VT Tyndall Global Select Fund

Monthly Commentary | April 2022

TYNDALL

“Patience is a necessary ingredient of genius” - Benjamin Disraeli

With the Chinese grappling with their zero-COVID or dynamic zero policies, vast numbers of people in the Zhongguo region are faced with enforced isolation while factories and businesses are standing still. Much of the Western world is inextricably entwined with China with many production facilities situated close to Shanghai, Beijing and Shenzhen and the consequences are likely only to add to the smorgasbord of headwinds that company managements have had to contend with so far this year.

The Federal Reserve has not helped the market with its increasingly hawkish rhetoric. The market now expects three 50bp interest rate hikes in the coming meetings and either 9 or 10 hikes in total over the course of the year. Although this rhetoric had led to a bid under the US dollar, concerns about whether this course of action may lead the US into a recession remain.

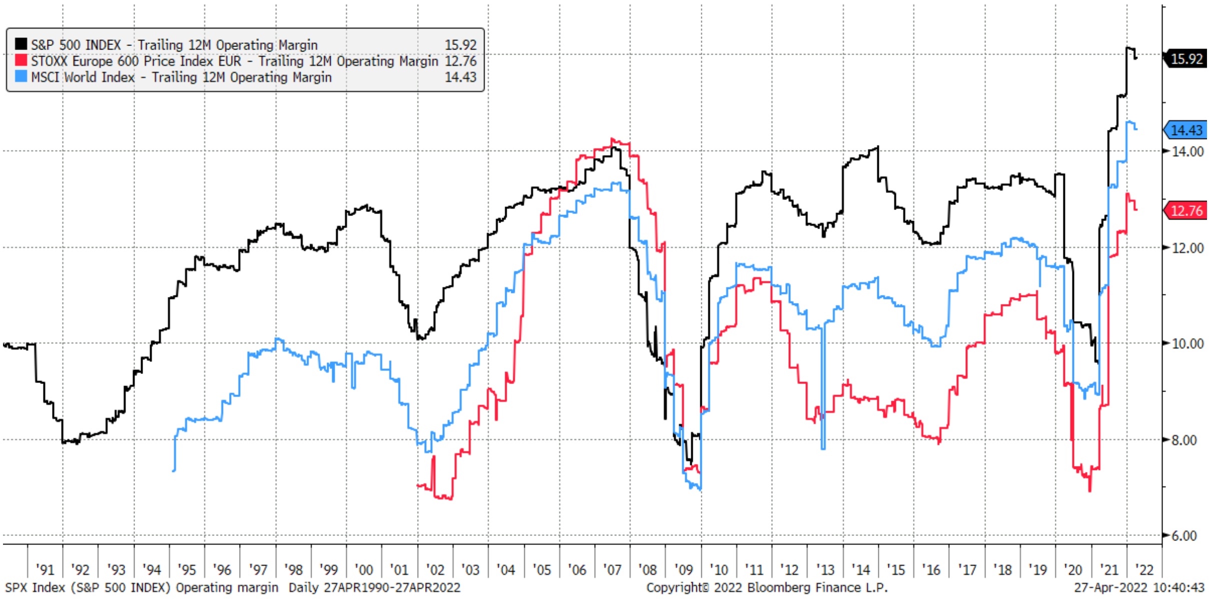
Current Year End Interest Rate Expectations

Source: TIM/ Bloomberg

The increase in the cost of living is only too apparent to everyone and felt more acutely than manufacturing surveys or management expectations. These surveys remain remarkably robust given the macroeconomic uncertainties but given that many of the supply constraints and inflation experienced over the past twelve months are showing signs of easing, perhaps this can be understood.

Company managements have continued to push through price increases to offset the impacts of the inflationary forces that they have encountered, and many are yet to see the effects from their latest round of increases. Company operating margins and profits have thus been resilient and remain close to the highest levels in a generation. While this is good for companies and shareholders, the end consumer is having to absorb most of the costs, further weighing on consumer confidence; if history is anything to go by, companies are much better at putting through price increases to offset inflation than they are at rolling them back as these pressures abate- just look at your local petrol station now that the price of oil has fallen 15% from its March highs.

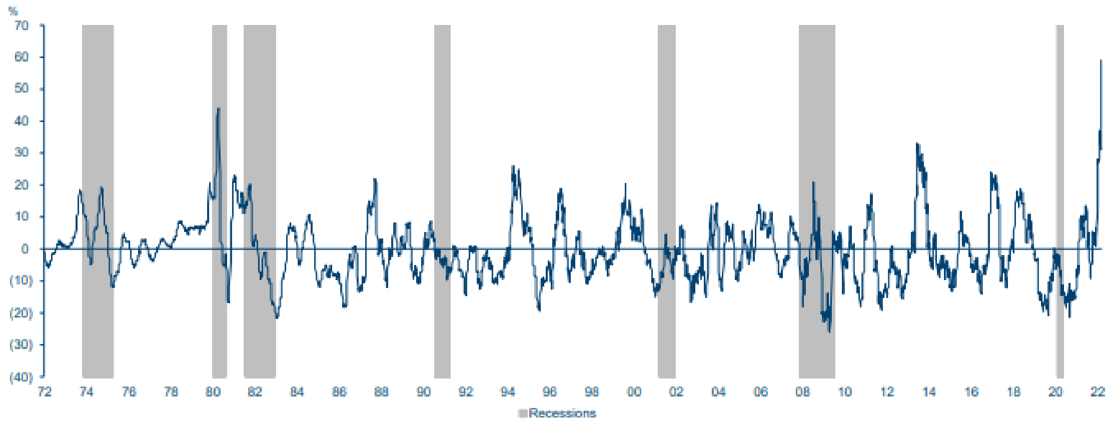
Corporate Operating Profit Margins by Region



Source: TIM/ Bloomberg

Adding to the issues facing the man on the street is housing affordability, as shortages of supply remain an issue and both house prices for those looking to own a home and rental prices have risen significantly on both sides of the Atlantic; the US median new home price to household income ratio has risen to 6.5 times from 3.9 times at the turn of the century. In the US the majority of homeowners are on 30-year fixed mortgages, which is not an issue for those who have managed to purchase their home during the past 10 years while rates have been close to all-time lows, however, for those looking to enter the market, move house or are coming close to having to renew their mortgages, the rates have risen markedly and show little signs of returning to prior levels.

Percent Change in 30-year Fixed Mortgage Rates Relative to the Rate 6 months Earlier - 1972 - Late March 2022

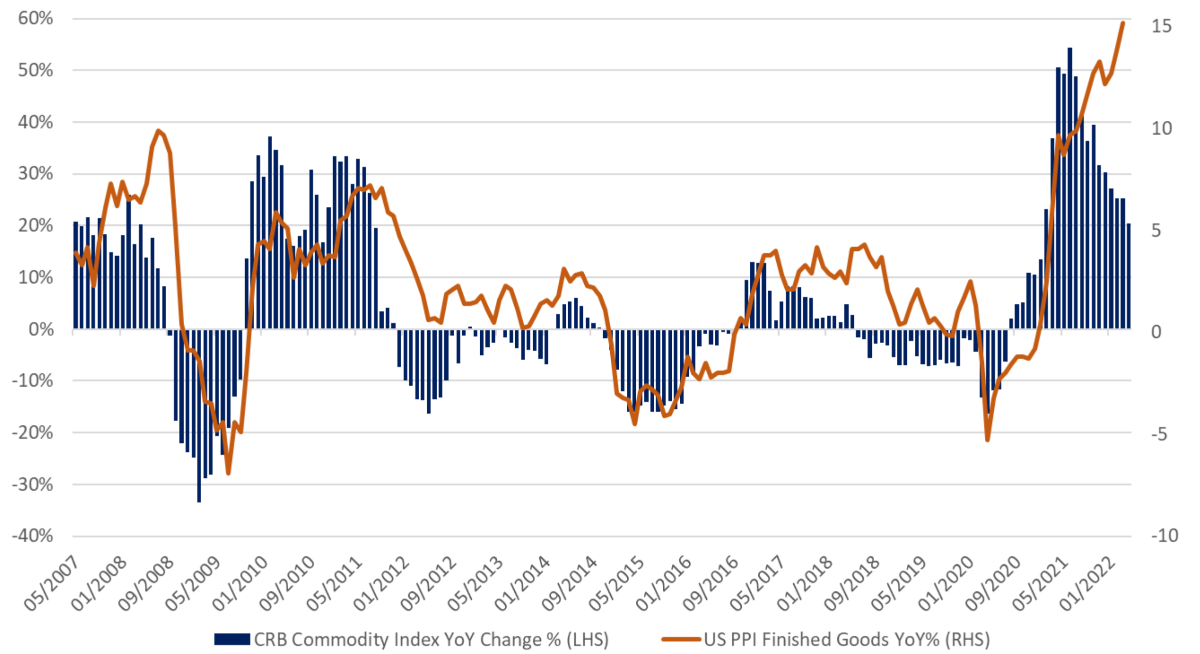


Source: Freddie Mac, National Bureau of Economic Research, Empirical Research Partners Analysis

Although it is easy to find reasons to be bearish on the outlook for the coming months there remain reason to remain optimistic for the longer term as inflationary pressures subside, supply chains unblock, inventories are restocked, and China emerges from its self-inflicted slowdown.

Commodity prices have been a significant driver behind the current rate of inflation that companies and consumers are currently having to grapple with, but as the chart below indicates, the rate of increase has started to wane, and although we are not seeing them decrease yet, there are signs that these prices are stabilising, and thus will become a drag on the inflation readings as the number annualises.

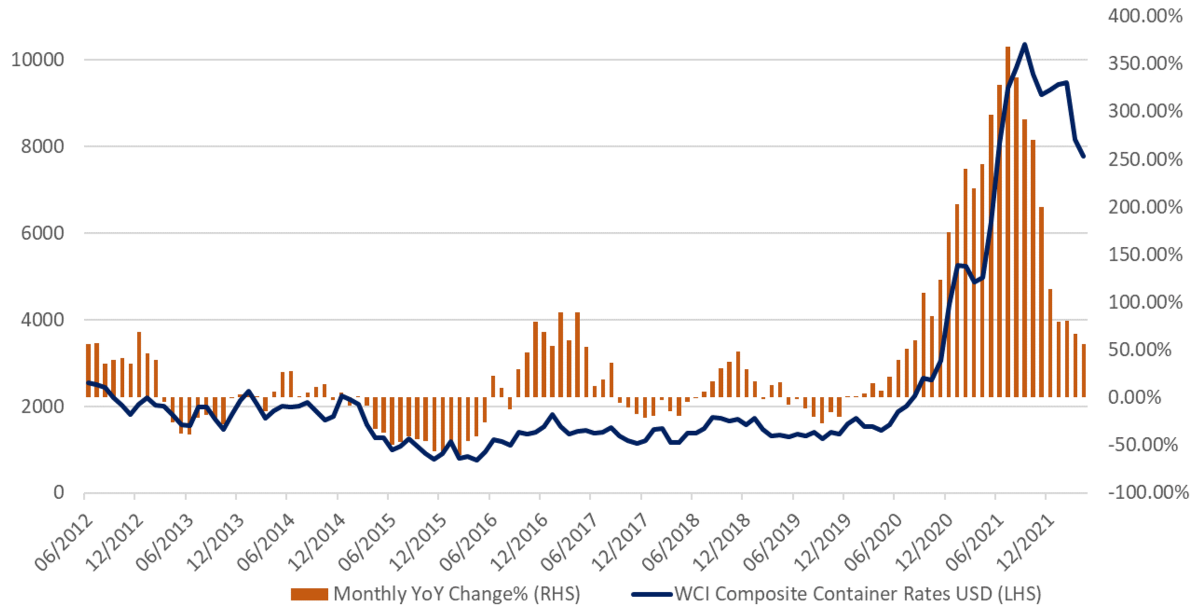
Decelerating Commodity Price Inflation



Source: TIM/ Bloomberg

Similarly, container rates which drove up transportation costs last year have started to decline, which should ease the components of inflation that came about due to excessive demand and supply constraints. While we expect the inflation numbers to start to fall over the course of the year, it is highly unlikely that the world will return to a state of zero interest rates and negligible inflation. Of higher probability is that inflation will settle at higher but manageable level than the average of the past decade, with interest rates lower than what the market is currently pricing in yet higher than they are today.

Container Rate Inflation Past Peak



Source: TIM/ Bloomberg

Despite the month end rally as on aggregate the earnings season delivered better than expected results, the damage to global markets from the factors listed above left the VT Tyndall Global Select Fund down 1.34% over the month. As a result, the VT Tyndall Global Select Fund B Acc (GBP) returns for 2022 thus far are -9.13%.

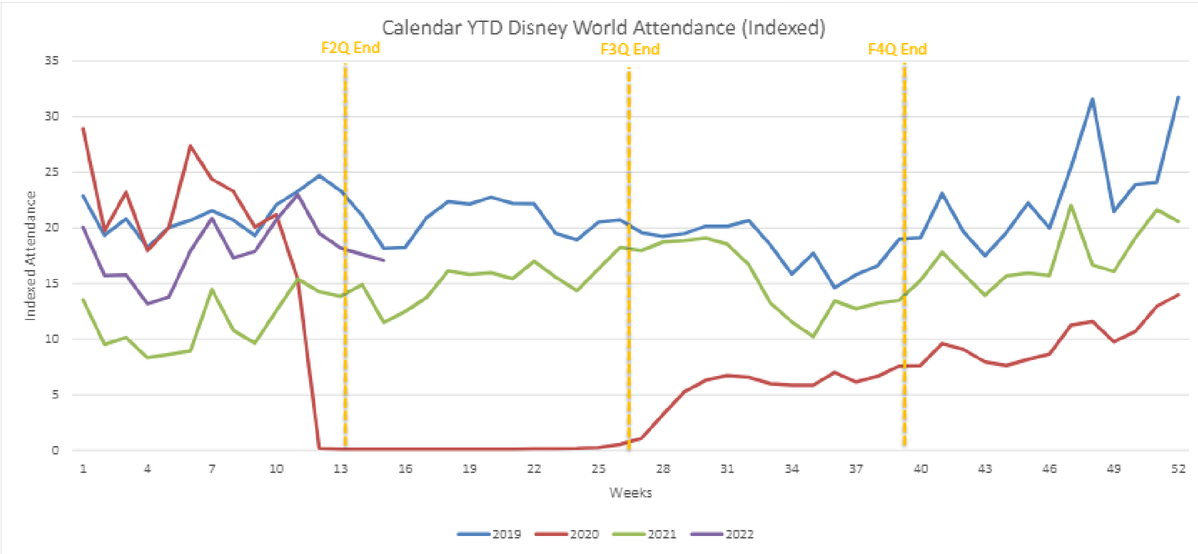
Fund Activity and News

We reduced our position in Walt Disney last year over concerns that subscriber growth may fail to be as impressive as it has been since its launch, and that the current subscriber target of 230m-260m by 2024 may be too much of a stretch. Netflix's recent subscriber loss of subscribers reported this month reaffirmed our concerns, and led us to exit our position completely.

We have long argued that there are distinct differences between Walt Disney and Netflix, however while the pandemic led to growth in both companies' streaming services, Disney's Park business, which has traditionally been the cash generating arm of the company, faced complete closures worldwide.

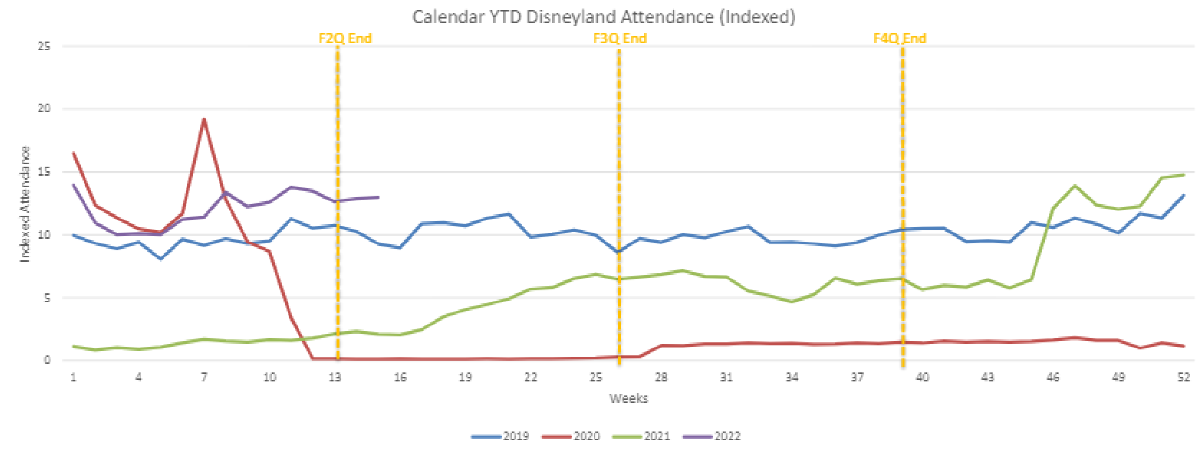
Since the world started to reopen the parks have filled up well, owing to lots of pent-up demand from a year without the opportunity for 'experience' spending. Despite the company putting distancing measures in place which reduced capacity, profits are running above 2019 levels due to visitors being more willing to increase discretionary spend while undertaking visits. The charts below show that visitor numbers to Disney World and Disneyland are close to, or slightly above, the pre-pandemic levels, suggesting that revenues will continue to be strong from the US parks businesses.

Figure 1: Calendar YTD Disney World Attendance (Indexed)



Source : dbDIG Primary Research

Figure 2: Calendar YTD Disneyland Attendance (Indexed)

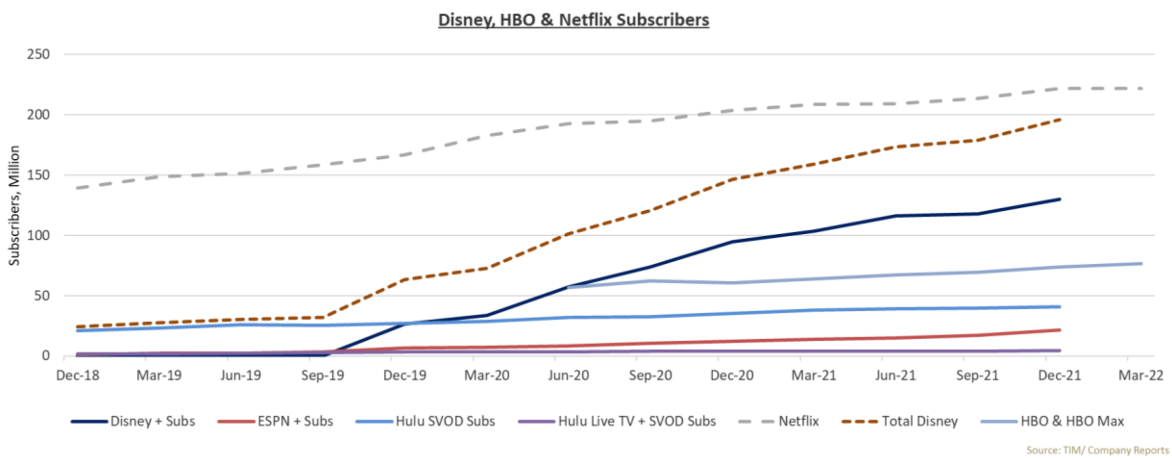


Source : dbDIG Primary Research

The current approach to COVID in China, however, remains a concern, as the Parks in Shanghai and Hong Kong, face temporary reclosures as the zero COVID restrictions prevent people from visiting these sites. When Shanghai Disney reopened at one-third of its 80,000 visitor per day capacity, the tickets were sold out within minutes, however, this is now academic. Even if demand remains at similar levels when China lifts restrictions, running at one-third capacity results in annual visitor numbers well below the 11 million who attended the resort when it opened in 2017.

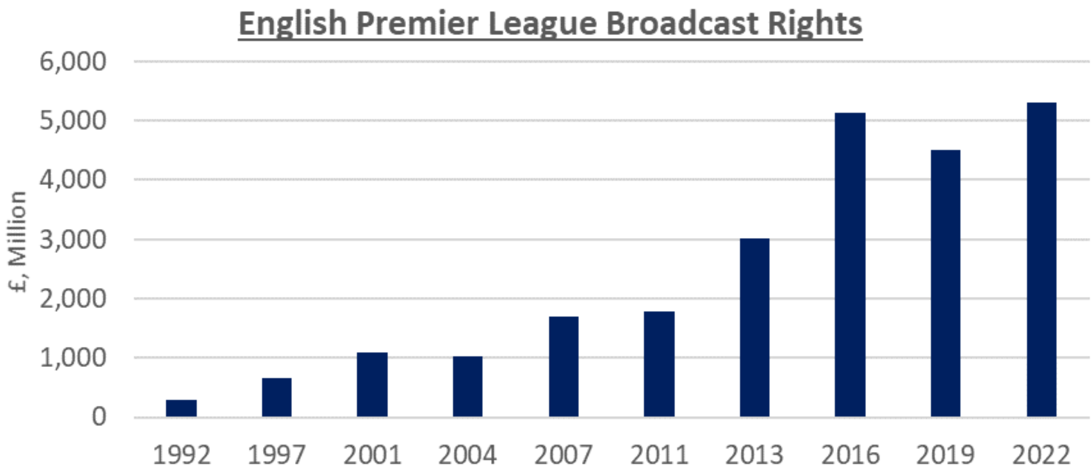
Unfortunately, the market is fixated upon the streaming arm of Disney when it comes to valuing the company and we cannot bury our heads in the sand, arguing that this misses the embedded value in the remainder of the business. The global steaming market has become increasing competitive over the past couple of years, with AT&T investing behind HBO Max, Comcast with Peacock, Paramount with Paramount+ and a host of smaller rivals all vying for eyeballs and their share of people's wallets.

With a somewhat deeper pocket, Apple TV has a slightly different approach as it 'gives' a year of free subscription to those who buy their products, making it difficult to ascertain true paying subscription numbers, however it is estimated to be around 25 million, and the success of CODA at the recent Oscar ceremony will only serve to support subscriber growth and may vindicate Apple's approach. Amazon also is not afraid to essentially give their streaming offering for no further fee to its 200 million Prime subscribers. The latest release from Amazon indicates that 117 million (58.5%) of their Prime subscribers take up the Prime TV option, although these numbers may well have grown since Jeff Bezos released them in early 2021.



The jury is still out as to how many streaming services people will be prepared to pay for, but the push to grow content and scale is afoot, which increases the risk and cost for the providers. Strong back catalogues will continue to benefit Disney and Netflix, but the risks of not investing in new content that ranks highly in viewer interest have increased. Warner Bros. Discovery recently demonstrated that streaming is not the panacea that many believe it to be, closing CNN+ only a month after launch having enrolled less than 10,000 daily active users.

Similarly, sports content has become increasingly important as events such as the Premier League, Major League Baseball, Formula 1, and the numerous other franchises that are not protected by national government intervention, have all seen increased competition as followers have little option but to subscribe, and costs have increased accordingly. In 2021 ESPN (owned by Disney) agreed to pay $2.7 billion for the rights to air Monday Night Football compared to the $1.9 billion it agreed to pay in 2011 and the chart below shows to cost for the European broadcast rights of the English Premier League.



Source: TIM, Premier League

Although Disney has numerous sporting licences, the largest concern is the renewal of the Indian Premier League (IPL) cricket contract that is due to be auctioned in June this year; Viacom, Disney, Sony, Zee, Amazon and a further undisclosed company, believed to be Apple, have thus far bought the invitation to tender document. The 2018-22 rights were purchased by Star (Disney) for $2.1 billion, and the current rights are currently expected to cost the winning party in the region of $7.2 billion, significantly more than the base price of $4.2 billion set by the Board of Control for Cricket in India (BCCI). Winning the auction is of paramount importance to Disney as Disney+ Hotstar accounts for 45.9 million of Disney+'s 129.8 million paid subscribers, and without the IPL this number is likely to fall significantly; as exemplified by Netflix, the market does not look kindly on streaming companies that lose subscribers.

Richard Scrope, Fund Manager, VT Global Select Fund, 30th April 2022
Data source (unless otherwise stated): Bloomberg.

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