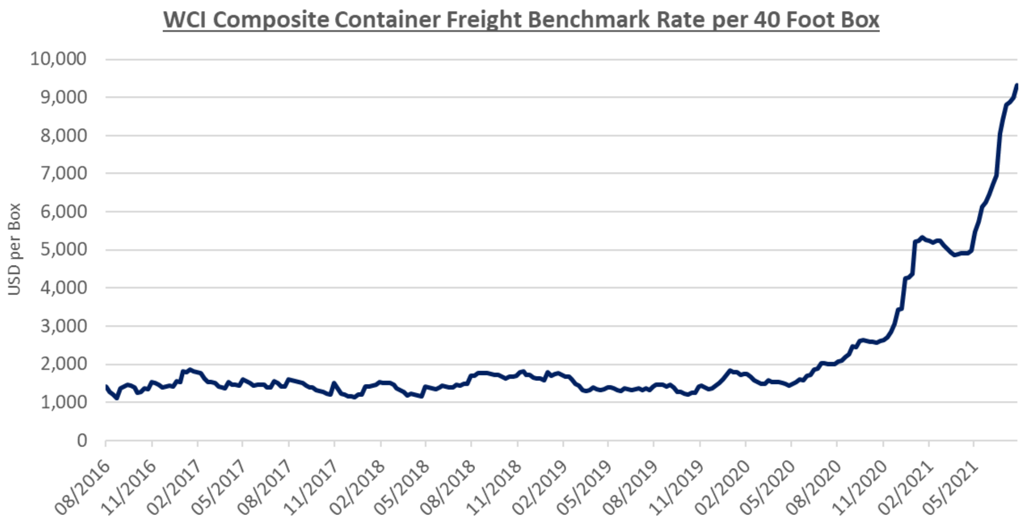
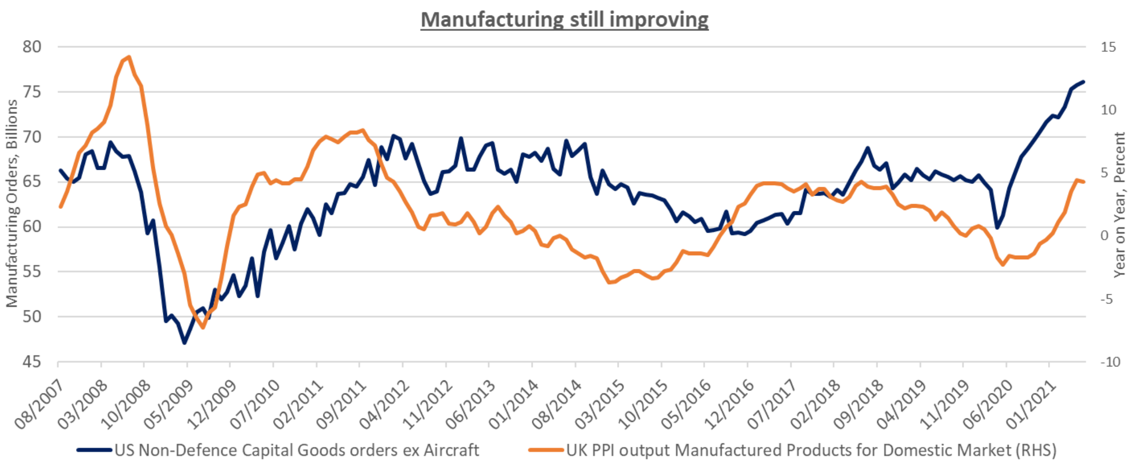
"Great things are not done by impulse, but by a series of small things brought together" - Vincent van Gogh.

With the reporting season in full swing, we are getting some useful insights into the pressures from supply shortages in components such as semiconductors (where lead times have risen from 12 to 20 weeks between order and delivery this year) and the likely inflationary pressures in the coming months. Many of our holdings have managed to weather these pressures thus far with index-linked pricing or other measures, but many are citing that the cost of transportation and haulage is currently at extreme levels. Jens Bjorn Anderson, the CEO of the Danish freight forwarder, DSV Panalpina commented that "*challenges in the sea freight market to continue into 2022, while the air freight market would not see improvements until 2023 or 2024 as long-haul flights remain very limited due to COVID-19*". Despite these challenges. the ratio of companies beating market expectations is over 80%, which is close to the rate experienced in the first quarter.



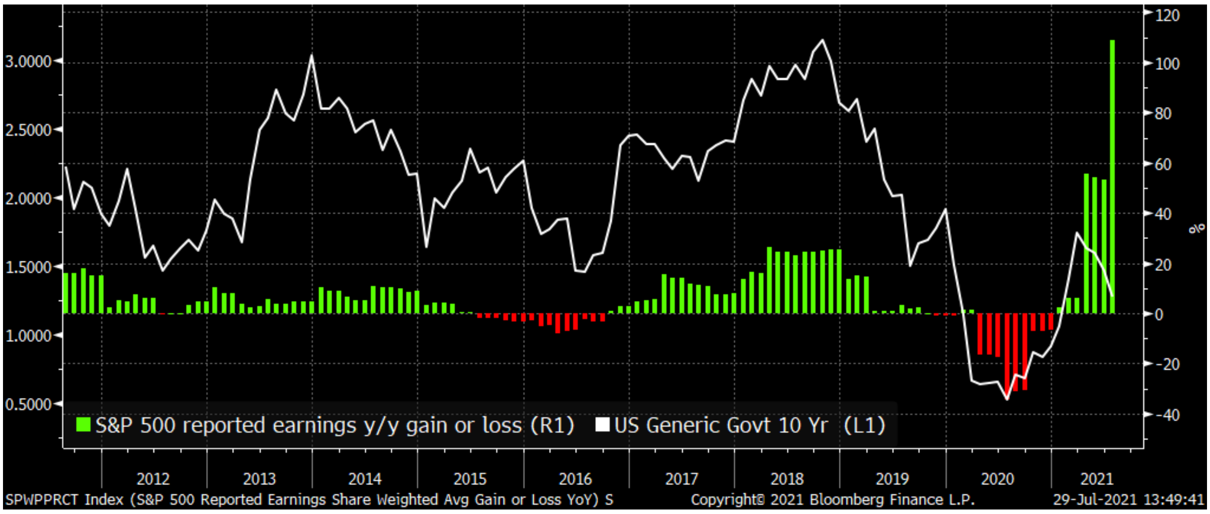
Source: TIM/ Drewry World Continer Index

Although there are signs of cracks appearing in global economic data, which thus far this year has been abnormally positive, there are still positives to be found, especially in consumer confidence, hiring intentions and manufacturing intentions.



Source: TIM/ UK ONS/ US Census Bureau

It is, however, important to contextualise this information by factoring in that this month sees the lapping of the 2020 trough of earnings and thus the easiest year-on-year comparisons; going forward comparisons will become more challenging and thus we continue to look for companies that can grow in this environment and take market share as conditions normalise.

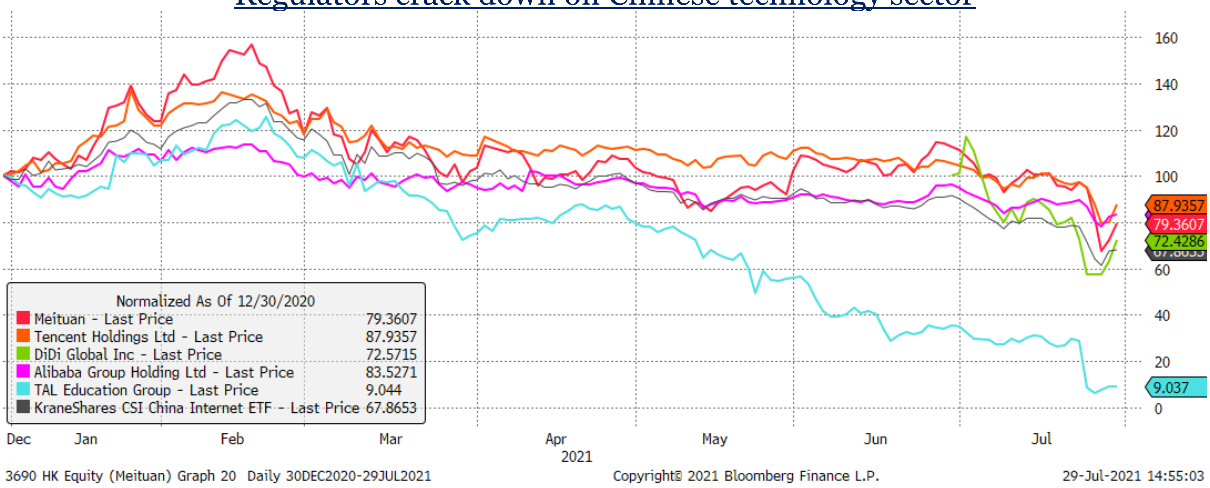


Global equity markets continued to post new all-time highs despite volatility in equity markets caused by the Chinese clamp down on technology stocks, tapering intentions, US bond yields and the prevalence of the Delta variant. The VT Tyndall Global Select Fund B Acc (GBP) also made an all-time high during the month, and rose by 3.30%, bringing the year-to-date returns to 12.71%.

Fund Activity and News

The listing of Didi on the NYSE on 30th June saw the Chinese authorities spring into life once again. After the IPO it was announced that the regulators had urged Didi to ensure the security of its data before proceeding or shift the IPO to Hong Kong or Mainland China. Having not done so, China central sent officials from multiple agencies into Didi's offices; there are now reports (refuted by the company) that Didi is considering returning to operating as a private company.

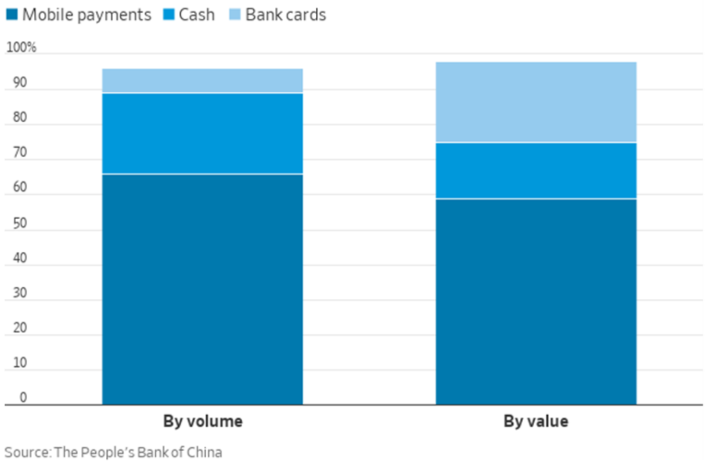
<u>Regulators crack down on Chinese technology sector</u>



After the failed IPO of Ant Financial last year, we adopted a more cautious approach towards our investments in mainland China and Hong Kong. The Fund has held a position in Tencent (initially through Naspers) since 2008, however given the increasing regulatory risk the position was reduced significantly over the course of this year. Unlike Alibaba whose US listing experiences four times more volume than the Hong Kong line, Tencent has shied away from adopting a dual listing, and thus is less exposed to the ire of the Chinese regulators towards those Chinese companies choosing to list in the United States rather than the STAR exchange or Hong Kong.

Both Tencent and Alibaba have significant sway over the Chinese population given the popularity of their platforms, and this influence is also a concern to the authorities, which are seeking ways to reduce what they deem to be monopolistic practices. Given that in some cities the use of hard currency has been almost totally replaced by digital payments through AliPay and WeChat Pay. The chart below shows the dominance of digital payments in 2019, when the Bank of China last released figures, however, we expect that the percentage is even higher today, especially given the events of last year. The authorities are in the process of creating a state-backed digital currency which it will demand that both Alibaba and Tencent host, thus reducing the revenues that these platforms can generate and simultaneously gaining a degree of control over the state currency circulation and the data that comes with it.

Transaction Mediums in China (2019)



A further blow to Tencent came as the State Administrator of Market Regulation (SAMR) ordered Tencent Music Entertainment to give up their exclusive rights to labels, which it sees as a monopolistic practice. However, given the dominance of the platform in China, and partnerships with Universal Music and other labels, it is unlikely that the small competitors to take significant share.

The coordination of the crackdown on the technology sector seen this month was unprecedented with not only SAMR, but also the Cyberspace Administration of China (CAC), the State Council, as well as the Ministry of Industry and Information Technology (MIIT) all going on the offensive. The private tutoring and online education sector faced a ban on foreign investment, going public or making profits, supposedly to reduce the cost of education which the centre blames for declining birth rates, despite the lifting of the two-child rule; we suspect that control of information and teaching standards may also be a factor in the decision.

The valuation of Tencent has, however, been impacted by the fact that it has minority stakes in numerous listed and unlisted companies, many of which have fallen significantly in value this month. The chart below is by no means exhaustive as the company has more than 600 investments in unicorn, public and private companies.

Selection of Tencent's Listed Equity Investments outside of gaming

Tencent 腾讯

DiDi 6.8%	Spotify 8.7%	TME TENCENT MUSIC ENTERTAINMENT 25.5%	12.0%
美团 Meituan 19.5%	sea connecting the dots 3.3%	JD.COM 1.1%	reddit $150m
阅文集团 CHINA LITERATURE 57.5%	TESLA 5.0%	NIO 0.5%	微医 WE DOCTOR 8.8%

Source: TIM/Bloomberg/Tencent

We continue to have confidence in the prospects for Tencent, however given the developments this month, we believe that the growth ambitions and cash flow generation will be more constrained. Although there are signs that the Chinese state is intervening to provide some support to their equity markets and has dialled back the rhetoric, we believe that many investors will be reluctant to invest in a sector that is for most off index, and there is no certainty that the state will not launch a further crackdown in future. Tencent has weathered the regulatory storm in the past (most notably with gaming approvals) and has a good track record of working to address the authorities' concerns; thus, we will continue to hold a small position in the company and assess the risk adjusted return valuation as to whether we add further funds to the company.

The largest contributor to performance this month was the German kitchen cooker manufacturer, Rational. We have held a position in the company for many years, but added significantly to the position in March and April 2020, when the company released upgrades to both their Combi-steam ovens and the Vario cooking stations – albeit at rather an unfortunate time. These new products are even more digitally advanced than the previous range, using intelligent cooking and making the process easier for the chef to deliver consistent quality food every time. The payback for restaurant owners remains about five months, and in times where the supply of trained chefs is constrained, the argument for buying Rational's cookers is even stronger.

The technology and performance of Rational's products remains about 4-5 years ahead of the competition and this is protected by over 600 patents, and a 98% referral rate by their existing customer base, making it hard for the other players in the kitchen appliance market to catch up. Rational is an excellent example of a German company, which could formerly have been considered part of the Mittelstand but has now outgrown that definition. The company only makes two products but carves out a niche by producing the best-in-class products within that segment.

In their recent pre-release of quarterly numbers, Rational reported that their revenues exceeded that of pre-crisis levels, stating that the combination of the opening up of the catering sector, State Aid programmes being used for investments and the tight supply situation led to both the iVario and iCombi-streamer product groups seeing strong orders worldwide.

Richard Scrope, Fund Manager, VT Global Select Fund
Data source (unless otherwise stated): Bloomberg.

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