economic reforms; plus ça change. Simultaneously Japan approved a ¥31.9 trillion ($296 billion) supplementary budget to counter the damage caused by COVID-19, only a month after the previous budget, bringing the county's total stimulus to ¥230 trillion ($2.1 trillion).

Once the initial euphoria of exiting the lock downs in Europe and the United States passes, the real cost of lockdowns will become apparent and the events described above may attract more attention and temper enthusiasm. As we stated in last week's update, we expect that in the short term more leveraged, cyclical companies may outperform, but in the medium to long term, those companies that have had the capital to invest during the downturn and have adapted to global mega-trends will prove to be the eventual winners.

We believe that during this time erring on the side of caution and not chasing the rush into more cyclical stocks is the correct strategy, and slowly taking the opportunity to add to existing positions when the situation arises.

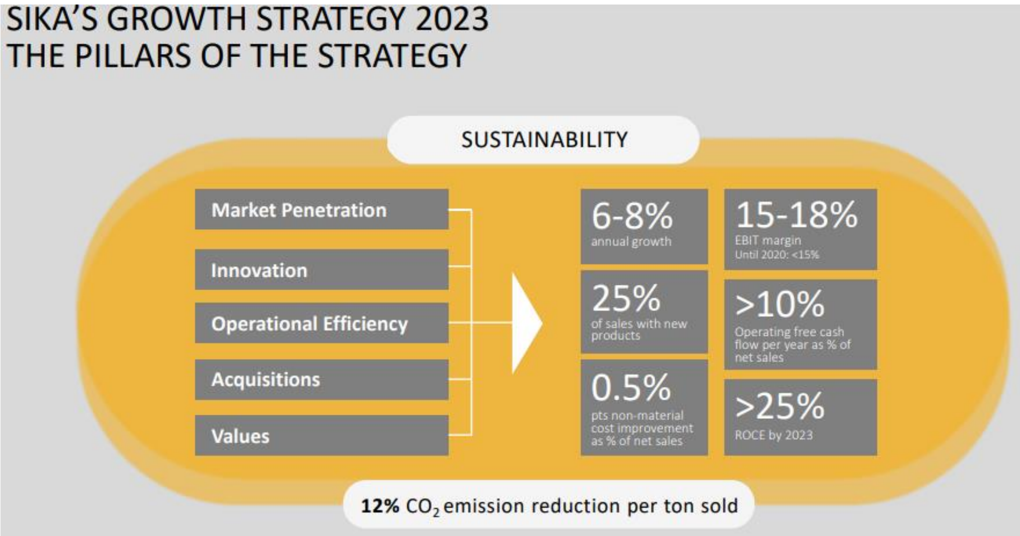
Throughout the lockdown we undertook the decision to provide weekly updates on our thoughts, which can be found on our website at https://www.tyndallim.co.uk/news-insights/ and if you wish to subscribe to receive them directly you can do so at: https://www.tyndallim.co.uk/subscribe/. Going forward they are likely to be more on an ad-hoc basis, writing when we believe that we can add value to investors in a topic that we have decided to focus on.

The VT Tyndall Global Select Fund B Acc (GBP) rose 5.51% during the month, thus eliminating the remainder of the decline experienced earlier this year and resulting in the Fund posting a positive year-to -date return of 1.82%.

Fund Activity and News

Since its failed takeover of Sika in 2018, St Gobain was left with an 10.75% stake having bought the Burkard family shares with a two-year lock-up period. As St Gobain sold the 15.2 million shares at a 6% discount to the previous close, we took the opportunity to increase our position in the Fund, encouraged by the increase in liquidity. As a result of the placement, The Bill & Melinda Gates Foundation are now the largest shareholders in Sika having bought 5.3% of the outstanding shares in early 2018.

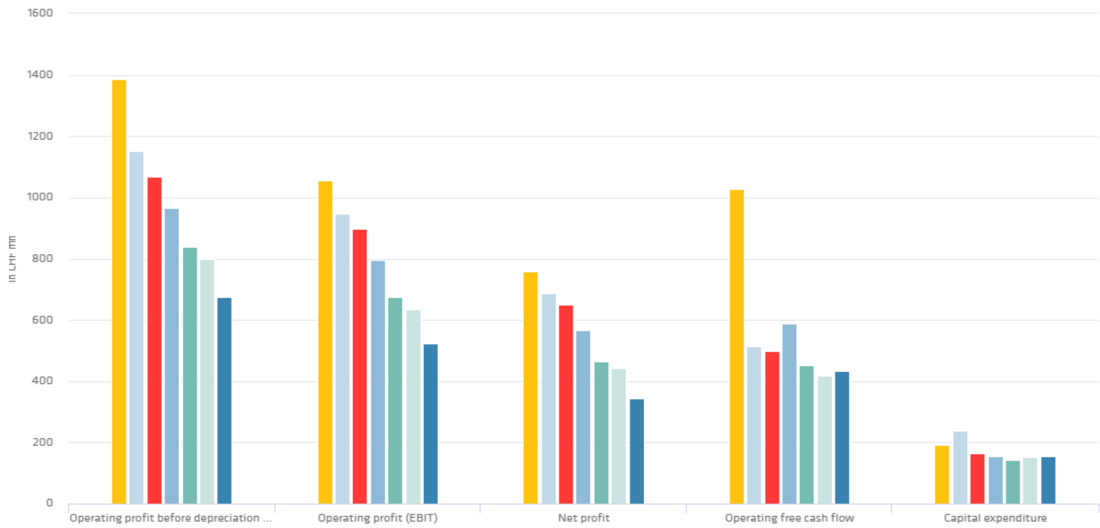
Although this year's sales will be impacted by the lockdown, Sika remains the global leader in speciality chemicals with a nine percent market share. The market is highly fragmented with the next 10 players accounting for 30% of the overall market, resulting in plenty of opportunities for small scale acquisitions to add on top of their market leading 6-8% organic growth; by way of comparison the peer group has averaged 3-4% organic growth over the past 10 years. Despite the recent headwinds the company has reiterated its targets and aims for a 12% market share by 2023.



Source: Company report

Sika is highly cash generative and has historically had little if any leverage on its balance sheet, easily financing the acquisitions through operating cash flow. The through-the-cycle Return on Capital Employed has steadily increased over time from 10% a decade ago to such a level that it is confident of it being in excess of 25% by 2023, proving how successful the current management team have been in allocating capital. Innovation is at the heart of the company and helps to sustain this profitability with 25% of sales from products released in the past five years.

Sika Profitability and Cash Flow 2013-2019



2019, 2018, 2017, 2016, 2015, 2014, 2013

Source: Company report

On top of these solid fundamentals the company taps into the secular mega-trends of urbanisation, combating climate change and demographic change through the innovative products and solutions it supplies to construction and other assembly industries.

Our holding in Novo Nordisk was adversely impacted by President Trump instigating a plan as of next year, to allow some elderly citizens on Medicare to pay only $35 a month for their insulin, saving them, on average, $446 per year according to estimates by the Centers for Medicare & Medicaid Services (CMS). There are around 60 million pensioners on Medicare and one third of those on Medicare have diabetes, and more than 3 million use insulin, however the policy only applies to a small subset, and has no effect on prices for users who have private insurance or no insurance where list prices can cost almost $5,000 per year.

With the 2020 Presidential election coming into view, the President is trying to garner support from older voters, where according to the latest polls 54% disapprove of his record in power. On making the announcement he tried to place the blame for high drug prices at President Obama's door and also suggested that Joe Biden would not be able to lower drug prices.

A bi-partisan deal to limit drug price increases in Medicare to the rate of inflation currently sits with the House Speaker, Nancy Pelosi, who wants to use the savings to provide vision, dental and hearing coverage for older citizens, a move that is opposed by most Republicans, including the Senate Majority Leader, Mitch McConnell. It is clear that drug prices are likely to become a key battleground in the forthcoming race for the White House, but this is nothing new, and pharmaceutical stocks normally struggle in the back end of election years.

Although the Fund has almost 22% of its holdings in the health care sector, the majority of our holdings are in the field of medical technology, which is less exposed to this threat.

The top contributors to performance this month were JD Sports Fashion, PayPal, Sage, Nike and Apple, while Becton Dickinson, Philip Morris, Roche, Johnson & Johnson and Tencent detracted from performance.

Richard Scrope, Fund Manager, VT Tyndall Global Select Fund, 31st May 2020