CG insights

Quarterly perspectives from the CG team

1st Quarter 2025

cgam

From the Trump bump to the Trump slump?

American businesses and consumers look on with concern

In the last quarter's update we noted that the US economy was appearing to slow. **We wondered what, if anything, might bring American exceptionalism to an end. Now we have a candidate: President Trump**.

Immediately after the election there was a surge of business optimism. This has ebbed away. The to-ing and fro-ing on tariffs has left businesses not knowing where they stand. Faced with uncertainty they sit on their hands. This is starting to show up in business surveys for capital spending. **The NFIB survey is nearly at its Covid lows and the more volatile regional Fed surveys are trending downwards.**

Nor is it just businesses that are showing caution. **Consumer sentiment is poor and inflation expectations are rising**. The savings ratio has been a concern to us for some time. It reached a low of 3.3% in December. With the froth coming out of the stock market the wealthy are likely to revert to more normal consumption patterns and lower earners will likely adjust their consumption too.

The budget proposals may make matters worse. They envisage tax cuts of $4.5 tn over 10 years and $2 tn in spending cuts. The spending cuts, if enacted, will largely fall on entitlement and welfare programmes: Medicaid and SNAP (Food Stamp Programme). **One in five Americans benefit from Medicaid. Faced with the threat of its withdrawal, Americans may opt to dramatically increase their precautionary savings.**

The probability of a recession is rising rapidly, though is by no means a certainty. President Trump's reaction function will be interesting. In his first term, he set much store by the stock market's level. Recently President Trump and his lieutenants have suggested that a recession might be an acceptable price to pay to bring about the "golden age of America [that] begins right now".

NFIB Survey – Capital Expenditure Plans

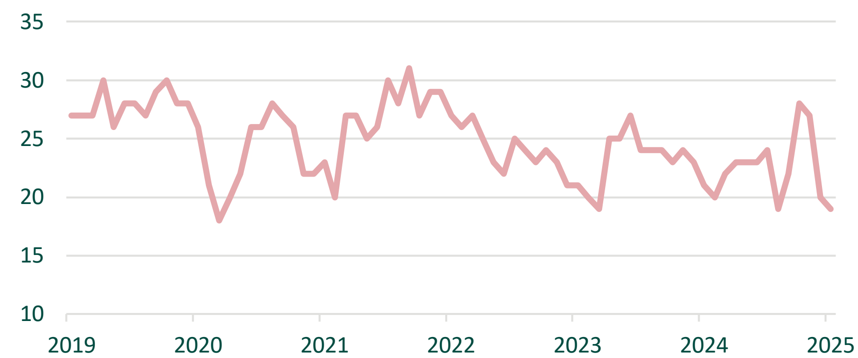

Chart takeaway: the surge of optimism has given way to nerves

Our Investment Judgement

1. The US was the only advanced economy with real economic momentum but policy uncertainty is undermining confidence
2. The probability of a US recession has risen dramatically
3. We have responded by adding duration to our US TIPS holdings and trimming our risk assets

The wrong answer to the right question

Investment trusts should benefit from Saba's intervention

For all their benefits, investment trusts have an Achilles' heel; the risk of significant share price discounts to their underlying net assets per share. **Currently discounts appear to be at cyclical troughs, which have attracted a number of hedge funds into the sector**, most prominently Saba Capital who have built up stakes worth in excess of £3bn across 28 investment trusts. After a period of standoff, battle commenced in the first quarter of 2025 as Saba requisitioned a series general meetings demanding radical change at several trusts.

To date all of the requisitioned general meetings have failed and, in our opinion, rightly so. The resolutions often lacked clarity, ran counter to established corporate governance norms and were transparently designed to benefit Saba. However, even if Saba presented investors with the wrong solution, they are certainly asking the right questions. **Why have directors allowed persistent discounts to emerge and why are they not acting with greater proactivity to resolve them?**

Nothing like barbarians at the gate to focus minds, even if the horde is initially repulsed. **We expect a rash of initiatives designed to narrow discounts, consolidate sub scale trusts and improve liquidity to be announced by boards over the coming year**. After a period of relative underperformance investment trusts could be set up to deliver a period of outperformance versus global markets. Against the backdrop of a potentially deflating US equity bubble, rising bond yields and geopolitical instability any source of relative performance is hugely valuable.

Hedge funds are correct to identify that the investment trust sector offers stand out value. **With luck, even in defeat, Saba will leave a positive legacy having been a catalyst for greater proactivity around the board table.**

Investment Trust Discounts by Asset Class Category

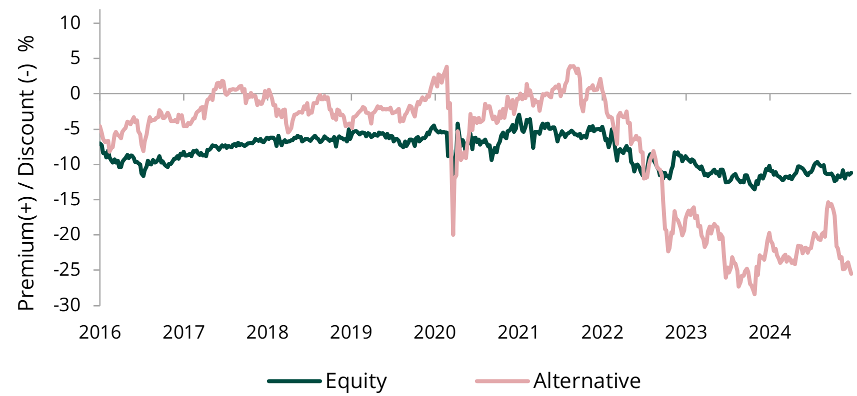

Chart takeaway: Both conventional and alternative investment trust discounts sit at or close to their widest level since the Global Financial Crisis in 2008

Our Investment Judgement

1. US equities remain highly valued on almost any metric and the "American Exceptionalism" bubble could be deflating.
2. We have been reducing risk asset weighting for six months now largely through reducing ETF exposure.
3. Our risk asset holdings would be even lower if we did not believe investment trusts offer significant relative attraction due to discount narrowing potential

Are we there yet?

Bond markets are anticipating the inevitable: stagflation

While the US nominal Treasury curve remains flat relative to even recent history, the US real curve (TIPS) is now markedly upward sloping.

Why the change? **Attention has shifted to the combined impact of tariffs and a tighter approach to immigration.** In the near term, these act as a supply shock to the US, reducing supply of labour and goods. Over time, they also erode domestic demand. This is before considering the impact of an additional channel weighing on the US economy: uncertainty. The on-off nature of tariff implementation and DOGE job cuts has begun to weigh on sentiment, which, at the margin weakens consumer and business activity.

The result is an economy that operates at a lower level of growth and higher level of inflation. This is what markets have started to price in: elevated inflation expectations are driving a wedge between the front end of the US nominal and real curves, creating an upward sloping real curve.

The combination of an upward sloping real curve and a weaker domestic outlook has driven two changes to positioning: (1) a shift away from barbell positioning, to **an emphasis on the belly of the curve**; and (2) **a preference for longer duration**, to give greater interest rate sensitivity against increased probability of a slowdown.

There is one final development which warrants mentioning: the extent of the movement in the UK index-linked curve. A combination of factors – elevated interest rates, concerns around the UK government's fiscal position, and the diminishing role of defined benefit pension funds – has seen **20Y UK real yields reach 2%.** For a sterling-denominated investor, the long-term real yield differential between US and UK yields is now historically narrow, without the US dollar currency volatility. **This change in relative value demands even greater consideration in UK multi-asset portfolios.**

US vs. UK 20 Year Real Yields (%)[1]

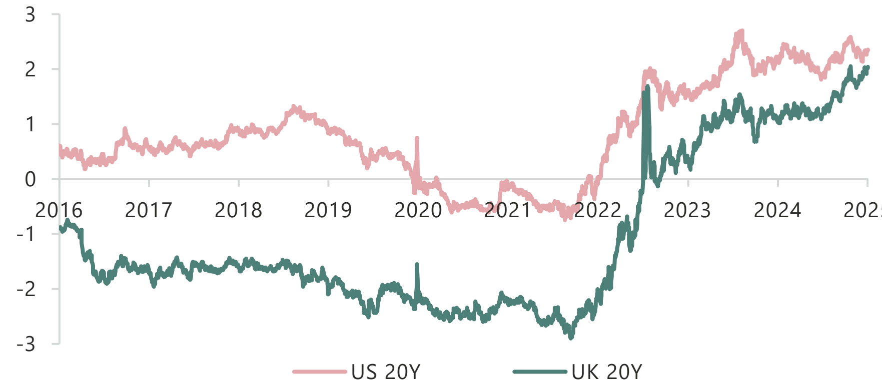

Chart takeaway: The gap between long-term real yields in the US and UK has narrowed considerably. This is a meaningful shift in relative value, suggesting that long index-linked gilts should have a greater allocation in portfolios.

Our Investment Judgement

1. We have lengthened our TIPS duration to approx. 8.5 years, reflecting the increased probability of a US economic slowdown.
2. As the TIPS curve is now upward sloping, we have shifted our curve position to place greater emphasis on the belly (7-10Y), where the gradient is steepest.
3. The change in relative value between TIPS and UK index-linked has led us to increase our allocation to longer duration index-linked gilts.

1. Sources: Bloomberg Finance L.P. Note: UK 20Y real yield is shown before adjusting for the RPI-CPI wedge. Making this adjustment reduces the yield differential by a further approx. 17bps at the 20Y point.

Recent changes to multi-asset portfolio positioning

Portfolio Category	Asset Classes	Changes in Portfolio Positioning
Dry Powder (32%)[1]	Cash, Treasury Bills & Short Duration Government Bonds Short investment grade credit Preference shares	• Dry powder has increased by 1% to 32% of the portfolio • Credit spreads have remained historically tight, so most of the dry powder has been invested into treasury bills (yielding 4.5%) with 9% of the portfolio invested into credit and preference shares

Index Linked Bonds (38%)[1]	Sovereign inflation linked bonds
	UK, US and other developed markets
		• Allocation to index linked bonds remains at 38%
		• On rising yields we increased our exposure to longer dated UK index linked gilts
		• Over the quarter US TIPS increased from 23% to 28% of the portfolio of which:
		  • 23% is allocated to unhedged TIPS where duration was extended to 8.5 years and the barbell position on the curve was removed
		  • A new position of 5% was initiated in shorted dated hedged TIPS

Risk Assets (30%)	ETFs Investment Trusts Non-investment grade credit Gold	• Risk assets were reduced by 1% over the quarter against weak US markets • US equities exposure reduced via sales of Polar Capital Global Financials and RIT Capital Partners early into the quarter • Infrastructure was increased to 6.7% of the portfolio, but will shortly reduce after a cash offer made for BBGI Infrastructure (0.7% of the portfolio) • Gold exposure was reduced to 1.2% of the portfolio

1,Data refers to Capital Gearing Trust. Weighting to index-linked bonds in CG Absolute Return Fund is 35% (with 36% in dry powder)

Asset Valuations and Investor Behavior Summary

Asset Class Valuations and Summary

	UK	US	Japan	Europe	CG View
Investment Trusts Discounts	Attractive				Discounts are attractive alongside a record return of capital and numerous engagement opportunities to target
Equity markets	Fair	Unattractive	Fair	Fair	CAPE: UK (19), US (36), Japan (23), Europe (23) US equity markets looking vulnerable combining elevated valuations and negative momentum
Short Government Bonds	Fair	Fair	Unattractive	Unattractive	UK T-Bills offer a risk free 4.5% return Japan attractive when hedged back to GBP
Long Index Linked Bonds	Attractive	Attractive	Unattractive	Unattractive	Favour US on valuation grounds but UK Index linked starting to look better value
Currency	Base Currency	Fair	Attractive	Unattractive	Yen is still attractive but faces near-term headwinds from tariffs, weak growth and stronger competition from Europe and China
Credit	Unattractive	Unattractive			Credit spreads are historically tight with unfettered issuance. Loan defaults have increased markedly in the US
Investor Behaviour	Fair	Unattractive	Attractive	Fair	Investor sentiment is beginning to turn negative on US policy uncertainty and economic outlook. Shareholder engagement and corporate reforms in Japan have proved constructive

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IR@cgasset.com
+44 (0)203 906 16349
20 King Street, London, EC2V 8EG

www.cgasset.com