VT Tyndall Global Select Fund

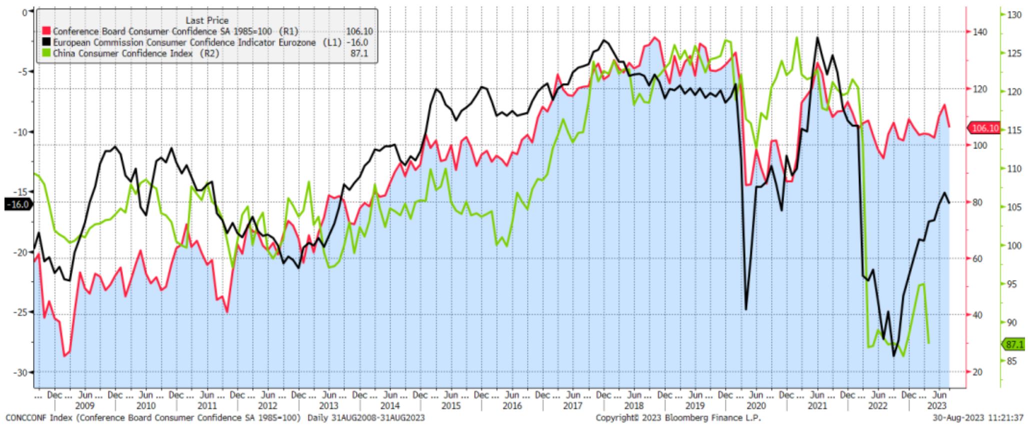
Monthly Commentary | August 2023

TYNDALL

“Common sense in an uncommon degree is what the world calls wisdom” – Samuel Taylor Coleridge.

The Chinese government has continued in its efforts to kickstart the economy, and in particular the beleaguered real estate sector where both Evergrande and Country Garden Holdings are teetering on the brink of default. The property developers in China could face a liquidity shortfall of 18.9 trillion yuan (15% of GDP) by the year end, as falling sales have led to restrictions on access to both debt and equity markets, unless the government can devise a policy that succeeds in stemming the tide; thus far the policies such as relaxing controls on purchases have failed to work.

The latest policy to come from the centre is to cut both deposit and mortgage rates to boost consumer spending which has also been lacklustre since the reopening of the region. It is not only, however, China where consumer confidence took a step back in August. While Chinese consumer confidence is close to all-time lows, that in the US and Europe had been improving until the latest readings came out below the market expectations.



The bifurcation between company outlook statements and the macro-economic data is astounding. While most companies are talking about improving conditions to come in the second half of the year and 2024, the macro data looks poor. In Europe, the manufacturing sector, led by Germany, appears to be in crisis mode as the Purchasing Managers’ data and even The Economist suggest. We caution, however, that often when mainstream publications highlight an issue on their cover it marks the point of peak fear, and conditions have a habit of improving from then on.

Source:TIM/S&P Global

Source: The Economist

With the fist-half reporting season drawing to an end, almost 80% of US companies have delivered positive earnings surprises, with positive skews across all sectors. Consumer staples and discretionary stood out with 90% and 84% of companies, respectively, reporting positive surprises and an aggregate growth in earnings of 6.9% and 32.7%. The data from European companies was much more mixed, with only 50% of companies reporting positive earnings surprises with aggregate earnings declines in all but the technology, financial, utility and health care sectors.

The Biden administration took actions to reduce Medicare spending during the month, identifying 10 medicines that will be subject to price negotiation over the next 12 months before announcing a "maximum fair price" to be implemented from 2026. As a result of these negotiations the US government expects to save nearly $100bn over the five-year period after the act and may extend the program to include further treatments in due course.

Drugs targeted by the administration.

Drug	Manufacturer	Treatment	2021 Medicare spending
Eliquis	Bristol/Pfizer	Blood Thinner	$12.6bn
Xarelto	Johnson & Johnson	Blood Thinner	$5.2bn
Januvia	Merck	Diabetes	$4.1bn
Jardiance	Eli Lilly	Heart Failure	$3.7bn
Imbruvica	Abbvie	Blood Cancer	$3.2bn
Entresto	Novartis	Heart Failure	$1.7bn
Farxiga	AstraZeneca	Heart Failure	$1.4bn
Enbrel	Amgen	Rheumatoid Arthritis	$0.6bn
Stelara	Johnson & Johnson	Psoriasis Treatment	£1.1bn
Fiasp	Novo Nordisk	Diabetes	$0.6bn

Source: TIM/Data.CMS.gov

Despite the plans to cut prices by 50%, the 2026 revenue impact on the individual pharma companies on the list above is less than 1%, except for Eliquis, which has a 3% impact, as many are about to go off patent, and will probably be facing generic competition by that point anyway. Governments adding to the pressure is not helpful, but in essence, these moves should not have a meaningful impact as Medicare only accounts for18.4% of health insurance, compared to 54.3% from employer-based cover.

At risk of being added to the list

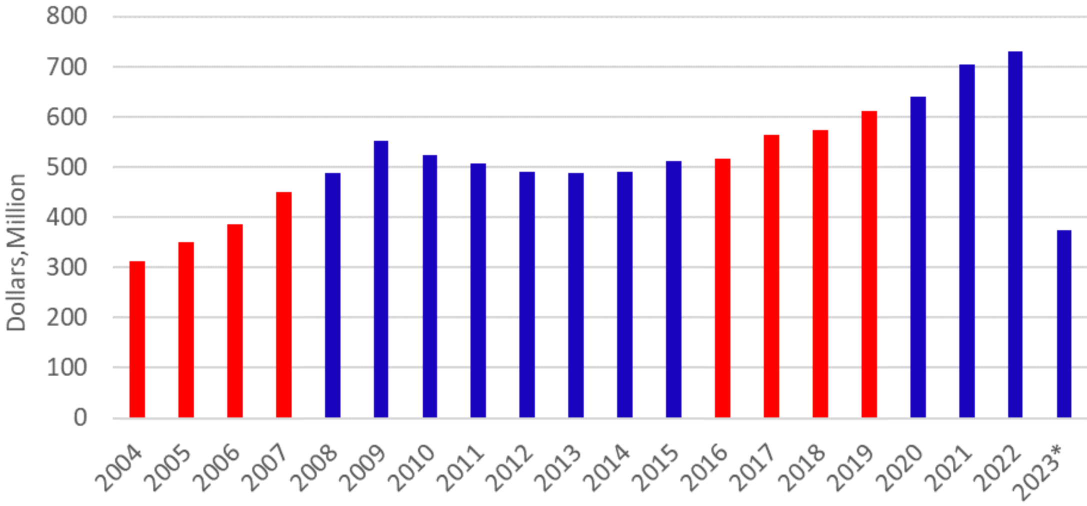
Drug	Manufacturer	Treatment	2021 Medicare spending
Trulicity	Eli Lilly	Diabetes	$4.7bn
Ozempic	Novo Nordisk	Diabetes	$2.6bn
Xtandi	Astellas/Pfizer	Prostate Cancer	$2.4bn
Symbicort	AstraZeneca	Asthma & COPD*	$2.1bn
Ibrance	Pfizer	Breast Cancer	$1.9bn
Spiriva	Boehringer Ingelheim	COPD*	$1.0bn

*COPD: Chronic obstructive pulmonary disease

Source: TIM/Data.CMS.gov

Historically pharmaceutical companies fare poorly in the run up to Presidential elections as the high price of treatment and health care insurance is an easy target for prospective candidates despite the strength of the health care lobby. So far, in 2023, the health care lobby has spent £371m on defending the industry. With this announcement coming out with just over a year to go before the electorate go to the polls perhaps the drug companies will get an easier ride over the next 12 months than has previously been the case.

US Pharmaceutical Lobby dollars- well spent?



Source: TIM/OpenSecrets.org

The VT Tyndall Global Select Fund B Acc (GBP) rose by 0.61% helped by strong returns in a variety of holdings such as Novo Nordisk, Canadian Natural Resources, Intuit and Booking Holdings. Performance was held back by our holdings in Zebra Technologies, Sika, Nike and Abbott Laboratories. The Fund has risen by 7.86% in the year-to-date.

Fund Activity and News

At the start of the month, we sold out remaining position in Estée Lauder which had been under pressure since its profit warning in May. We hold a position in L'Oréal in the Fund, however, unlike its French peer it had not focussed so heavily on duty-free and travel retail. This served the company well as China's wealth grew and the population's propensity to travel and spend on luxury cosmetics grew, however, Estée never had a manufacturing base in Asia, and order lead times extended to around eight months.

The lockdowns of 2022 meant that many customers had significant inventories of product with no ability to sell them, thus Estée was faced with a dramatic shortfall in its order books as their large customers sought to normalise their inventory levels.

Although the luxury sector remained cautiously upbeat on their views about the Chinese consumer in their recent quarterly result calls, we remain unconvinced about whether the recovery is buoyant enough for Estée to work through the inventory issues and return to growth in profits and cash flow in the near term. The retail sales numbers coming from Hainan have picked up from the dreadful conversion rate in March but still do not point to a strong recovery. Estée in its latest update also highlighted similar problems in Korea.

"For the full fiscal year ended June 30, 2023, the operating environment continued to be disrupted by the impact of the COVID-19 pandemic. Most notably, the pace of recovery in Asia travel retail and mainland China was slower than anticipated. In Hainan, prolonged store closures initially presented a headwind and, thereafter, low levels of conversion occurred when travel resumed. This was compounded by inventory tightening by certain retailers. In Korea, the travel retail business slowed during the transition to post-COVID regulations. In addition, the slower than anticipated resumption of international flights, granting of visas, and organized group tours further challenged the Asia travel retail recovery. As a result, the Company's Asia travel retail business was challenged throughout the fiscal year by the slower than anticipated recovery. In mainland China, the Company's performance in

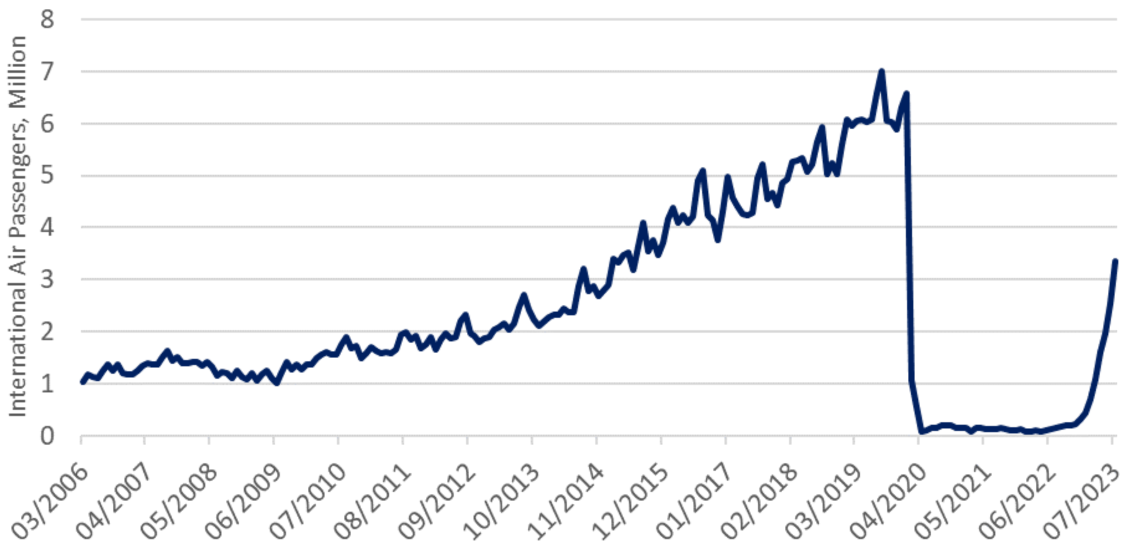
the first half of fiscal 2023 was hindered by low retail traffic as a result of COVID-related restrictions and the rise in COVID-19 cases."

Hainan still no seeing a surge in spending visitors.

Source: TIM/www.oeicdata.com

As travel retail is more than just visits to Hainan its is encouraging to see the strong rebound in Chinese international travel, which was all but impossible since the pandemic. The latest reding from the Civil Aviation Authority of China is only at half the pre-pandemic levels after the government lifted restrictions on international travel this month.

International travel restrictions finally lifted.



Source: TIM/CAAC

As a measure to address lead times Estée has announced that it is to build a manufacturing plant in Japan, however this also has drawbacks as although it reduces supply chains, it also reduces the inventory days that Estée's customers need to hold in the future. There are also planned investments in R&D, IT as well as advertising & promotions all of which led us to question the company's forecast of returning to pre-pandemic margins of 20% from 11.4% today, as we expect muted Free Cash Flow and any margin recovery to be curtailed by these investments.

Estée Lauder's P/E remains elevated despite the headwinds.

Source: Bloomberg

Given that these headwinds are likely to remain in the medium term and that we expect limited cash flow and margin recovery, we expect that the management may have to revise its forecast in the coming year, and the valuation, which despite the warnings remain elevated, may return closer to the historical average.

Richard Scrope, Fund Manager, VT Global Select Fund, 31st August 2023

Data source (unless otherwise stated): Bloomberg.

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AAA Rated Fund Manager

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