Second Quarter Report

June 2020

Dollar Fund

Real Return Fund

Absolute Return Fund

Capital Gearing Portfolio Fund

CG Asset Management

General Commentary

June 2020

ESG is the dominant topic amongst investors currently, with environment and social aspects particularly widely discussed. Governance has received less emphasis; yet it is vital for the long-term interests of investors and for wider society. CG Asset Management has for many years engaged with boards of trusts where corporate governance has been weak but until recently our approach has been to hold private discussions rather than to use public letters and headlines in the press. It is easier for people to improve their behaviour if it looks as though it is their own idea.

In general, we have focused on specific failures of governance. In one recent example the directors of a liquidating trust tried to repay preference shareholders, including our clients, less than their entitlement. Surprisingly this attempt was supported by those directors whose explicit role was to protect preference shareholders. It also transpired that the Chairman of the trust had negotiated a personal bonus scheme linked to the profit made by a prominent hedge fund who had built up a position in the company. Rather than seeking to impartially balance the interests of competing stakeholders, the Chairman partnered with a single shareholder and then acted in way designed to maximise his own financial reward. We mounted a robust legal defence and achieved a satisfactory result, without a public intervention.

There are cases when a more public intervention is useful. Recently we wrote a public letter in support of the board of Gabelli Value Plus ("GVP", https://www.gabelli.co.uk/docs/pdfs/GVP_cgam.pdf). This trust has had a notably poor record since its listing in 2015 and remains sub scale and illiquid. Both the board and a significant independent shareholder have publicly stated that the trust should discontinue. The concern is that the largest shareholder, Associated Capital Group ("ACG"), has a 27.9% stake and is closely associated with the investment manager. So close in fact that ACG was only recently spun out of the investment manager and both companies share the same Chairman, Mario Gabelli. ACG is us-

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ing their voting block to seek to continue the trust for the benefit of the manager and against the interests of minority shareholders and the recommendation of the board.

This makes for a particularly interesting case as directors are trying to act in shareholder's interests but may be blocked by a significant stake held by a close associate of the manager. It is widely believed that a manager with "skin in the game" is an attractive feature in a trust. At the asset level there is evidence that the returns are positively affected. What is more problematic is the impact on corporate governance of stakes, or archaic voting structures, that give control to one shareholder. Those trusts with the largest and most persistent discounts are almost all controlled. In an ideal world, control would not matter because the independent directors would ensure that minority shareholders would not be disadvantaged. In practice, all too frequently directors fail to stand up to dominant managers; it is uncomfortable to do so and success relies on marshalling disbursed and often apathetic shareholders against the manager's voting bloc. We hope that GVP will be an example of independent directors successfully protecting minority shareholder's interests, and that directors of other controlled trusts will take note.

Most of our interventions in private have been to remind directors of commitments that they have made but not kept, usually for reasons that are quite unconvincing. In future we would hope that corporate developments will be more positive and aimed at growing trusts. The motivation for boards to act is supported by the realisation that at least half of all trusts, by number, have lost their raison d'etre. The purpose of an investment trust is to provide an efficient vehicle for the savings of individuals and small institutional investors, often intermediated by wealth managers and IFAs. Sadly, changes in the regulatory regime and consolidation amongst wealth managers means that small illiquid trusts can no

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longer fulfil this role. The definition of a small trust is controversial, but a good case can be made for a threshold of around £500m for anything other than very specialised investment trusts. Pressure is at last starting to grow from investors. Brokers too are reluctant to take on trusts with no viability and no plan. That could prove to be a powerful influence.

With so many trusts that need restructuring, no doubt reform will take several different forms, including mergers, rollovers into larger trusts or open-ended funds and simple liquidation. We hope that many with liquid underlying portfolios will adopt the more constructive approach of transitioning to a Zero Discount Model ("ZDM"). Under this model, pioneered by Personal Assets Trust plc in the 1990's, the trust buys back or issues shares to ensure that the net asset value per share and share price do not meaningfully diverge. The great advantages of a ZDM is that, if properly implemented, it transforms the liquidity of investment trusts as well as removing discount risk. It does so whilst maintaining the advantages that investment trusts have over open-ended funds, namely independent boards and the power to gear modestly. Another key plus is that it allows even a small trust the chance to grow to a relevant size. Of course, if shareholders do not rate the manager, it can also shrink. However, if the starting position is an investment trust that shareholders no longer value then shrinking and ultimately restructuring is the best path forward.

History suggests that where the management is sound and the strategy meets the needs of investors, the potential reward for aligning the structure of a trust with shareholders' interests is much greater size. After all, a ZDM allied to NAV growth per share has seen Capital Gearing Trust grow, since 1982, from a market capitalisation of c. £0.5m to over £500m.

Peter Spiller

July 2020

Dollar Fund

June 2020

After the financial crisis, many commentators[1] predicted that the monetary innovations enacted by central banks, chief among them Quantitative Easing (QE), would lead to elevated inflation. Monetarism was the leading economic framework of the time and in that context Milton Friedman's famous maxim loomed large - "inflation is always and everywhere a monetary phenomenon in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output". Monetarism is a useful framework but, as is often the case in academia, what started as a tool became an intellectual hammer which found itself surrounded by a profusion of nails.

Inevitably the nature of inflation is rather more complex: David Hackett Fischer in his masterpiece on the subject[2] identified seven different narratives of inflation. Even within its own strictures monetarism, properly considered, can explain why expansion of the narrow money basis does not necessarily lead to inflation. The role of credit – and therefore the role of commercial banks – has become increasingly important in any description of broad money aggregates. More generally, velocity of money is not constant: if either banks are unwilling to lend or borrowers to borrow then expansion of the money base will not cause broad money growth nor the associated nominal GDP growth. This situation prevailed after the great financial crisis (GFC). Stuffed with soured loans, banks were reluctant to lend. Indeed they were precluded as capital and liquidity requirements were increased. On the demand side, consumers and corporates both sought to deleverage rapidly.

There are parallels today: it seems likely that the desired savings rate for corporates and consumers will rise in response to the shock of COVID-19. Of greater significance are the differences. After the GFC fiscal accommodation was quickly withdrawn, today there is no sign of that happening in any developed country. The banking system is certainly in much better condition today and the speed and scale of monetary accommodation is greater than post-GFC. It seems also that globalization, if not actually waning, has at a minimum reached its apogee. Some commentators have estimated increasing globalization has detracted 1% from global inflation rates over the past decade. If globalisation is going into reverse it will put upwards presure on goods prices.

Perhaps the greatest difference is also the most nebulous: psychology. The fear of inflation is entirely absent from policy makers, academia and the commentariat. Markets, at least as expressed through breakevens, have taken their cue and predict massive shortfalls to central bank inflation targets stretching out over the next 30 years. We take a contrary view, just as Minsky proposed that periods of calm encourage risky behavior resulting in bouts of extreme volatility, so the prolonged absence of elevated inflation encourages the kind of behaviour by governments and other actors which will ultimately give rise to elevated inflation. Fortunately, even if this analysis is wrong the cushion provided by low breakevens is enough to ensure that an investor in TIPS will do no worse than investing in nominals. If correct and inflation rises to, and exceeds target, we would expect real yields to fall further still, delivering further capital gains to owners of TIPS.

[1] CGAM included!

[2] The Great Wave, 1996, Oxford University Press.

CGAM

Dollar Fund

Fund Information as at:
30th June 2020

Fund price:
£179.45

Status:
Open

Investment objective

To achieve real returns through long only investment in Treasury Inflation Protected Securities (US government index linked bonds).

Fund information

Fund size	£852m
Class size	£288m
Dividend Yield	< 2%
Management fee	0.25%
Total Expense Ratio	0.34%

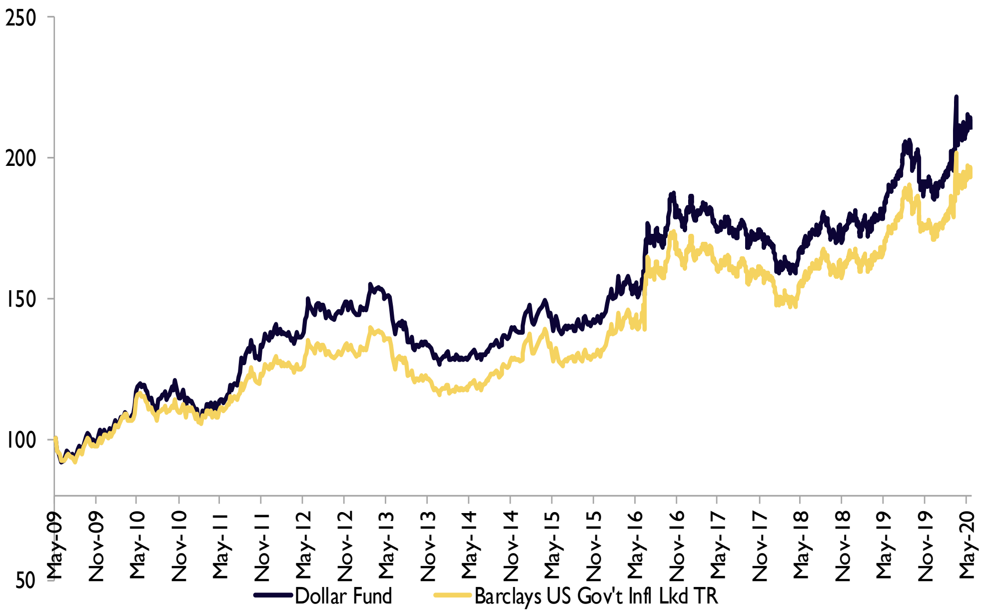
Return history (total returns)

1 month	1.2%	2019	4.9%
3 month	4.4%	2018	4.9%
6 month	14.6%	2017	-6.3%
Year to date	14.6%	2016	24.2%
1 year	12.3%	2015	5.6%

Largest holdings

US I/L 0.75% 15/02/45	5.6%
US I/L 1.00% 15/02/46	5.3%
US I/L 1.375% 15/02/44	4.8%
US I/L 0.625% 15/04/21	3.7%
US I/L 0.625% 15/07/21	3.6%

Performance since inception (total return)



Credit ratings

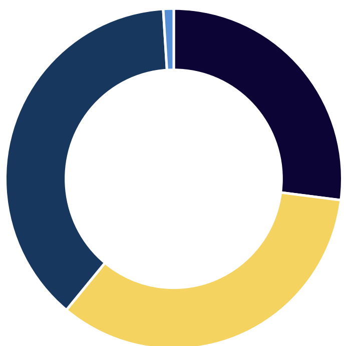
AAA	100%
AA	0%
A	0%
BBB	0%
BB and below	0%

Characteristics

Number of bonds	39
Yield to maturity (real)	-0.6%
Average Maturity	11.0 Yrs
Average coupon (real)	1.0%
Composite rating	AAA

Maturity analysis

10 + Yrs	34%
5 - 10 Yrs	26%
0 - 5 Yrs	38%
Cash	2%



Duration history

30 June 20	9.9
30 Sep 19	8.9
30 Sep 18	7.4
30 Sep 17	6.8
30 Sep 16	5.9
30 Sep 15	5.4

Dollar Fund (GBP Hedged)

Fund Information as at:	Fund price:	Status:
30th June 2020	£103.81	Open

Investment objective

To achieve real returns through long only investment in Treasury Inflation Protected Securities (US government index linked bonds). All US dollar currency exposure is hedged back to Pound Sterling.

Fund information

Fund size	£852m
Hedged class size	£564m
Dividend Yield	< 2%
Management fee	0.25%
Total Expense Ratio	0.34%

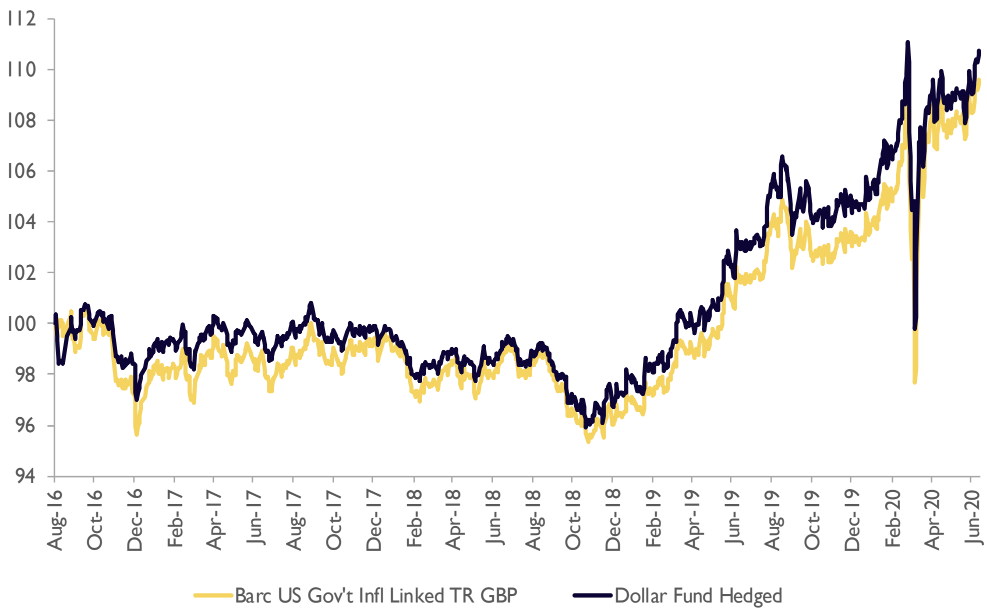
Return history (total returns)

1 month	1.2%	2019	7.4%
3 month	4.0%	2018	-2.6%
6 month	5.6%	2017	1.4%
Year to date	5.6%	2016	-1.5%
1 year	7.1%	2015	n/a

Largest holdings

US I/L 0.75% 15/02/45	5.6%
US I/L 1.00% 15/02/46	5.3%
US I/L 1.375% 15/02/44	4.8%
US I/L 0.625% 15/04/21	3.7%
US I/L 0.625% 15/07/21	3.6%

Performance since inception (total return)



Credit ratings

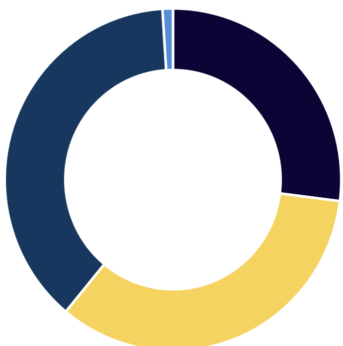
AAA	100%
AA	0%
A	0%
BBB	0%
BB and below	0%

Characteristics

Number of bonds	39
Yield to maturity (real)	-0.6%
Average Maturity	11.0 Yrs
Average coupon (real)	1.0%
Composite rating	AAA

Maturity analysis

10 + Yrs	34%
5 - 10 Yrs	26%
0 - 5 Yrs	38%
Cash	2%



Duration history

30 June 20	9.9
30 Sep 19	8.9
30 Sep 18	7.4
30 Sep 17	6.8
30 Sep 16	5.9
30 Sep 15	5.4

Real Return Fund

June 2020

As measured against a basket of major world currencies the dollar has depreciated 7% since its 20th March peak. The date of the peak and its subsequent depreciation is no co-incidence. In its most significant intervention of the crisis, on the 19th March the Federal Reserve extended swap lines to 14 foreign central banks essentially supplying unlimited dollar financing globally. The acute scramble for dollar financing, that caused a 7% appreciation in the eight days up to the 20th March, has now reversed over the last 4 months.

Amongst currency traders, where analysis normally extends to “the trend is your friend” it is now consensual that dollar weakness will continue. There are solid arguments supporting this view, most notably that US interest rates have reduced significantly relative to other developed markets in 2020. It is also argued that the Fed’s increasing interventionism caps dollar appreciation; given an unlimited supply of dollars from the Fed in every crisis there must be other more attractive safe haven options out there.

These arguments hold some weight but would be more powerful to us if it were clearer which other currencies were likely to structurally appreciate. The dollar holds a central role in the global trade and financial architecture. In 2019, 90% of all currency trades had the dollar on one side. Within global currency reserve holdings the dollar makes up 60%, the euro 20% and the yen 6% (with 14% made up of a basket of lesser currencies including GBP, CNH, CAD, CHF, SEK, AUD). Global intervention by the Fed may cap the dollar’s upside, but it also reinforces the Fed as the world’s central bank and the dollar as its reserve and trading currency. During the COVID crisis other central banks were relegated to satellite distribution hubs, administering the Fed’s dollar swap programme.

In theory the euro should be the strongest candidate for appreciation. For a decade the eurozone has run vast positive trade and current account balances. Northern European manufacturers remain very competitive at prevailing exchange rates, underpinning a vast export machine. However the euro faces existential challenges due to its ramshackle institutional underpinnings. At the same time the Fed was supporting the global economy by supplying dollars, the ECB’s modest historic QE programme was being ruled illegal by the German constitutional court. As COVID 19 struck at the heart of the vulnerable Italian economy, EU politicians struggled to agree even modest fiscal transfers within the bloc. The history of currencies that are not backed by a coherent sovereign state make us wary of assuming structural appreciation of the euro.

Japan meets all the criteria of a coherent sovereign state, making the yen another obvious candidate. Since the mid 80’s Japan has run trade surpluses, which would be a supportive factor had the balance not recently tipped into a trade deficit. That said, having amassed huge overseas asset holdings, Japan will run a current account surplus for the foreseeable future. It is Japan’s fiscal situation that looks terrifying. It has the highest gross debt to GDP ratio in the world (> 250%) and it continues to run huge deficits with no credible plan to control spending. The stabilising factors are the huge pool of domestic savers willing to fund the government and an interventionist central bank. Real yields in Japan are now higher than those in the US. So whilst the yen may not look like an appealing currency in conventional terms, it does hold some relative attractions at this time. This fund has been increasing its exposure to the yen from a very low base. Other recent additions have been small increases in the Swedish krona and the Australian Dollar. That said, absent an extreme appreciation, it is hard to see the dollar being displaced from its anchoring position in this fund, much as it is difficult to see the dollar being displace from its dominant position in the global economic and financial system.

CG AM

Real Return Fund

Fund Information as at:

30th June 2020

Fund price:

£216.95

Status:

Open

Investment objective

To achieve real returns through long only investment into a global portfolio of government index linked bonds outside the United Kingdom.

Fund information

Fund size	£495m
Dividend Yield	< 3%
Management fee	0.30%
Total Expense Ratio	0.39%

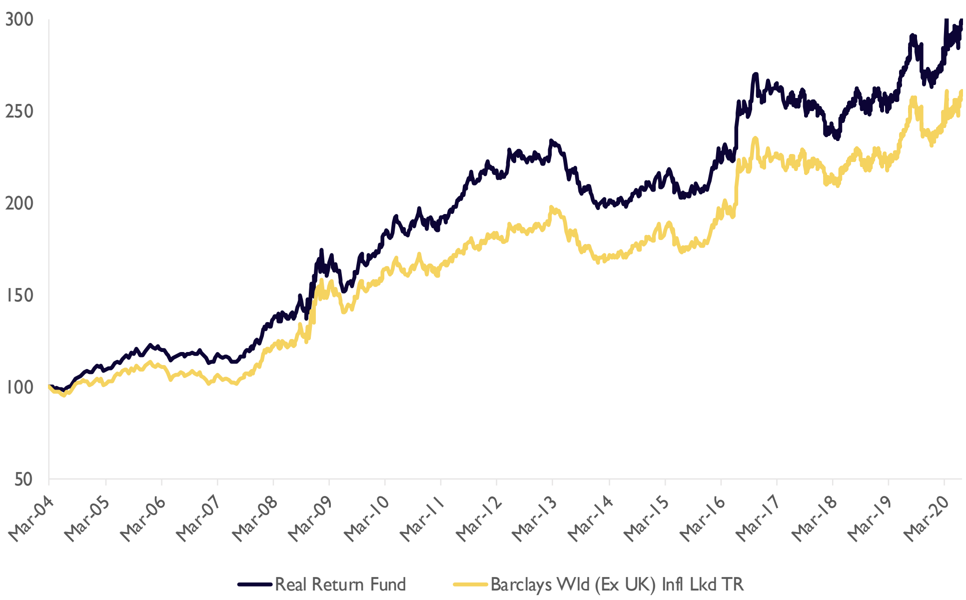
Return history (total returns)

1 month	1.4%	2019	2.6%
3 month	4.9%	2018	3.6%
6 month	12.3%	2017	-4.4%
Year to date	12.3%	2016	22.9%
1 year	9.1%	2015	2.5%

Largest holdings

US I/L 2.00% 15/01/26	7.6%
US I/L 2.375% 15/01/27	5.0%
US I/L 2.375% 15/01/25	4.5%
German I/L 0.1% 15/04/23	4.4%
US I/L 1.75% 15/01/28	3.3%

Performance since inception (total return)



Credit ratings

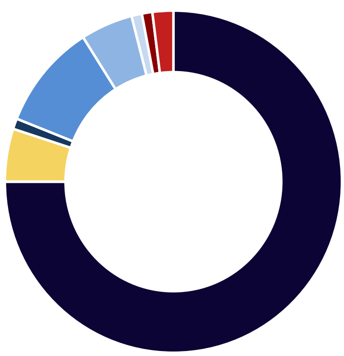
AAA	100%
AA	0%
A	0%
BBB	0%
BB and below	0%

Characteristics

Number of bonds	54
Yield to maturity (real)	-0.7%
Av Maturity	9.0 Yrs
Average coupon (real)	1.4
Composite rating	AAA

Asset allocation

USA	74%
Sweden	5%
Germany	10%
Canada	4%
Denmark	1%
Japan	2%
Australia	2%
Cash	2%



Duration history

30 June 20	8.4
30 Sept 19	7.6
30 Sep 18	6.4
30 Sep 17	6.2
30 Sep 16	5.6
30 Sep 15	5.4

Absolute Return Fund

June 2020

Equity holdings make up just under 40% of the portfolio and are made up of listed collective vehicles. These collective vehicles include investment trusts, investment holding companies, ETFs and property companies. When reporting on these equities we look through the collective structures and focus on the underlying assets, which are made up of 45% conventional equities, 40% property and 15% alternative investments (largely infrastructure funds and loan funds). Given this spread of assets with diffuse characteristics we refer to our equity holdings as risk assets.

The makeup of our risk assets changes continually in response to value opportunities, although typically these changes are modest in the short term and profound in the long term. At the start of the year our risk asset holdings were just over 30% of the portfolio, and concentrated in defensive "low beta" areas to protect downside risk. In a crisis correlations go to one, and these low beta holdings in infrastructure and alternative property fell as calamitously as the broader equity markets in mid March. Fortunately many have recovered and are now trading near historic highs but it was a stark reminder that even defensive equities are very volatile in a crisis.

In terms of geographic exposure, our equity portfolio looks very different to any mainstream index. If we analyse all of our risk assets together and compare them to the MSCI Global index it looks as follows ~

	MSCI Global	CGAM Risk Assets
US	55%	8%
Europe ex UK	15%	20%
Emerging Markets	14%	7%
Japan	9%	9%
UK	7%	56%

Our very substantial UK overweight is because a majority of our property and alternative equites are UK assets. We also have substantial Europe (ex UK) property holdings. As regards conventional equities we have a broad geographic spread but an overweight to the "value markets" most notably UK and Japan. Our major underweight has been US equities. Like many value investors we have stayed away from America on the basis of high valuations. This has proved extremely unfortunate over the last 5 years as US equities have roared ahead to stratospheric heights leaving all other markets in its dust. We are cynical of any claim that "this time it's different" and are not intending to jump onto the growth / US equity momentum trade. We anticipate value will have its day in the sun, eventually.

Given the difficulties in comparing our risk assets to any mainstream index, we have historically measured them against the investment trust index. Historically the investment trust index has been a strong performer, outperforming UK equity markets over all meaningful periods. CGAM's risk asset portfolio has in turn outperformed the investment trust index over all meaningful periods. Less happily, over the last 5 years, we have largely sat on the side-lines of one of the great US equity bull markets of all time. Fortunately the value investment themes we have pursued have performed well and allowed us to keep up with the global equity market even with a substantial underweight to the US.

If, and we are tempted to say when, value markets have a stronger relative run we would hope to put some clear blue water between our risk asset performance and the global equity index. In the meantime we hope that our particular style of value investing will allow our risk assets to outperform the investment trust index and stay in touch with the US dominated global equity index.

CG Absolute Return Fund

Fund Information as at:	Fund price:	Status:
30th June 2020	£127.94	Open

Investment objective

To achieve absolute returns through asset allocation across equities, bonds and commodities. In most cases bond investments are made directly and equity investments via collective funds such as ETFs and listed closed ended funds.

Fund information

Fund size	£413m
Dividend Yield	< 1.5%
Management fee	0.35%
Total Expense ratio	0.44%
Comparator Index	3m Libor

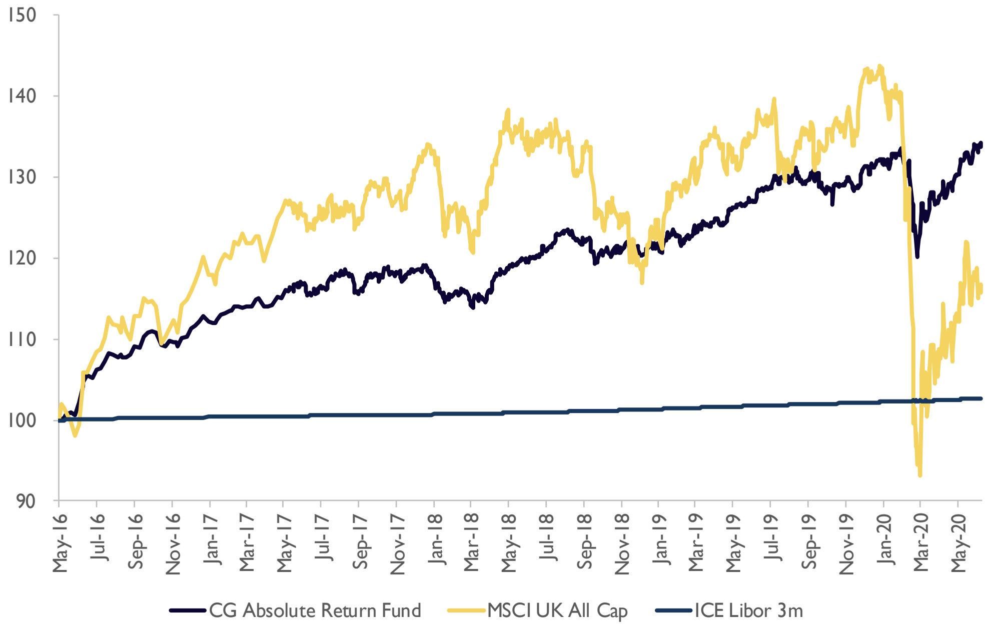
Return history (total returns)

1 month	1.2%	2019	8.2%
3 month	6.3%	2018	1.5%
6 month	2.6%	2017	6.3%
Year to date	2.6%	2016	n/a
1 year	5.3%	2015	n/a

Largest fund/equity holdings

Vanguard FTSE Japan ETF	4.2%
Ishares FTSE 100 ETF	3.3%
Vanguard FTSE 100 ETF	3.0%
Vonovia	2.2%
Wisdontree Physical Gold ETF	2.1%

Performance since inception (total return)



Largest bond holdings

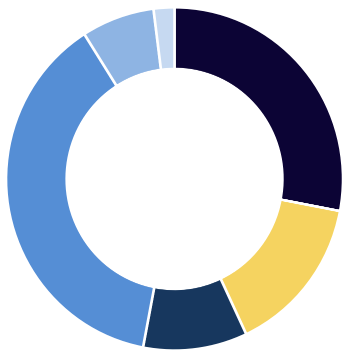
UK I/L 0.125% 22/03/24	2.6%
US I/L 1.375% 15/02/44	1.8%
US I/L 0.75% 15/02/45	1.6%
UK I/L 0.00% 10/08/20	1.5%
UK I/L 0.00% 05/10/20	1.2%

Currency exposure

GBP	55%
USD	27%
SEK	4%
EUR	6%
JPY	6%
Other	2%

Asset allocation

Index Linked Gov't Bonds	28%
Conventional Gov't Bonds	15%
Pref Shares / Corp Debt	10%
Funds / Equities	38%
Cash	7%
Gold	2%



Fund/equity breakdown

Equities	19%
Property	15%
Loans	3%
Infrastructure	1%

Capital Gearing Portfolio Fund

June 2020

The fund returned 5.9% in the quarter, underpinned by a strong equity market rebound from its March nadir. The year to date returns have been 1.4%. A feature of the investment trust market in recent years has been the absence of discounts opportunities in those trusts holding conventional equities. Mindful that discounts are a double edged sword, and confronted with such poor opportunities, your fund has preferred to avoid taking discount risk and instead has used ETFs to acquire equity exposure. In the last quarter, since the financial turmoil of March, that situation has changed and a number of interesting discount opportunities have emerged. Attempting to exploit such opportunities has been a mainstay of the fund over its near 20 year history and so it is pleasing to see them return.

Over the quarter the fund was active in around a dozen conventional equity trusts, mostly purchasing new positions with a small number of sales where situations matured unusually quickly. Typically each individual opportunity is relatively modest in size but in aggregate they are meaningful. In order to purchase these holdings, without increasing equity expose too significantly the fund sold ETFs holdings. In doing so the fund has rotated capital from broad market exposure to individual situations with real prospects of outperforming over the coming years. The exposure to conventional equities is at 18% of the portfolio.

Another theme of note has been continuing purchases of property companies adding around 3% in the period and bringing the total exposure to just under 16%. The fund holds essentially no retail property and very little office property preferring instead specialist property companies with some combination of long leases, good inflation linkage to rents or structurally undersupplied residential properties. The rationale for these purchases are that the risk premia associated with property are at record levels and, despite their relatively defensive characteristics, many property companies trade at substantial discounts. Those property opportunities we have been adding to remain close to their March lows, unlike the broader equity market that enjoyed a strong rebound this quarter.

During the last quarter the fund sold a large portion of its holding in short US TIPS, when sterling fell below 1.18 to the dollar. During this quarter much of the proceeds of those sales has been invested into Japanese, Australian and Swedish index linked bonds. The rational for this diversification is discussed in more detail in the Real Return fund report. In summary after a strong period of outperformance, there is a case to move away from our very concentrated exposure to US TIPS. TIPS continue to play a central role in our portfolio construction but there is now a case for a broader inflation linked bond exposure. For similar reasons the holding of gold has been increased from a token 1% to a still token 2%!

A final theme of the quarter has been the ongoing purchase of corporate credit and zero dividend preference shares on attractive risk adjusted terms. This category now makes up 17% of the portfolio. In our assessment there are very few areas of the capital markets offering low risk positive real returns. The credit and preference share purchases we have made fulfil these criteria, indeed a number hold out the prospect of equity type returns with significantly lower risk than equity exposure. These opportunities are concentrated in smaller issues, so investors are exposed to patchy liquidity. However for a patient investor happy to hold to maturity and to manage liquidity in a disciplined way across a portfolio, these are rewarding additions.

Capital Gearing Portfolio Fund

Fund Information as at:

30th June 2020

Share prices:

P shares £34,537
V shares £167.96

Status:

Hard Closed

Investment objective

To achieve absolute returns through asset allocation across equities, bonds and commodities. Equity investments are made in quoted closed ended trusts and other collective investment vehicles.

Fund information

Fund size	£439m
Dividend Yield	< 1%
Management fee	0.90%
Total Expense Ratio	0.99%
Comparator Index	3m Libor

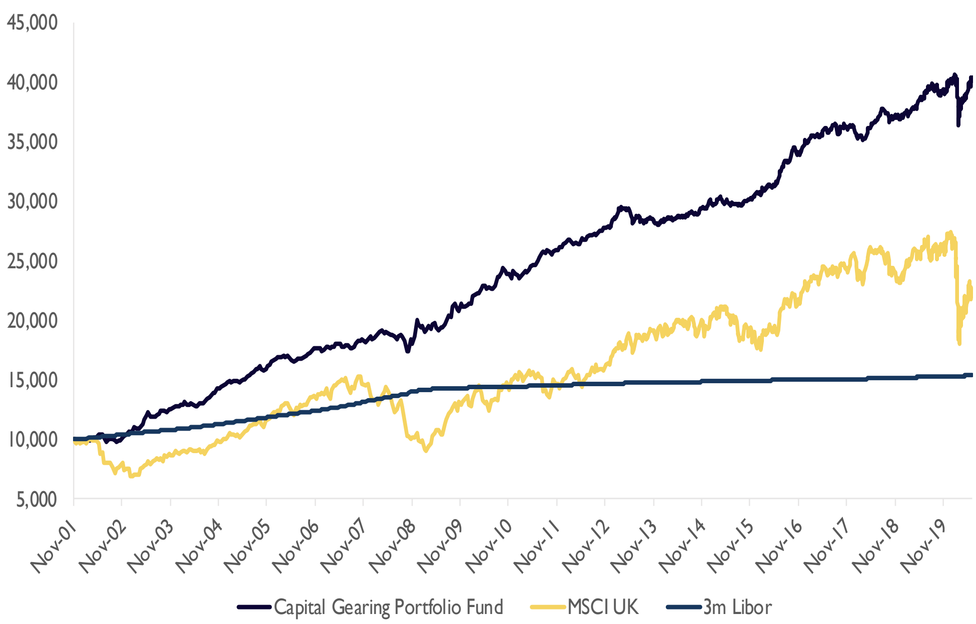
Return history

1 month	1.1%	2019	7.7%
3 month	5.9%	2018	1.5%
6 month	1.4%	2017	4.9%
Year to date	1.4%	2016	13.3%
1 year	4.1%	2015	4.0%

Largest fund/equity holdings

North Atlantic Smaller Co	3.7%
Vanguard FTSE Japan ETF	3.3%
Vonovia	2.3%
Wisdomtree Physical Gold ETF	2.1%
Pershing Square Holdings	1.9%

Performance since inception (total return, P Shares)



Largest bond holdings

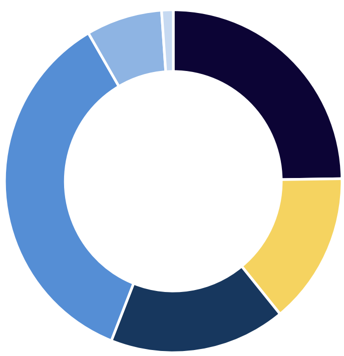
UK I/L 0.125% 22/03/24	3.0%
US I/L 2.375% 15/01/27	2.1%
UK I/L 1.75% 15/01/28	1.9%
US I/L 2.00% 15/01/26	1.7%
US I/L 1.375% 15/02/44	1.7%

Currency exposure

GBP	56%
USD	27%
SEK	4%
EUR	5%
JPY	6%
Other	2%

Asset allocation

Index Linked Gov't Bonds	28%
Conventional Gov't Bonds	10%
Pref Shares / Corp Debt	17%
Funds / Equities	38%
Cash	5%
Gold	2%



Fund/equity breakdown

Equities	18%
Property	16%
Loans	6%
Infrastructure	1%
Private Equity/Hedge Fund	1%

Thoughtful Investing

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