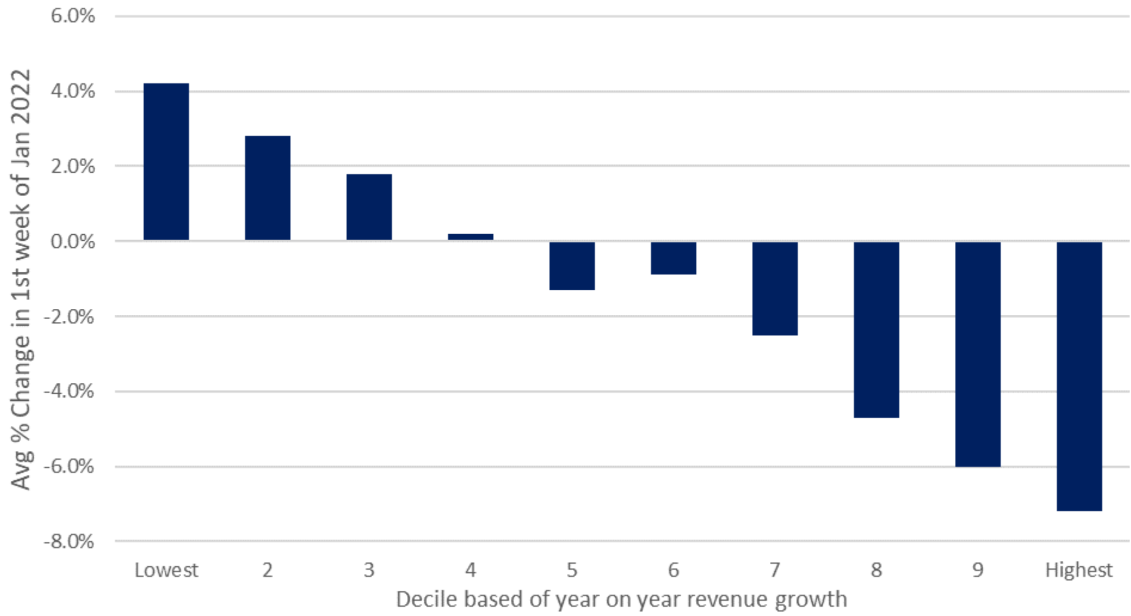
"One of the basic causes for all the trouble in the world today is that people talk too much and think too little" - Margaret Chase Smith.

2022 started in a manner which was unkind on those managers, of which we are one, who prefer to invest in high quality companies, as investors sold last year's winners in favour of the more leveraged and cyclically exposed laggards. It is not unusual to see rotations of this kind during the course of the economic cycle, and often they have the ability to overshoot, leading to opportunities to pick up or add to companies that have been thrown out with the bath water.

Russell 1000 performance in first week of Jan 22 based on year-on-year revenue growth.



Source: TIM/Bespoke Investment Group

Since the lows of the pandemic, markets have proved to be like a roller-coaster ride with many sharp shifts in sector and style performance, and this year is proving to be no different. We do not claim to be experts in market timing and therefore are not in favour of trying to chase these shifts but instead stick to investing based on fundamentals, which we believe will outperform over the long-term. This does not make months like this easy for us as fund managers, however avoiding heuristic tendencies is part and parcel of a sensible philosophy and process. We continue to believe that a balanced fund of quality companies with resilient recurring revenues combined with more cyclically exposed quality companies, those that are the backbone of an increasing digitalised economy as well as those who will continue to benefit as the economy reopens is a sensible composition as we face the year ahead. We do, however, continue to eschew mining and energy stocks which have highly volatile earnings streams due to factors outside our control or analysis.

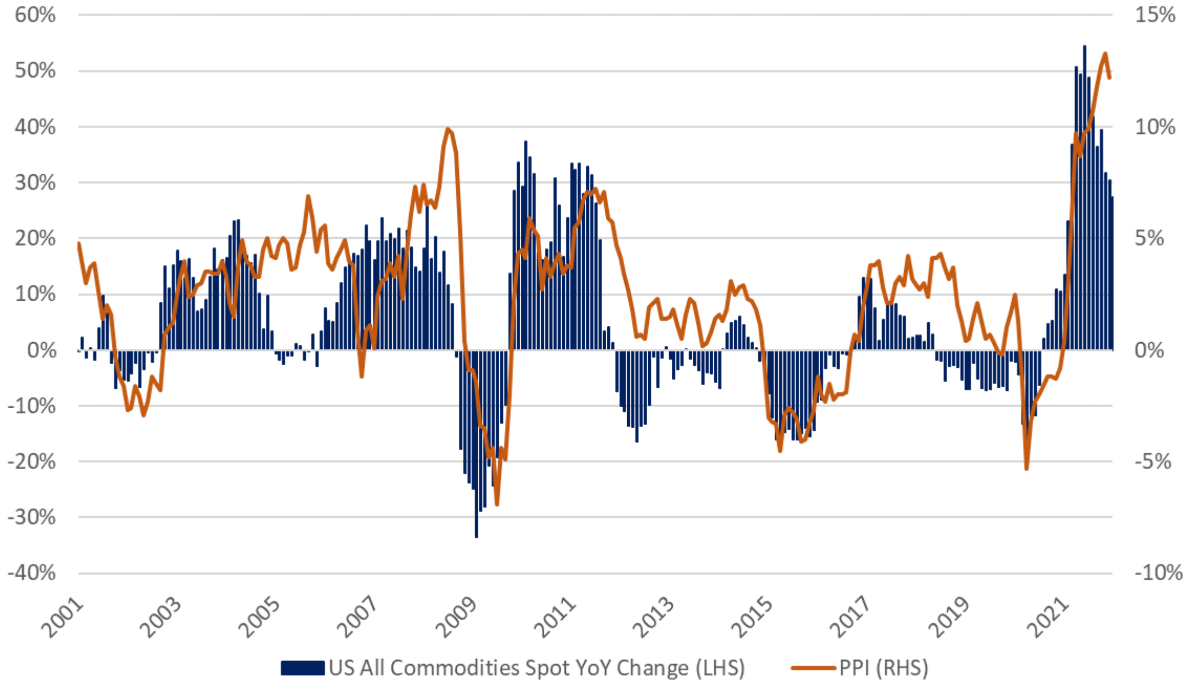
The blame for the sudden shift seen so far this year has been lain at the door of the central bankers and in particular, the US Federal Reserve, as the boards pledge to 'do whatever it takes' to combat inflation. The market now expects four or more increases in interest rates in the US this year, and the reversal of quantitative easing is likely to amplify the effects. As the value of a company is the present value of its future cash flows, a raising of interest rates can reduce the perceived value of many companies and the technology sector has been particularly punished as a result.

The broad-brush assault on the technology sector has led to some valuation multiples becoming more attractive. We believe that certain technology stocks should not be tarnished with the same brush as those with little or no earnings, as there are companies within the sector that have become mission critical and part of the 'fourth industrial revolution'. Companies such as Apple and Microsoft, both of which last week, reported record quarterly growth numbers, with the latter continuing to grow across all its business segments at over 20%, with margins also increasing. Both are fundamentally intertwined with the day-to-day operation of most companies or our daily lives, that they stand apart from the crowd, and the 12.5% and 16% corrections respectively, prior to announcing their results are signs of company agnostic selling.

Much of the data that the central bankers are focussing on, which show multi-year high inflation numbers are backward looking and ignore the year-on-year lapping effect that will optically reduce inflation numbers as we progress through the year. The multiple variants of coronavirus and case numbers are inextricably linked to inflation and supply chain constraints. However, as coronavirus seems to be turning from a pandemic to an endemic and the world learns to live with the virus, new strains appear to be becoming less deadly, some of the drivers of inflation are likely to prove to be transitory at the time when the Chairman of the Federal Reserve changes his stance from transitory inflation to being more embedded.

The rate of change, not the absolute level, is the key factor in determining the likely path of inflation, and much of the supply chain constraints, bottlenecks and delivery times we saw in 2021 are starting to show signs of stabilising or even improving. The charts below show the trend in commodity prices and industrial prices paid, but similar signs can be seen in the Baltic Dry index, freight rates and even semiconductor supply lead times.

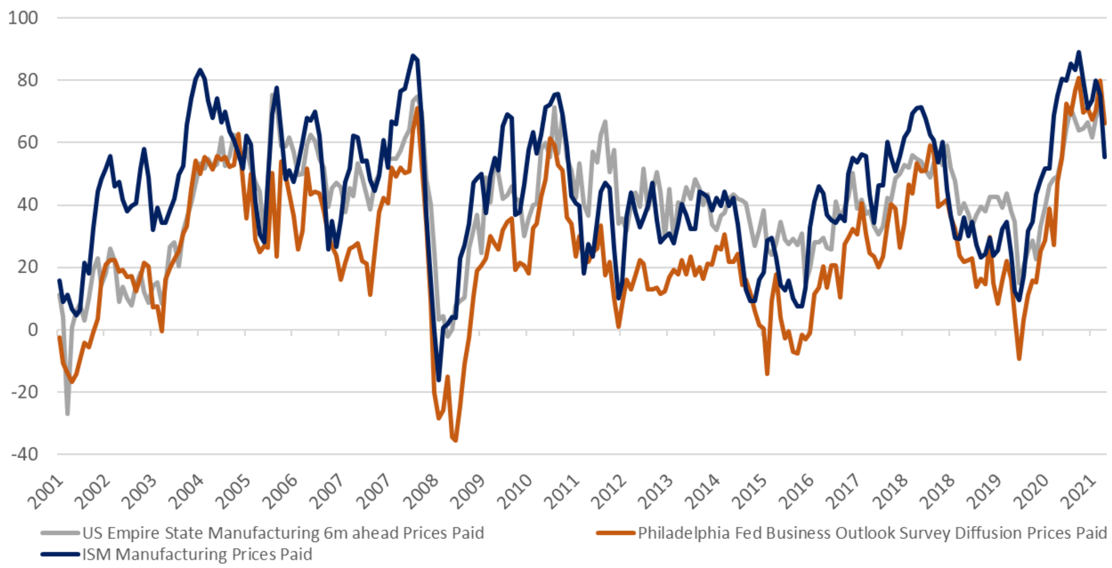
Commodity YoY price changes vs PPI



Source: TIM/Commodity Research Bureau/Bureau of Labor Statistics

As the low level of inventories start to correct and companies draw back from the doubling or tripling up on their order levels that they have undertaken to ensure that they are not caught short again, we expect that the prices paid will are likely to fall further and with them should come a drop in inflation.

US Business Surveys of Prices Paid Improving

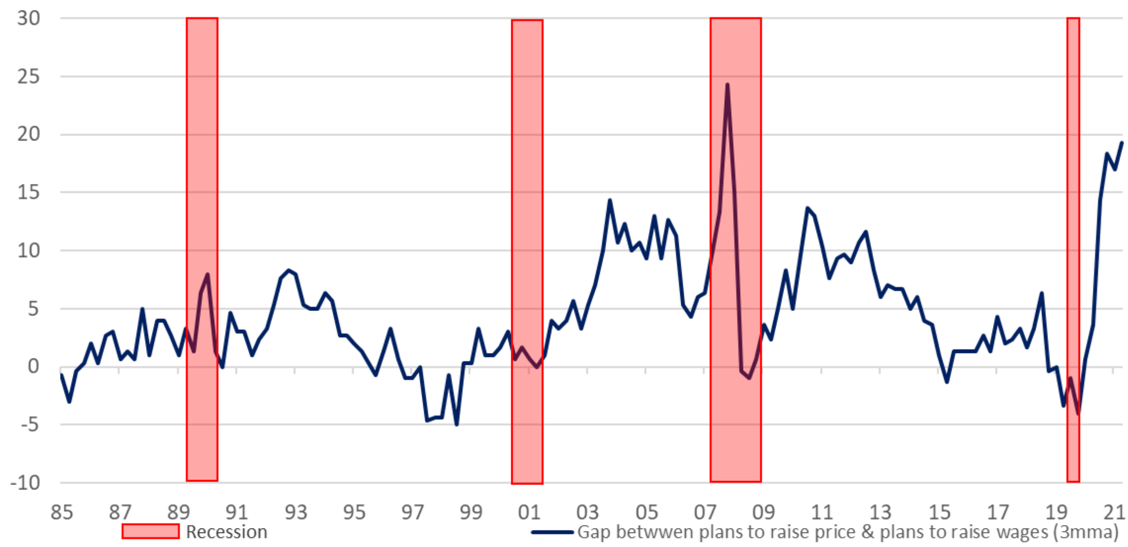


Source: TIM/Philadelphia Federal Reserve/Federal Reserve Bank of New York/Institute for Supply Management

Wage inflation has also caught policy makers' and journalists' attention alike as job openings are plentiful and unemployment rates continue to fall. The Biden administration has just implemented a $15 an hour minimum wage for all federal workers, which is more than double the National Minimum Wage of $7.25, but equal to the new minimum wages at many public companies such as Costco, Amazon and Starbucks; in the UK the National Living Wage, for over 23yr olds, is set to increase from the equivalent of $12.0 to $12.8. The aforementioned businesses are not alone, as most companies have had to raise their minimum wage thresholds, in order to attract and retain workers.

While this would in normal times be negative for operating margins, the chart below from the National Federation of Independent Business shows that the gap between those raising prices and those raising wages has continued to expand. With consumers having $2 trillion more cash on their balance sheets than pre-pandemic levels, plentiful job openings and see their house prices increasing, it is hardly surprising that companies see the opportunity to pass on their increased expenses to the end consumer. A recent survey by S&P Global reported that almost 70% of companies responded that it was either very easy or somewhat easy to pass on cost increases to most companies.

Plans to raise prices vs wages



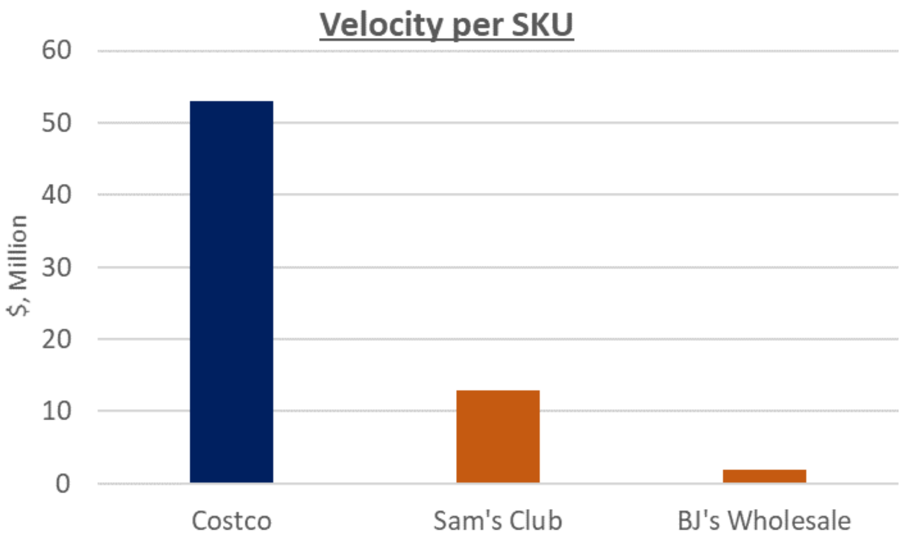
Source: TIM/Bloomberg

After 16 successive months of marking new all-time highs, the VT Tyndall Global Select Fund had a disappointing month as high-quality equities with resilient and recurring revenues were sold in favour of more leveraged cyclical assets. As a result, the VT Tyndall Global Select Fund B Acc (GBP) fell by 9.10% during the month.

Fund Activity and News

In a tumultuous month the largest detractors to performance were Accenture (-17.3%), Zebra Technologies (-17.6%) and Zoetis (-20.0%), while American Express (+8.2%), Visa (+5.2%) and Banque Cantonale Vaudoise (+8.2%) added to performance.

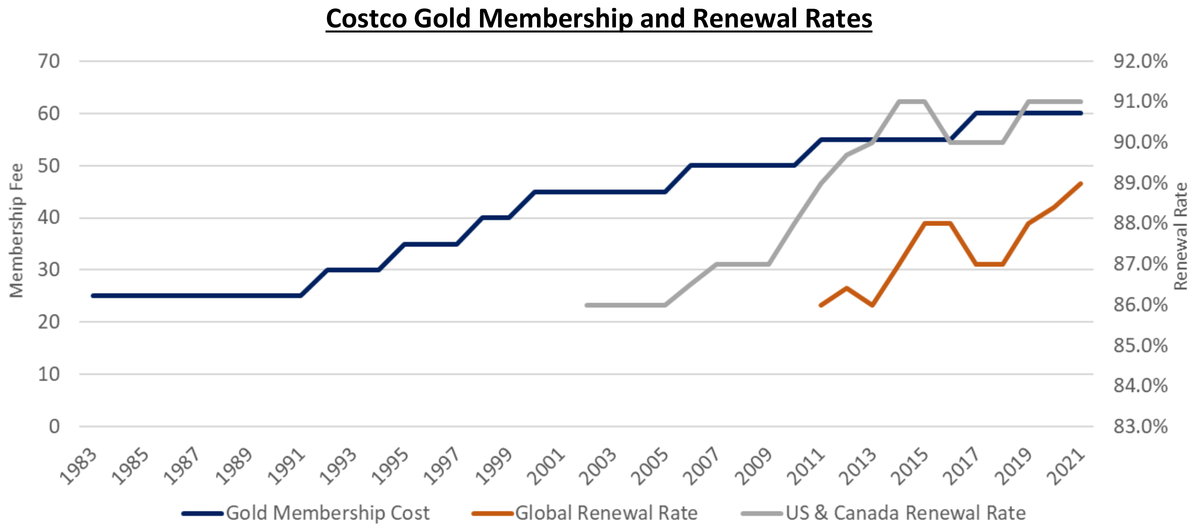
During the month we added one new holding. Following a 16% decline in the share price we initiated a position in the US warehouse retailer, Costco. The company operates as a wholesale retail club with an annual membership model from which it derives revenues allowing it to offer its members a variety of high quality, nationally available and private label (Kirkland) goods at lowest prices in the market. It derives cost efficiencies through bulk purchasing and limiting items to fast-selling models, sizes and colours. By carefully selecting products on quality and price, the average Costco warehouse carries only 3,800 SKUs which is significantly lower than the 30,000 found in most of its peers. This strategy of a select offering drives velocity and profit density above that found in its peer group.



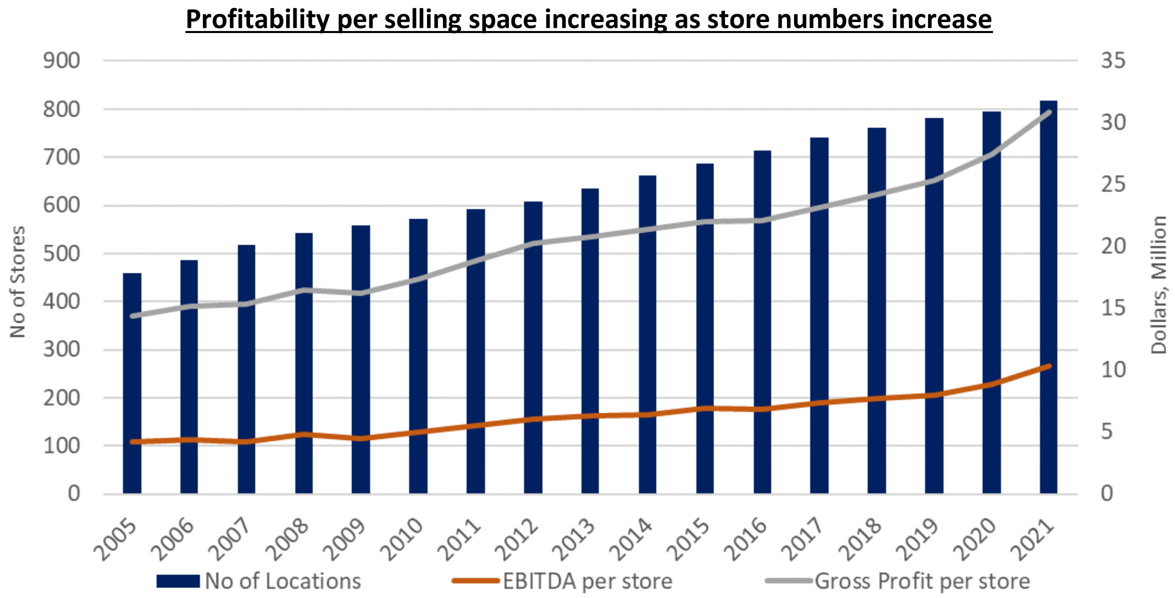
Source: TIM/Company data

Membership numbers grew at a faster rate of 7-8% during the pandemic but remain above its long-term growth rate of 4-5%. Customer loyalty remains very high at 91% in North America and 89% globally, despite occasional membership fee increases owing to their commitment to offer high quality products at the best prices. The average spend varies by demographic with 18-24yr olds averaging $1,700 per year, 35-45yr olds at $4,100 and $2,200 for the over 75s.

Given the current input cost inflation and the fact that it has been over four years since the last increase we would not be surprised if the company rose membership by a further $5. It is worth noting that Executive membership (membership fee of $120), where average spend is $5,000 per year, now accounts for 50% of accounts in the US, and 81% have signed up for auto-renewal compared to 29% of new members pre-pandemic.



We believe that the increase in sales and customer visit numbers experienced during the pandemic are likely to be sustained during an inflationary environment as customers are more likely to seek quality at low prices when their other costs are increasing. We also expect Costco to continue to expand its number of warehouses both in the US and internationally. The chart below shows that, with the exception of 2009, the company has successfully increased profitability per square metre, while at the same time increasing the number of warehouses.



Source: TIM/Company Reports

With increasing profitability improving and the company driving efficiencies, despite sticking to its mantra 'to continually provide our members with quality goods and services at the lowest possible prices', cash flows and returns on invested capital have improved sequentially, and as such, the company has a robust, cash positive balance sheet. Since initiating a dividend policy in 2004, the company has increased its dividend per share every year, including paying four special dividends over the past decade, which we expect to continue.

Richard Scrope, Fund Manager, VT Global Select Fund, 31st January 2022
Data source (unless otherwise stated): Bloomberg.

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vadevalor
AAA Rated Fund Manager

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