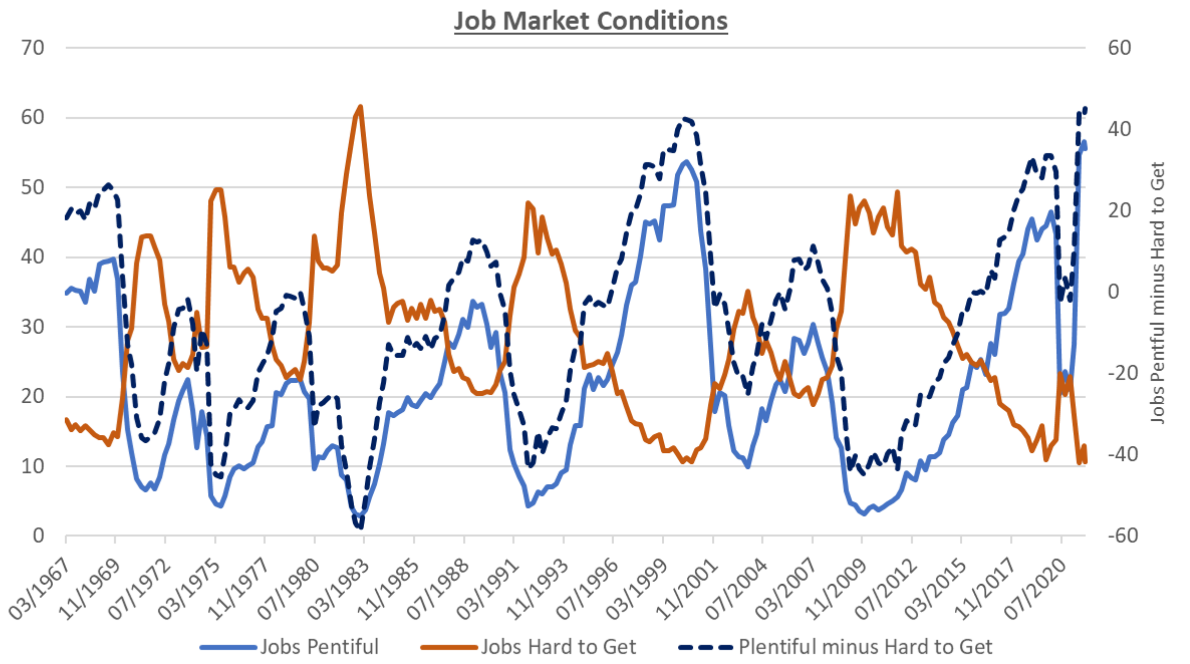
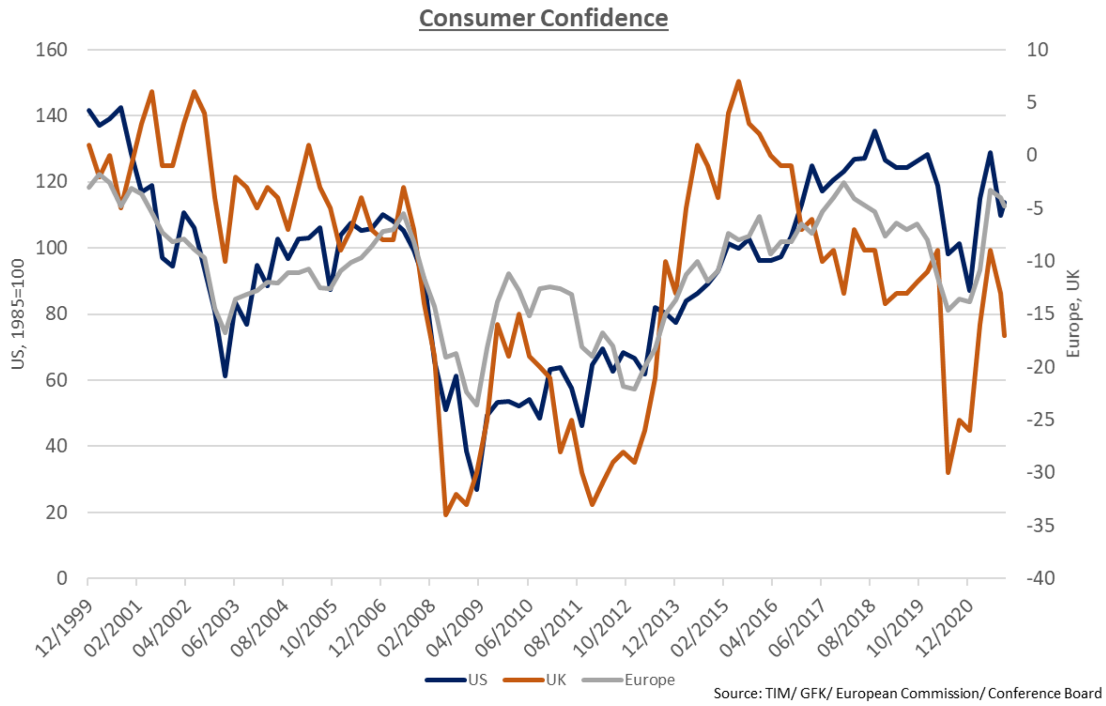
"The simpler you say it, the more eloquent it is" - August Wilson

The reporting season has been almost universal in companies commenting upon the rapid increase in raw material prices and supply chain bottlenecks, it has also been marked by many companies being able to put through price increases and consumers becoming more confident in their jobs to offset the fear from inflation; the October report from The Conference Board showed that 'jobs plentiful' minus 'jobs hard to find' rose to a new all-time high.

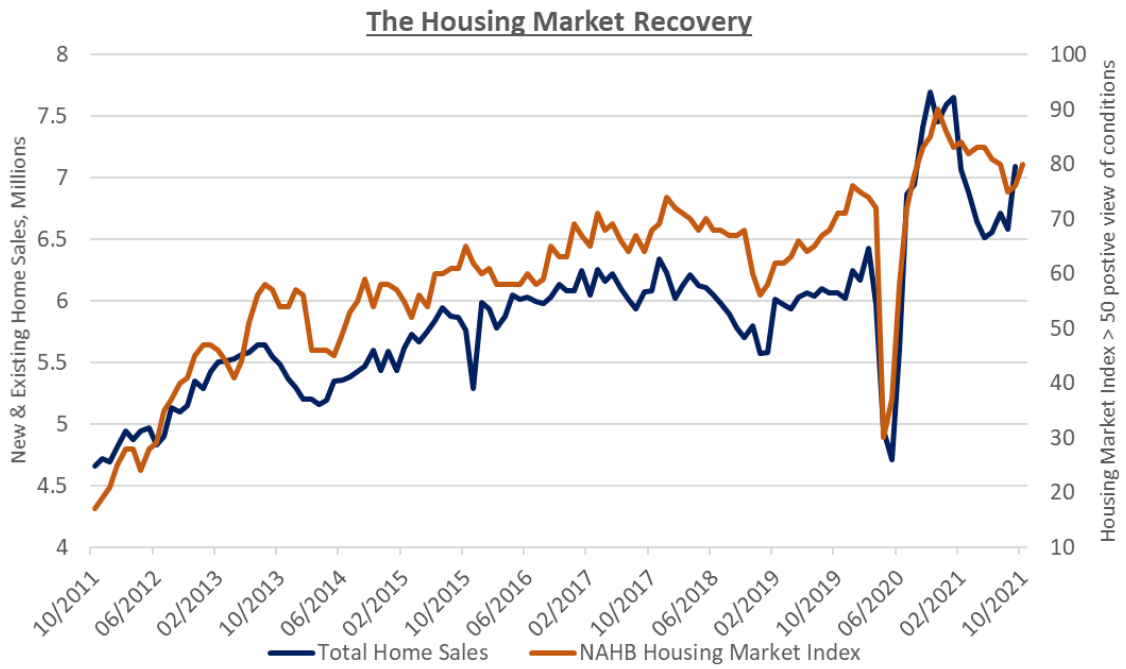


Source: TIM/ The Conference Board

Sadly, these conditions are not universal across the globe, with China experiencing a slowdown in their economy after being the first to recover from the pandemic, and the UK experiencing good shortages and energy price increases, all of which weigh on consumer confidence. Given that household consumption accounts for 69% of US GDP, 59% of UK GDP and 51% of European GDP, buoyant consumer confidence is essential for a sustained recovery in global economies.



A further positive sign in the US is the housing market, which despite tight supply leading to rising prices, has rebounded well having dropped from the peak in late 2020. This improvement in economic data is backed up by weekly jobless numbers continuing to fall and both the New York and Philadelphia manufacturing and non-manufacturing surveys providing a strong outlook for current and future capital expenditure.



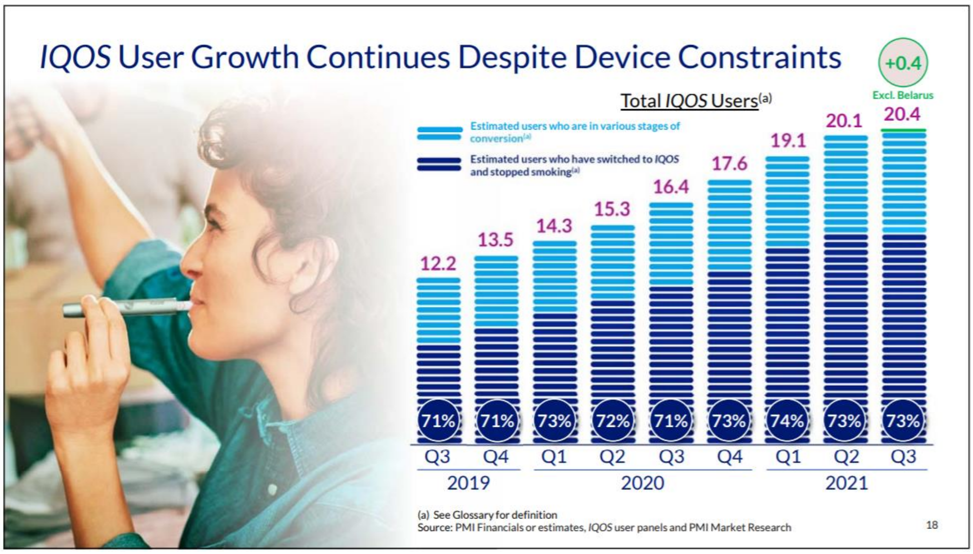
Source: TIM/ National Association of House Builders/ US Census Bureau

The question remains as to whether we have passed peak pressure in inflation and supply constraints. Certainly, management commentary, so far, appears to expect these pressures to wain in the coming months, and that a combination of price increases and the ability to fulfil the excess demand for their products and goods, should not only offset the pressure that they have experienced in the last quarter, but also see revenues and margins grow going forward.

Global equity markets eked out new highs during the month with the US leading the pack, however, European markets are testing their recent August highs also. The VT Tyndall Global Select Fund B Acc (GBP) rose 1.50% during the month, bringing the year-to-date returns to 15.07%.

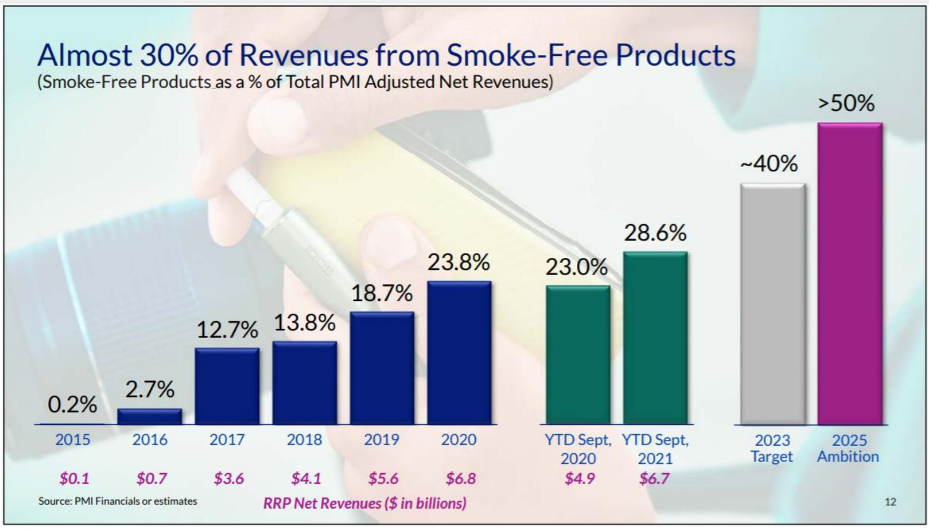
Fund Activity and News

During the month we exited the remainder of our long-held position in Philip Morris after a period of strong performance over the past year. We had been, and remain supportive, of their investment behind IQOS which has seen impressive growth since its launch and delivers a higher margin than combustible tobacco. There are, however, signs that this rate of growth has started to slow and the market share in Europe and Japan have dropped recently. Furthermore, we are concerned that, with governmental finances tight, the generous tax advantages that reduced risk products have benefited from to date may be scaled back and thus put pressure on margins.



Source: Philip Morris

Post the introduction of IQOS, the company has been vocal in its ambition to become a smoke-free company as it seeks to promote their portfolio lower risk products. This transformation will not happen overnight, especially in Asia where smoking is more socially acceptable, however their target of 50% of revenues coming from smoke-free products by 2025 seems ambitious, while emphasising their desire to be at the forefront of this change.

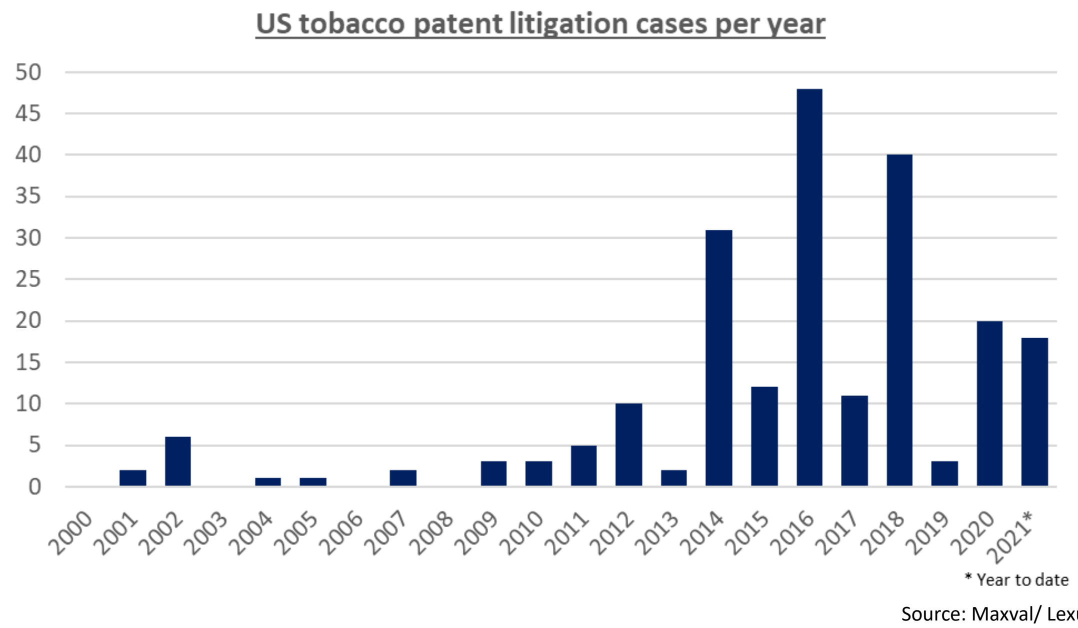


Source: Philip Morris

We have long preferred Philip Morris' focussed strategy over that of their US sister, Altria's more diverse one, as it keeps management's attention focussed and investment goals more product specific. We are therefore disappointed to see the new CEO embark on an acquisition path, diversifying Philip Morris' portfolio of smoke-free products and venture into the medical space.

The acquisitions of OtiTopic, which focusses on developing inhaled therapeutics in August, and the asthma drug maker, Vectura Group, which it ended up in a costly bidding war against Carlyle Group this month, although based around inhalation, are far removed from Philip Morris' core competencies. Further diversifying the products on offer, Philip Morris also acquired the Danish producer of 'well-being' products, Fertin Pharma in September. All these acquisitions suggest that the target of >50% of revenues coming from smoke-free products may in a large way, be achieved from inorganic growth which reduces the quality of the ambition.

Litigation has always been part of the tobacco landscape, however the move to reduced risk-products should have fundamentally reduced the costs of being a tobacco producer, however this has not proved to be the case. While it has defeated Reynold's (British American Tobacco) suits over patent infringement in Europe to date, a US Judged recently ruled in BAT's favour, and prohibited Altria from selling IQOS under license from Philip Morris in the US. We expect that Philip Morris will appeal the decision. however, the landscape is blurred, and we expect to see further lawsuits and countersuits between the tobacco producers in further geographies.

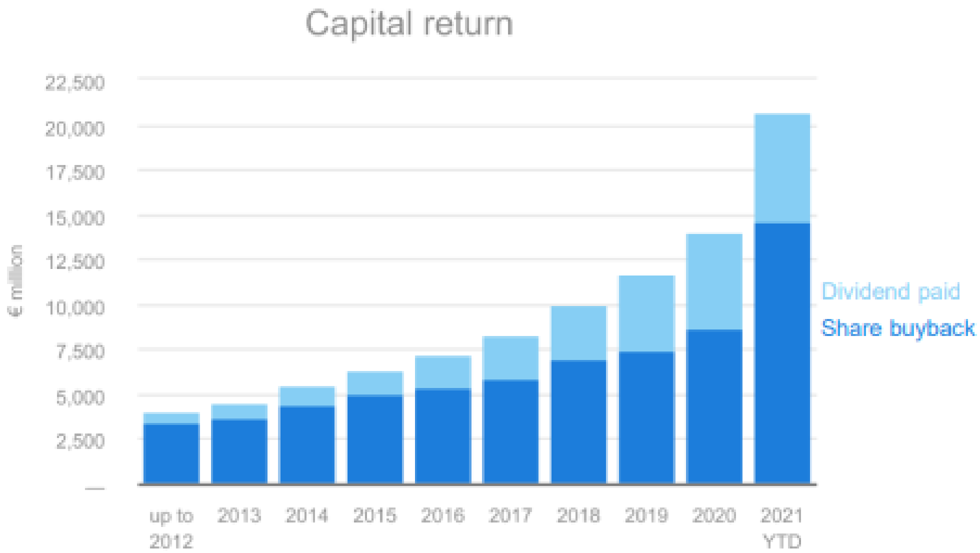


Source: Maxval/ LexusNexis

We have used some of the proceeds to add to our position in the lithography system manufacturer, ASML, which experienced a rare 18% correction in its share price at the start of the month. The shortage in semi-conductor chips and the drive by governments and firms to not only increase the supply but also diversify the geographic concentration of this supply has been well documented, and with each month further announcements of new capacity expansions or foundry investments are being announced.

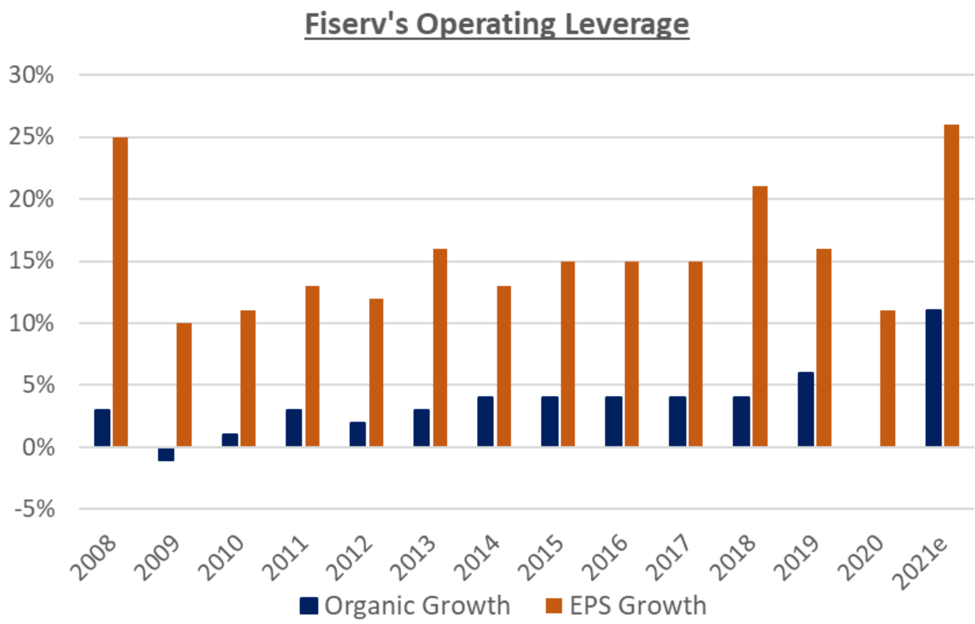
ASML is a key beneficiary of this trend as without their machines the chip producers are not able to start production, and it is the market leader in a field where being second best is unlikely to garner much support from the leading customers. Such is the uplift in demand at the moment that ASML's backlog is growing, and the company is predicting 35% growth in sales in 2021; we expect further extra-normal growth in 2022, well in excess of the stated 2020-2030 11% compound annual growth rate target, given the backlog.

On top of good underlying demand, the company has a cash positive balance sheet and generates a large, and growing amount of free cash flow which enables it to invest to remain at the leading edge of the industry as well as return increasing amounts of cash to shareholders in the form of dividends and regular share buybacks.



Source: ASML

Our holding in Fiserv held back performance this month despite reporting revenue growth of 10% and 21% growth in net income, ahead of market expectations. The company also raised the midpoint of their guidance for the full year to 11% organic growth and for margins to increase by more than 2.5%, normally this sort of operating leverage, which Fiserv has a multi-year history of producing, should satisfy the market (it has grown EPS by over 10% for an impressive 35 years in a row), however the shares fell over 10% on the day.



Source: TIM/Company Reports

This reaction was attributed to the announcement by the company that it had lost a Merchant Acceptance client, which was likely to be Stripe. Stripe was a joint venture and would account for a 5% drop in volume, but as it is only having a yield of $0.01 per transaction compared to the group average of $0.10 it has immaterial effect on group revenues.

This loss would have been more damaging had Fiserv lost Stripe to a competitor, however, this is not the case as Stripe is simply transferring to do the transactions in house. Given that Merchant Acceptance, which accounts for 43% of revenues, and exceeded expectations, growing by 18% in the quarter (and 119% over the year) despite the loss of this client, demonstrates how immaterial Stripe was to revenues; Clover by comparison pays 10-20x the rate of Stripe and is growing volumes by 47%. We do not see any material change to Fiserv's business model and expect it to continue to post steady top line growth with significant leverage to earnings growth.

Richard Scrope, Fund Manager, VT Global Select Fund, 31st October 2021
Data source (unless otherwise stated): Bloomberg.

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