VT Tyndall Global Select Fund

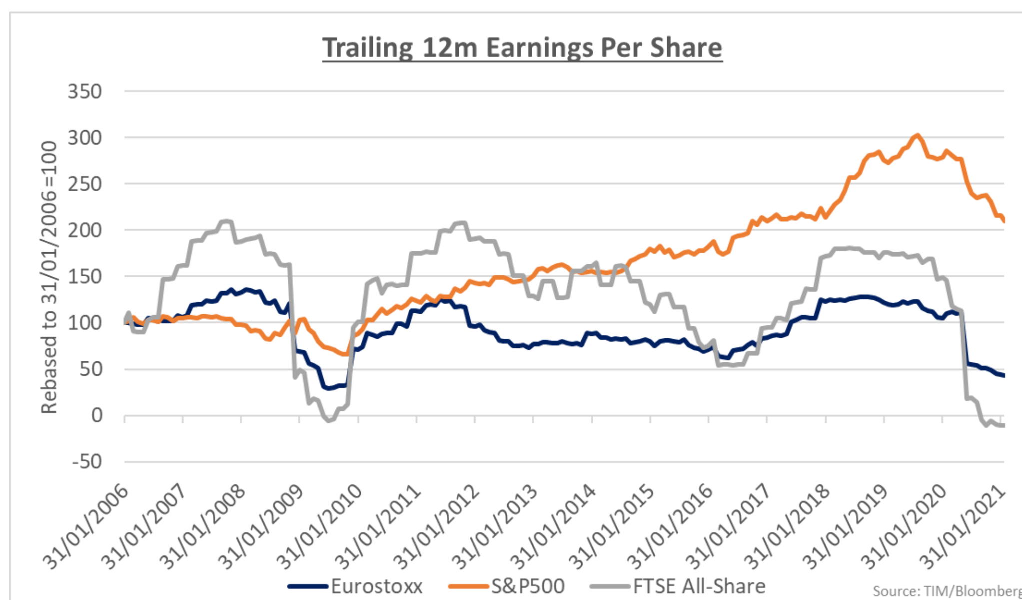
TYNDALL

Monthly Commentary (28th February 2021)

"Hope smiles from the threshold of the year to come whispering 'It will be happier'" -Alfred, Lord Tennyson.

As the reporting season comes to a close, we remain optimistic of the prospects for companies' revenues to recover once the pandemic enforced lockdowns are rolled off. Analysts estimates proved to be short of both what investors and the market expected in terms of revenues and earnings in 2020, and as such we have experienced nearly 78% of S&P500 companies coming in ahead of market estimates; the second highest reading since 2008.

On a backward-looking basis, the scale of the impact of the pandemic on corporate earnings should not be underestimated. While understandably, given the Brexit cliff edge, the UK experienced the largest decline in earnings, it also appears to be the first to have experienced a stabilisation in the trailing EPS and, just perhaps, for the first time since the fateful night on 23 June 2016, the UK might have just become investible again; the recent move in Sterling against the US Dollar would suggest so.



The market, however, is a forward-looking mechanism and there remains many positive drivers. Global industrial activity continues to improve and the *CPB World Trade Monitor* now shows global industrial output and merchandise trade at levels not seen since 2018 and the US Purchasing Manufacturers' Index is at the highest level since 2015. The UK government is busily patting itself on the back at the success of its vaccine roll-out (comparing yourself to Europe on these metrics, however, would make almost any nation look good) and the first few doors are slowly being reopened which should be beneficial for UK equities. The Fund increased its exposure to the UK in late November with the addition of the UK Homebuilder, Persimmon, and given the relative valuation of UK equities more opportunities may be available. However, we remain bottom up focussed within our stock selection process and buy for long-term sustainable cash flows and fundamentals rather than country of listing.

The Biden administration is still yet to pass the well trailed infrastructure bill despite Janet Yellen's vocal support. There is a risk, however that the combination of this, the $1.9trn COVID relief bill, last

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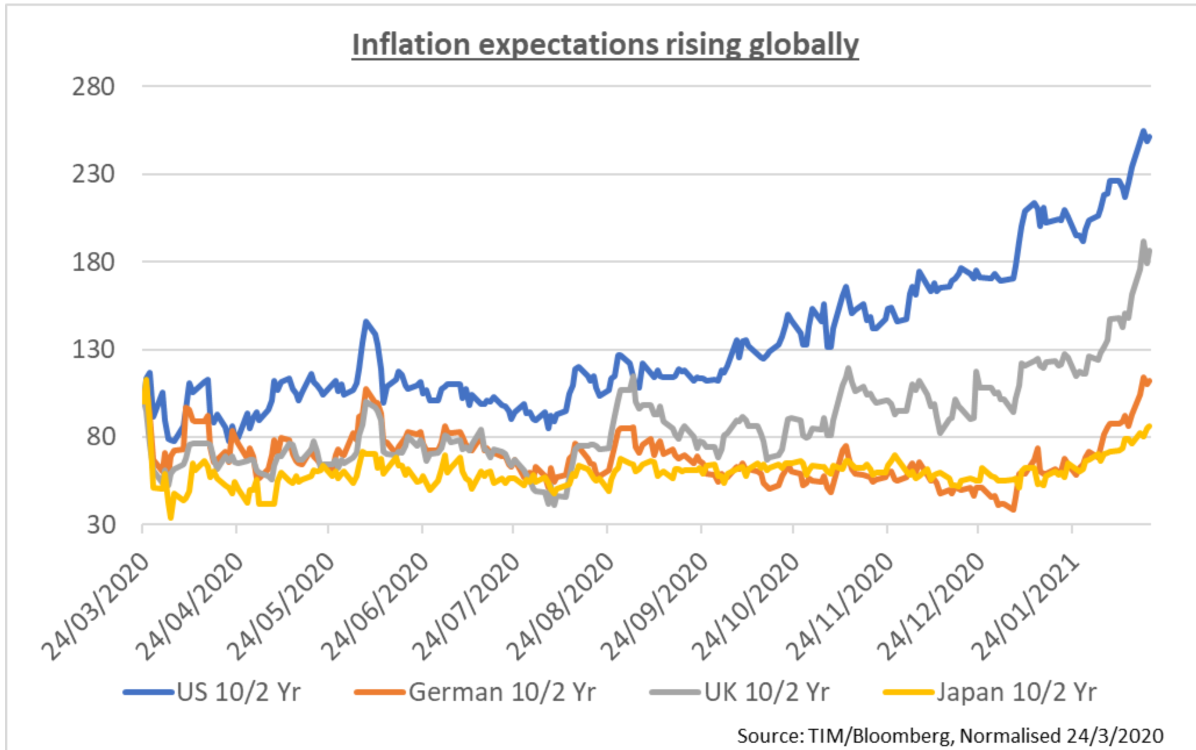
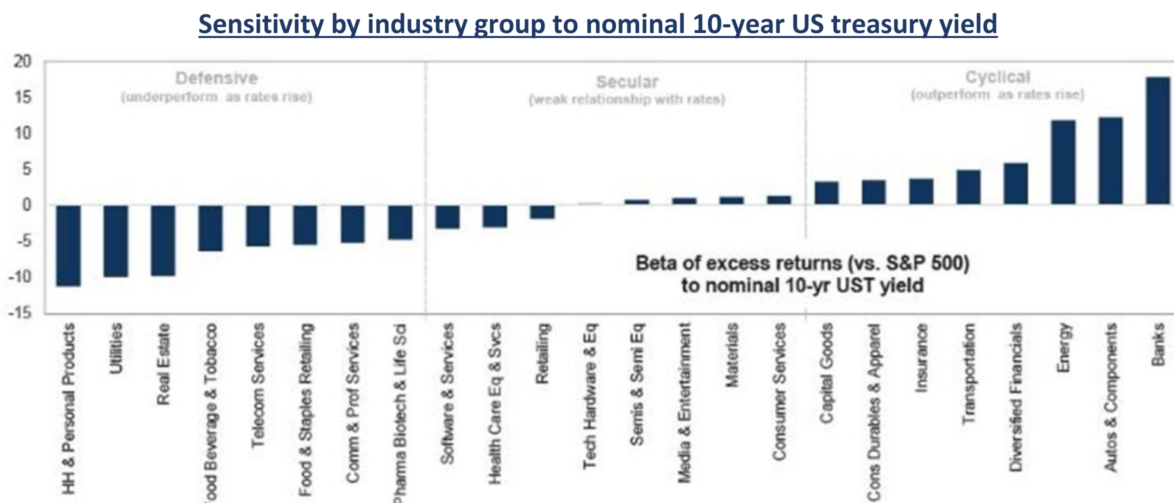
years' $900bn stimulus and ultra-loose monetary policy could cause the US economy to overheat at the same time as the economy faces inflationary pressures. Long-term interest rates are suggesting that the market is also expecting inflation to be the base case, not only in the US but in Europe and Japan too.



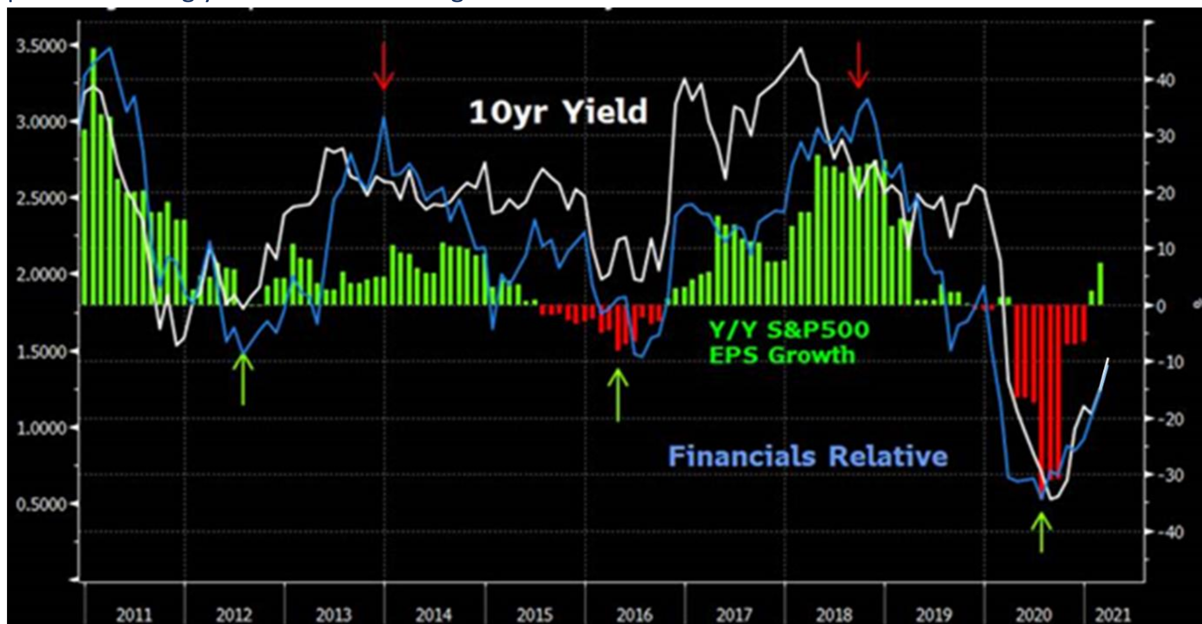
Rising inflation expectations has wide ranging implications on investor appetite for equity classes, and the recent underperformance of consumer staple stocks has not been for their underlying fundamentals, but more of a shift to more economically sensitive alternatives. The chart below gives an outline of how investors over the past five years have expressed their views on inflation on an asset allocation basis.

Sensitivity by industry group to nominal 10-year US treasury yield



Source: Goldman Sachs Global Investment Research

There is also a good correlation between 10-year yields and the earnings cycle, with the earnings cycle acting as a leading indicator. Despite the trailing EPS chart shown above, the chart below shows that the declines in EPS bottomed in June last year and have eventually turned positive in the first two months of this year. The blue line on the chart also shows the correlation of the banking sector to the yield and earnings cycle. Banks are a logical beneficiary of rising yields, especially after an elongated period of falling yields and a flattening of the curve.



Source: TIM/Baird/Bloomberg

The Fund has never shied away from the banking sector for stigma or other spurious reasons and has had exposure to it through the cycle. We believe there are good quality franchises that warrant inclusion in the Fund, and we currently have four holdings in the sector; for example, we have held JP Morgan for the past 12 years delivering a total return of over 430%, and thus outperforming the S&P 500 financial sector by over 185%.

The month proved to be volatile as the market lurched between commodity led reflation trades, opening up news and company reporting. By mid-month, the Fund had recorded four all-time highs before giving back some of the gains as the rotation trade and rising bond yields hit the healthcare, technology, and consumer discretionary sectors. By the month end, The VT Tyndall Global Select Fund B Acc (GBP) rose by 0.05%.

Fund Activity and News

Has the sun gone down on the mega-caps?

Investors who have avoided mega-cap tech stocks over the past few years will have faced an uphill battle to outperform the S&P500 and MSCI World Index. However, having peaked in August last year, the mega-cap tech stocks (and Amazon) had a somewhat lacklustre run into the year end as market rotation occurred. As seen to be the beneficiaries of the lockdown, they neither fell into the opening-up rally, the 'value' rotation, the vaccine basket, or the stimulus plays that have all in turn fuelled the market over recent months. Does this mean that US mega-cap tech has had its day after a multi-year

period of outperformance and now should be used as a source of funds? We believe that it is unwise to write them all off quite yet.

Amazon, Microsoft, Alphabet & Apple vs MSCI World Index

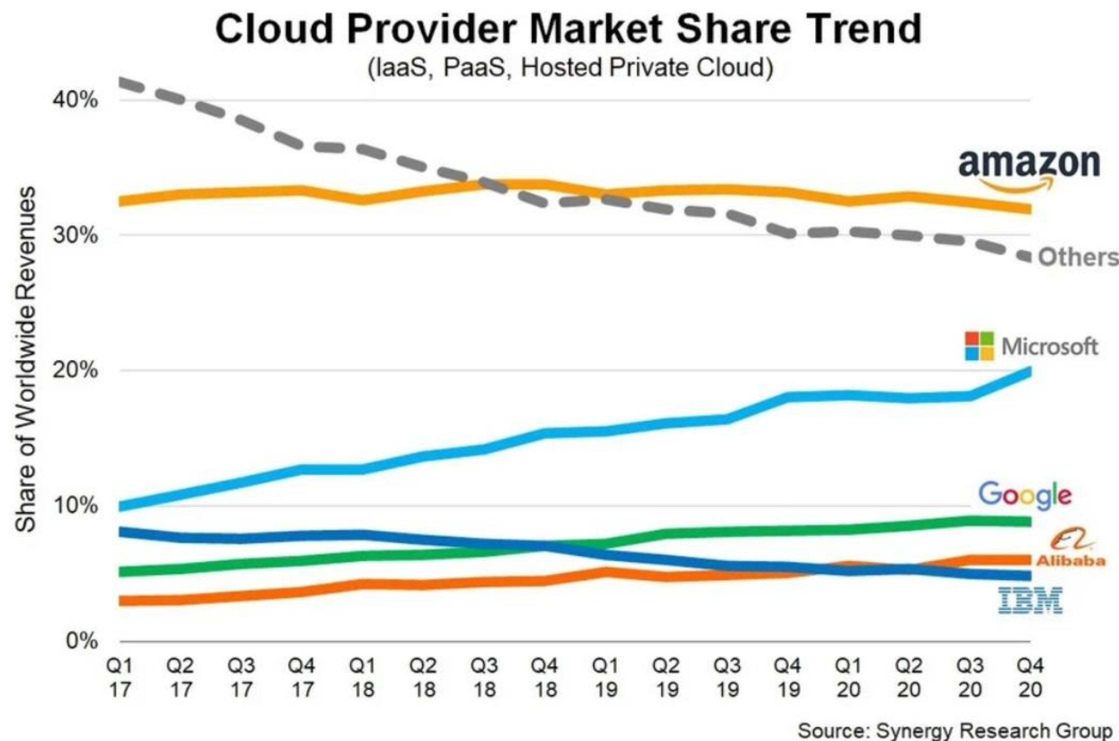
Source: Bloomberg

At the end of January, Apple, Microsoft, Amazon, and Alphabet accounted for 12.6% of the MSCI World Index. Being such a large part of the overall index, their collective performance has a significant bearing for all the multitude of index tracking funds that hold them regardless of their underlying fundamentals. Being such dominant weightings in so many ETF funds brings its own threats, as selling of a particular theme is likely to also involve selling one or more of the above company's stock; the recent $465m drawn down of the ARK innovation ETF in a single day exemplified this, resulting in a significant increase in volatility.

This, however, ignores the fundamental changes that COVID-19 has accelerated. Early in the lockdown Satya Nadella commented that "we have seen two years' worth of digital transformation in two months" and we expect that the second/third waves and subsequent lockdowns has further accelerated the need for companies to implement remote working, cloud infrastructure and security. This is a structural shift that will not reverse, and we expect technology spend as a percentage of GDP to double over the next decade. The debate should be over the depth of the defensive moats and how entrenched they are, as we consistently see new entrants attempt to take market share in these growing markets; thus far the incumbents have managed to capitalise on their size and dominance to wave off these threats.

A consequence of the dominance of this set of companies and their inbuilt part of everyday life, gives them a deep defensive moat. This also gives them the capacity and ability to invest for the very long term, making investments that entrench their position further. What is noticeable, however, despite their power over clients, they are also long-sighted enough and prepared to show that they understand that without them their business models are at threat. Therefore, we believe that the actions of Microsoft, which offered short-term payment holidays during the pandemic, as a positive move, as it further cements customer loyalty.

In the cloud space Amazon Web Services remains the clear leader, but there are signs that Azure (Microsoft) and Google Web Services (Alphabet) are catching up. This was confirmed in our discussions with Microsoft, when they told us that in most tenders, they normally only see Amazon, or Google when the company does not want Amazon with access to their data. Furthermore, they commented that Google was often prepared to take contracts at unprofitable levels to try and capture market share.



Company	2020 Revenues	YoY Growth Rate		Margin	
Amazon Web Servies	$45.370 bn	29.5%	Decelerating	29.8%	Improving
Azure*	~$28 bn	~37%	Accelerating	~30%	Improving
Google Cloud	$13.059 bn	46.4%	Accelerating	-42.9%	Improving

Source: TIM/ Company Reports

*Microsoft does not specifically break out Axure from the Intelligent Cloud segment

Despite the underperformance going into the recent reporting season, all the aforementioned companies posted stellar figures, showing that, despite the negative sentiment towards them, they too can be beneficiaries of the reopening trade; we believe that growth rates will remain strong under normalised conditions also.

Apple passed a psychological milestone, recording sales of $111.4 billion in the last quarter, with margins of 30.1% through improvements in both its product and services lines. Amazon also surpassed $100bn of quarterly sales for the first time, recording revenues of $125.5bn with margins of 13.2%. Alphabet grew across all its business lines, with particularly strong growth in digital advertising both in search and YouTube, but the real improvement was in the leverage through to its earnings line which grew over 40% compared to the same quarter last year. Microsoft also saw all three segments

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come in above consensus as the company grew revenues by 16.7%, Free Cash Flow by 16.9% and margins increased to 41.5%.

Companies with growth characteristics like these do not often come at deep value multiples. However, in the long-term, benefits can be realised paying a little more for companies that can continue to dominate their sectors for years to come, while simultaneously growing margins and revenues at rates in excess of the wider market.

	Fwd Yr P/E	Fwd Yr EV/EBITDA	Fwd Yr FCF Yield
Alphabet	18.6x	11.7x	5.9%
Amazon	46.2x	19.0x	0.8%
Apple	30.2x	22.5x	3.4%
Microsoft	27.1x	18.3x	3.6%

Source: TIM/Barclays

In uncertain times, we believe that it is worth revisiting those companies with wide economic moats and reliable cash flows that deliver a service to their end customers that others cannot. In the Fund, we continue to hold positions in Amazon, Apple, and Microsoft, albeit only Microsoft appears in the top 20 holdings.

Richard Scrope, Fund Manager, VT Tyndall Global Select Fund, 28th February 2021

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