First Quarter Report

March 2020

Real Return Fund

Dollar Fund

Capital Gearing Portfolio Fund

Absolute Return Fund

CG Asset Management

General Commentary

March 2020

The FT's Martin Wolf contributes to and reflects consensus thinking on the correct fiscal and monetary response to the COVID-19 crisis. "The focus must be on today, not on the high public debt and other burdens of the future. [Taking no thought for the morrow...] sufficient unto the day is the evil thereof". Hence "abandon outworn shibboleths" against Modern Monetary Theory (MMT), unlimited fiscal deficits, helicopter money, and monetary finance.

Investors, though, do have to think about "the morrow". Where will we be once the virus has been defeated? That partly depends on the duration of restrictions and the shape of the recovery. It is clear that some pre-existing trends have been accelerated. British Land believes that online retailers will double their market share to 40%; some estimate that 30% of now closed shops and restaurants will never re-open. On the other hand, the evidence from China is that manufacturing can snap back quickly.

Travel may be constrained for much longer and is at risk from border controls; tough on tourist-dependent countries in Southern Europe. But it will recover with time. Deeper structural changes are more important. Globalization, already under pressure from trade wars, will roll back as its weaknesses emerge. The model of just-in-time, single sourced but complex international supply chains may be replaced by more emphasis on higher inventories with a greater number of, and more local, suppliers. That would reverse a potent source of deflation over the last 30 years.

Most important of all, attitudes towards debt might finally change. In both the 1920's and in recent decades, debt was allowed to rise to unsustainable levels. However, the policy response to the debt induced recessions of 1929 and 2009 was quite different. In 1929 tightening monetary policy helped to create a deflationary depression. In 2009, emergency policy easing staved off a depression, but created the environment for an explosion of corporate debt. It seems unlikely that such a model can be the source of growth over the next 10 years.

With desired personal savings rates also likely to rise after the Coronavirus trauma, the deficit in demand can be made up only by governments. Monetary finance will be a sustained feature. Under MMT that would not be an issue so long as inflation is not at problematic levels. The definition of what constitutes problematic levels is rising all the time, as a matter of consensus in academic, political, media and central banking circles. Even before the crisis, concepts such as “catch up“ and “running the economy hot“ were prevalent. Current targets will not be a meaningful guide.

The extent of policy support this year has been astonishing. The U.S. Committee for a Responsible Budget (CFRB) estimates that the fiscal deficit will quadruple to 18.7% of GDP. In 2021 it is likely unemployment will still be elevated and Trump’s ambition for a substantial infrastructure programme still in place, suggesting a second year of double digit deficits. Central bankers have already spent over $5 trillion on public and private assets and are a long way from finished. Indeed the U.S. Treasury backstopping the credit risk in corporate and junk bonds blurs the distinction between monetary and fiscal policy. Both are now driven by the White House; that alone settles the issue as to whether deflation or inflation finally prevails.

In the short term, of course, a dramatic fall in GDP is powerfully deflationary. Wages that were rising nicely will decelerate and the price of energy, hotels, restaurants, clothes etc. will be weak. In the absence of the fiscal and monetary offset, a deflationary depression would have ensued. With the dramatic policy support, overall activity might with luck return to 2019 levels by 2022. But austerity will not follow; there is no political appetite for it and the debt burdens of governments and companies would be insupportable without powerfully growing nominal GDP. Inflation will permit prolonged financial repression to bring balance sheets back into equilibrium. Lower purchasing power for investors and consumers will be the "evil" that "the morrow" brings.

Peter Spiller

April 2020

Dollar Fund

March 2020

When Genius Failed, is Roger Lowenstein's fast paced account of the collapse of the hedge fund, Long-Term Capital Management ("LTCM") during the Asian Financial crisis of 1998. LTCM pursued a range of strategies including "relative value" trades which sought to exploit tiny price differences between cash securities and derivative contracts. For example in normal times there is a small positive return gap between the yields on holdings of Treasury securities and the corresponding interest rate futures.

In relative value trades investors typically use very high levels of leverage. For example, if an investor can borrow $99 by pledging $100 worth of Treasury securities, only $1 of upfront capital is required to secure a $100 Treasury position. The investor can then sell futures against these Treasury securities and pocket the tiny interest rate difference. The investor's return on capital is magnified 100x by the leverage, delivering a steady income stream against the $1 of upfront capital. Nassim Taleb described these types of trade as "picking up pennies in front of a steamroller" and John Kay as "tailgating strategies".

When Genius Failed describes in vivid detail what happens when times cease to be normal. In their worst month in 1998 LTCM lost $1.4bn, an amount that seemed unimaginably large at the time. According to the Bank of International Settlements, leveraged Treasury futures positions grew from c.$50bn in 2016 to c.$650bn in mid 2019, an example of the explosion of risk that has occurred due to extraordinarily low interest rates. Recent activity makes LTCM seem rather insignificant in scale.

The rapid unwinding of highly leveraged holdings caused one of the most severe bouts of volatility ever seen in the Treasury market. Initially in early March investor de-risking saw Treasury prices rise, however from the 9th March prices fell sharply as a wave of forced selling took hold. The trigger was that prices in the interest rate futures markets were rising even faster than prices in the cash Treasury market, imposing short term mark-to-market losses on relative value investors. Even though these loses were temporary, the extraordinary amount of leverage employed meant $100 of Treasuries needed to be sold because the $1 of upfront capital had been lost on a mark-to-market basis. The elevated volatility meant dealers withdrew from the market at exactly the time that liquidity was most needed. It took huge intervention by the Federal Reserve, including the purchase of $670bn of Treasury Securities directly from dealer's clogged inventories, to stabalise the market.

Dealing costs were high during the turbulence, but the relatively small size of this fund allowed us to manage fund flows and other dealing requirements without material obstacle. Despite this it was a sobering period.

At their lowest the breakeven on 10 year TIPS fell to lows of 0.6%. The collapse in energy prices and the current huge recession has weighed on short term inflation prospects. However, the low breakeven was not just an expression of depressed inflation expectations, it also reflected liquidity preference. The TIPS market is smaller and less liquid than the conventional Treasury market. Certain investors, including foreign central banks and sovereign wealth funds, pay a premium (and accept lower returns) to hold more liquid nominal bonds. 10 year breakevens have now recovered to 1.2%. In our opinion, they remain very good value due to the elevated illiquidity premium. Looking further out the short term impact of this recession may be deflationary, however the unprecedented policy response may prove to be inflationary. With breakevens at these depressed levels the cost of protection against the inflationary risk is unusually low.

Dollar Fund

Fund Information as at:
31st Mar 2020

Fund price:
£171.91

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	£713m
Class size	£267m
Dividend Yield	< 2%
Management fee	0.25%
Total Expense Ratio	0.34%

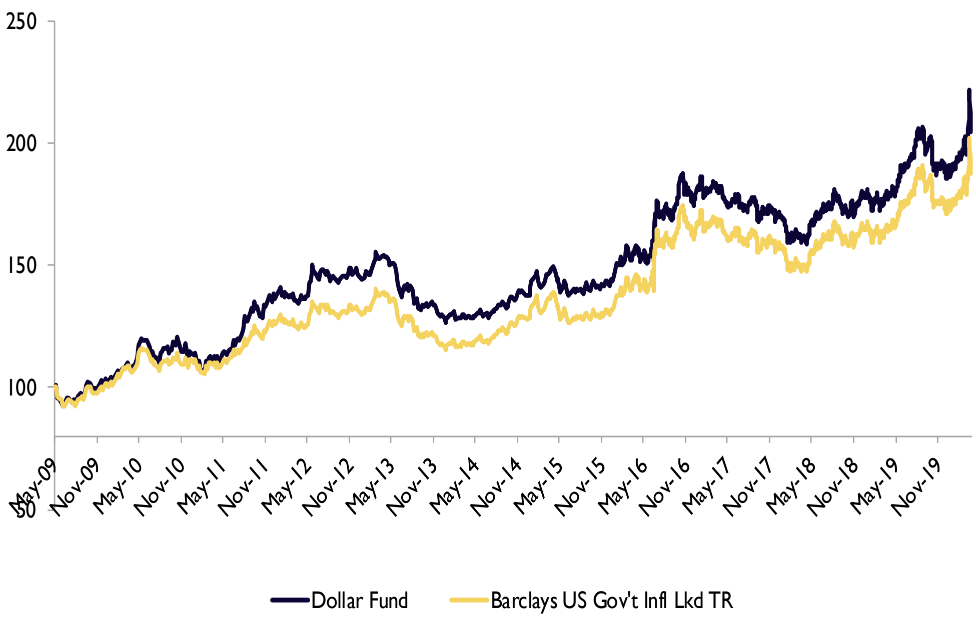
Return history (total returns)

1 month	1.6%	2019	4.9%
3 month	9.7%	2018	4.9%
6 month	2.6%	2017	-6.3%
Year to date	9.8%	2016	24.2%
1 year	13.7%	2015	5.6%

Largest holdings

US I/L 0.125% 15/01/22	5.1%
US I/L 0.75% 15/02/45	4.9%
US I/L 0.625% 15/07/21	4.5%
US I/L 0.125% 15/04/22	4.4%
US I/L 1.375% 15/02/44	4.4%

Performance since inception (total return)



Credit ratings

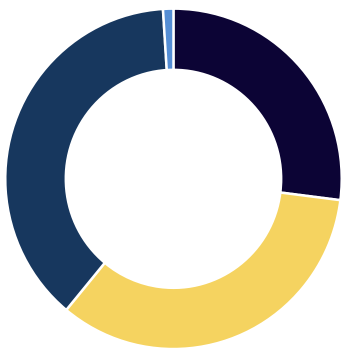
AAA	100%
AA	0%
A	0%
BBB	0%
BB and below	0%

Characteristics

Number of bonds	36
Yield to maturity (real)	0.3%
Av Maturity	9.1 Yrs
Average coupon (real)	1.1%
Composite rating	AAA

Maturity analysis

10 + Yrs	25%
5 - 10 Yrs	29%
0 - 5 Yrs	44%
Cash	2%



Duration history

31 Mar 20	8.3
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

CGAM

Dollar Fund (GBP Hedged)

Fund Information as at:

31st Mar 2020

Fund price:

£99.84

Status:

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	£713m
Hedged class size	£446m
Dividend Yield	< 2%
Management fee	0.25%
Total Expense Ratio	0.34%

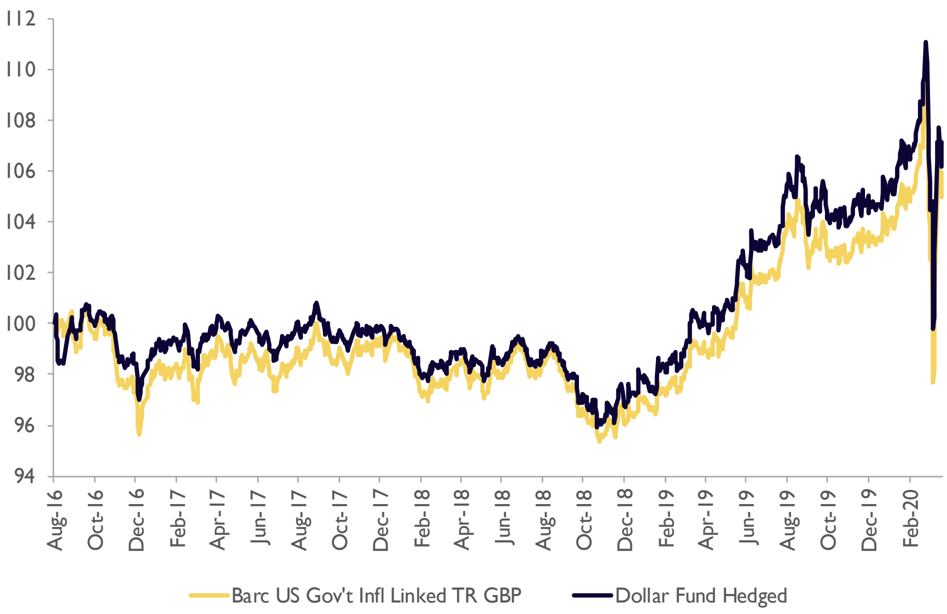
Return history (total returns)

1 month	-2.4%	2019	7.4%
3 month	1.6%	2018	-2.6%
6 month	1.7%	2017	1.4%
Year to date	1.6%	2016	-1.5%
1 year	5.75%	2015	n/a

Largest holdings

US I/L 0.125% 15/01/22	5.1%
US I/L 0.75% 15/02/45	4.9%
US I/L 0.625% 15/07/21	4.5%
US I/L 0.125% 15/04/22	4.4%
US I/L 1.375% 15/02/44	4.4%

Performance since inception (total return)



Credit ratings

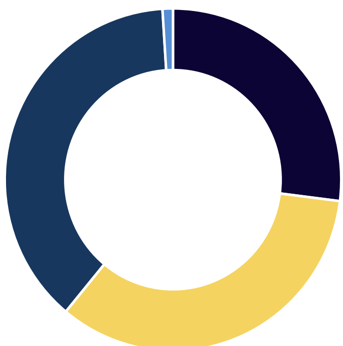
AAA	100%
AA	0%
A	0%
BBB	0%
BB and below	0%

Characteristics

Number of bonds	36
Yield to maturity (real)	0.3%
Av Maturity	9.1 Yrs
Average coupon (real)	1.1%
Composite rating	AAA

Maturity analysis

10 + Yrs	25%
5 - 10 Yrs	29%
0 - 5 Yrs	44%
Cash	2%



Duration history

31 Mar 20	8.3
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

March 2020

In early April, as Eurozone leaders failed to agree a concerted response to the Covid-19 crisis, Mario Draghi's house caught fire. The symbolism of the event is so potent it is hard to believe it actually happened. The Umbrian fire service were called out to douse the flames and fortunately no one was hurt.

Mario Draghi, the former president of the European Central Bank ("ECB"), is widely credited with saving the Euro in 2012 with a speech in London including the remarks "the ECB is ready to do whatever it takes to preserve the euro and believe me, it will be enough". The market took those confident words at face value and the crisis subsided as peripheral bond prices rose sharply, with investors seeking to front run an assumed wave of ECB bond buying. What the audience listening to the speech did not know was that Draghi did not have the approval of his own team in Frankfurt to make those remarks, nor did the ECB have the license to act in the way he implied.

Outright Monetary Transactions ("OMT") the policy manifestation of "whatever it takes" unveiled in September 2012, contained so much conditionality that is has never been used in practice. The assistance provided by OMT requires the distressed borrower to submit to politically humiliating terms which transfer significant powers from domestic democratic institutions to technocratic EU bodies. Tellingly, even though the programme was a paper tiger the President of the Bundesbank voted against its adoption, raising concerns of back door debt mutualisation and monetary financing of government expenditure. With hindsight Draghi's charismatic intervention did no more than kick the can down the road until the next recession, which fortunately for him occurred with a new ECB president in position.

In September 2019 at the European parliament hearing for Christine Lagarde's appointment as ECB president, she was asked whether she would do "whatever it takes" to save the euro. Her response - "I hope I never have to say something like that… if I had to it would mean that other economic policy-makers are not doing what they have to". Six months later she announced a €750bn bond buying programme in the face of the largest recession since the 1930's with the familiar sounding phrase, "there are no limits to our commitment to the euro". The second time around it does not have quite the same power. In the eyes of the economics establishment eurozone political actors are failing to do what is needed and the ECB response is inadequate to solve the crisis.

The scale of the economic, political and financial challenge to the euro, unleashed by the Covid-19 crisis, is hard to overestimate. It is possible that in the white heat of a crisis a new eurozone unity will be forged, in the form of Corona-bond issuance (debt jointly guaranteed by all eurozone countries) and a eurozone wide banking deposit scheme backstopped by the German taxpayer. However, the political discussions to date suggest this outcome is far from certain. At the other end of the spectrum a disorderly breakup of the euro, whether due to short term financial pressures or the longer-term political rejection of the EU by Italian voters, remains an openly discussed and plausible scenario.

The most significant decision taken in managing the Real Return fund, has been the total exclusion of weak eurozone credits including Spain, Italy and since 2012, France. During risk on periods that has looked like a poor decision, however in risk off periods like this quarter it has been helpful. The key portfolio overweight's to the US and Germany were both advantageous as investors focused on safe haven jurisdictions. Changes to the asset allocation in the period have been modest, however small sales of US TIPS were made and corresponding purchases in Japan, Australia and Germany.

Real Return Fund

Fund Information as at:

31st Mar 2020

Fund price:

£206.91

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	£452m
Dividend Yield	< 3%
Management fee	0.30%
Total Expense Ratio	0.39%

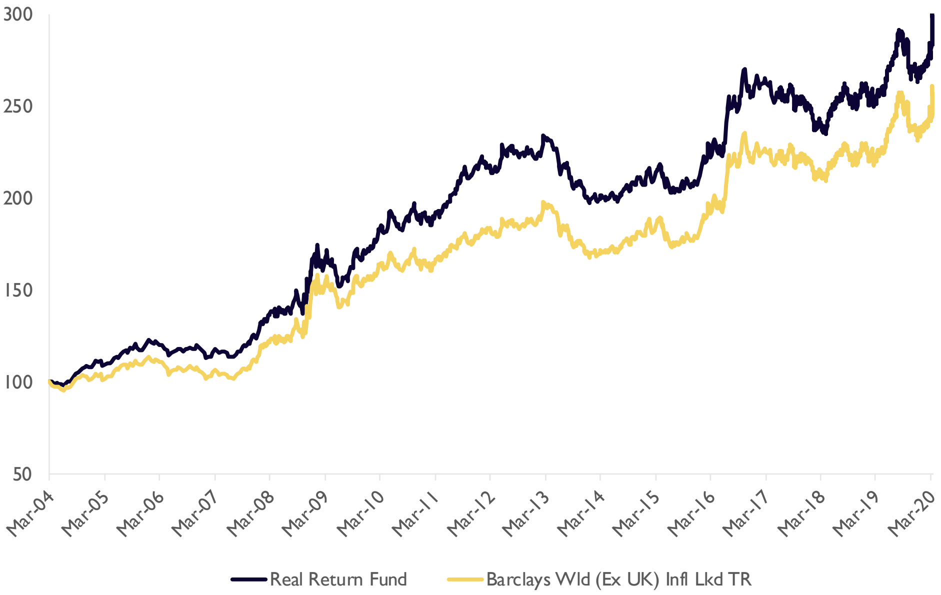
Return history (total returns)

1 month	0.7%	2019	2.6%
3 month	7.1%	2018	3.6%
6 month	0.7%	2017	-4.4%
Year to date	7.1%	2016	22.9%
1 year	9.7%	2015	2.5%

Largest holdings

US I/L 2.00% 15/01/26	8.5%
US I/L 0.125% 15/01/23	5.4%
US I/L 2.375% 15/01/27	5.3%
US I/L 2.375% 15/01/25	4.7%
German I/L 0.1% 15/04/23	4.6%

Performance since inception (total return)



Credit ratings

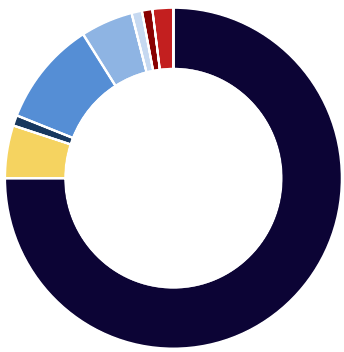
AAA	100%
AA	0%
A	0%
BBB	0%
BB and below	0%

Characteristics

Number of bonds	47
Yield to maturity (real)	-0.1%
Av Maturity	7.6 Yrs
Average coupon (real)	1.5
Composite rating	AAA

Asset allocation

USA	74%
Sweden	5%
Germany	12%
Canada	4%
Denmark	1%
Japan	1%
Australia	1%
Cash	2%



Duration history

31 Mar 20	7.6
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

March 2020

After a tumultuous quarter it is wise to pause, take step back from headlines and market gyrations, and think about fundamentals. At the time of writing the S&P 500 is at 2,750 a level it was at in May 2019. We thought it expensive then, corresponding to a CAPE ratio at the time of 29x. Since then its fundamental value has fallen, though since equities are long duration assets, the change is probably less than is intuitive. Earnings will likely be significantly lower this year compared with 2019 and not likely recover to those levels before 2022 at the earliest, but these lost earnings are a relatively small portion of the index's net present value.

Beyond short term earnings, what is there to consider? Corporate balance sheets will be weaker as firms take on debt to fund short term losses caused by Corona Virus (CV) shutdowns. This does two things. First, it mechanically makes equities less valuable as the greater debt is subtracted from the enterprise value. Second, it makes equities riskier; they are less able to weather shocks. Rationally we should expect boards and corporate treasurers to reduce expenditures to try to reduce debts l to pre-CV levels. It seems likely that the spending axe will fall on two areas: primarily to share buy-backs and, to a lesser extent, to capital expenditure. Buy-backs have been for many years the single largest source of demand for share purchases, so this is less supportive for equity prices. Capital expenditure is a factor in future earnings growth. In addition financial conditions have tightened, though this is somewhat ameliorated by rock bottom interest rates. To summarise, the future outlook for equities has deteriorated in both the short and longer term, valuations remain at levels that are high by historic standards and risks are elevated.

Complicating this picture are the actions of the Federal Reserve. The Fed balance sheet has expanded at an astonishing rate from $4.2 tn to $6.1 tn in 6 weeks. It could rise much further. During WWII the Fed's balance sheet grew from c. 35% of GDP to c. 115% of GDP over 4 years. US GDP is around $20 tn, applying the same constraint it could grow 3.8x from here. In addition the Fed has dramatically expanded the types of securities that it will purchase, extending its remit to corporate bonds, junk bond ETFs and certain state and municipal securities.

We find ourselves in a situation where the Fed has indicated an unlimited appetite to purchase US treasuries. It will therefore control the price of money, both short and long term. In addition through its intervention in the corporate bond market it has also become responsible for setting the corporate cost of capital. For the time being the cost of equity remains in private hands but this will not be unaffected as investors are crowded out of other asset classes through the Fed's actions. The Fed is following a well-trodden path: enacting financial repression. This will be required to reduce the high existing debts and those incurred from the fight against the Corona Virus, just as the debts arising from WWII were. Against this backdrop an allocation to a portfolio of index-linked bonds remains essential.

Investors have learned well the lesson over recent decades "not to fight the Fed" and they may be right to do the same again here and buy equities. Their calculus is that, poor though the prospective returns of equities may be, the equity risk premium is sufficiently high to truly make equities "the only game in town". Our investment approach has been, and remains, not to be reliant on the kindness of strangers – even one as munificent as the Federal Reserve. For the time being, we proceed with caution.

CG Absolute Return Fund

Fund Information as at:
31st Mar 2020

Fund price:
£120.37

Status:
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	£355m
Dividend Yield	< 1.5%
Management fee	0.35%
Total Expense ratio	0.44%
Comparator Index	3m Libor

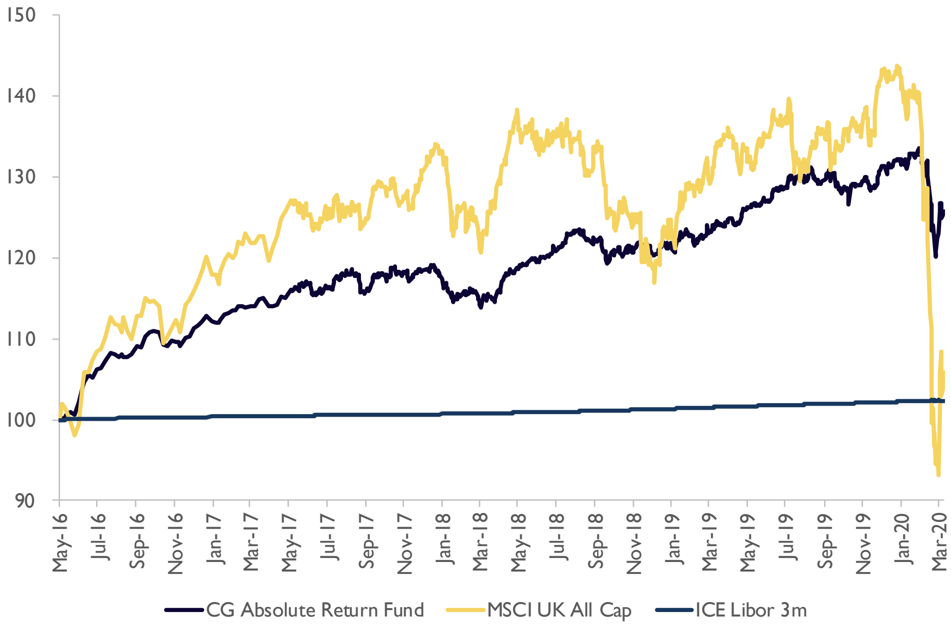
Return history (total returns)

1 month	-3.4%	2019	8.2%
3 month	-3.5%	2018	1.5%
6 month	-3.5%	2017	6.3%
Year to date	-3.5%	2016	n/a
1 year	1.4%	2015	n/a

Largest fund/equity holdings

Vanguard FTSE Japan ETF	4.3%
Ishares FTSE 100 ETF	4.2%
Vanguard FTSE 100 ETF	2.6%
Vonovia	1.8%
Ishares FTSE 250 ETF	1.8%

Performance since inception (total return)



Largest bond holdings

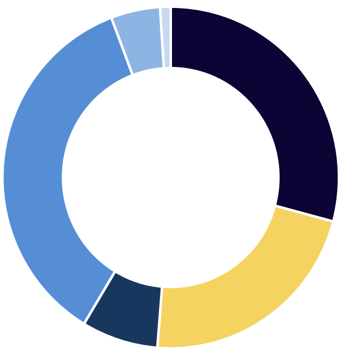
UK I/L 0.125% 22/03/24	3.0%
UK I/L 0.00% 10/08/20	1.7%
UK I/L 0.00% 01/06/20	1.4%
UK I/L 0.00% 22/06/20	1.4%
UK I/L 0.00% 20/07/20	1.4%

Currency exposure

GBP	60%
USD	25%
SEK	4%
EUR	5%
JPY	4%
Other	2%

Asset allocation

Index Linked Gov't Bonds	24%
Conventional Gov't Bonds	22%
Pref Shares / Corp Debt	10%
Funds / Equities	35%
Cash	8%
Gold	1%



Fund/equity breakdown

Equities	20%
Property	12%
Loans	2%
Infrastructure	1%

Capital Gearing Portfolio Fund

March 2020

The activity of the fund in January and February was characterized by selling. The S&P 500 and Nasdaq displayed characteristics of an exuberant blow-off and pulled the prices of risk assets in many other jurisdictions with them. Many assets within our portfolio reached levels where the risk/reward profile was much less attractive and positions were trimmed or sold entirely. Among the fund's larger individual positions these sales included about one third of each of the positions in Investor, Castellum and Grainger. The fund also sold substantially all of its holdings in renewable infrastructure. With the benefit of hindsight, we should have sold much more. At the time, the fund was close to its minimum weighting to risk assets. In that context, the decision to sell was relatively easy, much harder was what to do with the proceeds. Inaction served our allocation to "dry powder"1 rather better. As corporate credit rolled off, it became ever harder to purchase corporate bonds. The combination of an inverted yield curve with exceptionally tight credit spreads meant the fund became a more enthusiastic buyer of treasury bills.

Financial markets were slow to recognize the risks presented of COVID-19, lulled perhaps by experience of prior outbreaks which were able to be contained with comparative ease. However, we have felt for some time that asset prices and debt levels were too high, and economies too fragile, to withstand unpleasant surprises of any kind and so our overall positioning was satisfactory. As the crisis began to shift from humanitarian to financial, some of our assets and exposures performed as expected (notably the price of index linked bonds) while others did not (the dollar). During times of stress we expect the dollar – the global reserve currency – to find a bid. That it initially fell sharply came as a surprise. Our best guess is that the Euro and Yen – which are the most popular funding currencies for speculators – were bought back as carry trades were unwound. As the sell-off became a panic, this move reversed, the dollar appreciated rapidly and GBPUSD sold off from 1.31 to 1.15 in the space of 10 days.

Meanwhile the US treasury market became dysfunctional as, in a flight to safety, highly leveraged RV hedge funds were forced to liquidate their treasury holdings2. Dealer balance sheets, already bloated with high levels of treasury issuance over the past 12 months, simply were not able to accommodate this new supply. Treasury prices fell precipitously and dealers' bid-offer spreads rose to unprecedented levels. Notwithstanding the poor prices and high dealing costs, the fund liquidated short dated US TIPS and repatriated the proceeds to sterling. The fund's duration rose as it held onto its long dated TIPS which we judged to be severely mispriced. These moves proved correct, sterling rapidly recovered to the 1.24 at quarter end and prices of long TIPS rose by >22% from their nadir. The fund would have been active buyers of TIPS at these lower prices, but poor liquidity made achieving that aim challenging.

The fund added to its holdings of risk assets during March to maintain and then increase its weighting from 35 to 36%, including buying back many January and February's disposals. Inevitably many of the purchases proved premature, though we judge long term prospects of these holdings to be reasonable. For a brief period, conventional investment trust discounts rose to interesting levels. However in most instances those opportunities rapidly disappeared. As we explain in the Absolute Return Fund report, we aren't convinced that risk assets offer compelling value and so, for the time being, proceed with caution.

Capital Gearing Portfolio Fund

Fund Information as at:
31st Mar 2020

Share prices:
P shares £32,615
V shares £158.61

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	£420m
Dividend Yield	< 1%
Management fee	0.90%
Total Expense Ratio	1.02%
Comparator Index	3m Libor

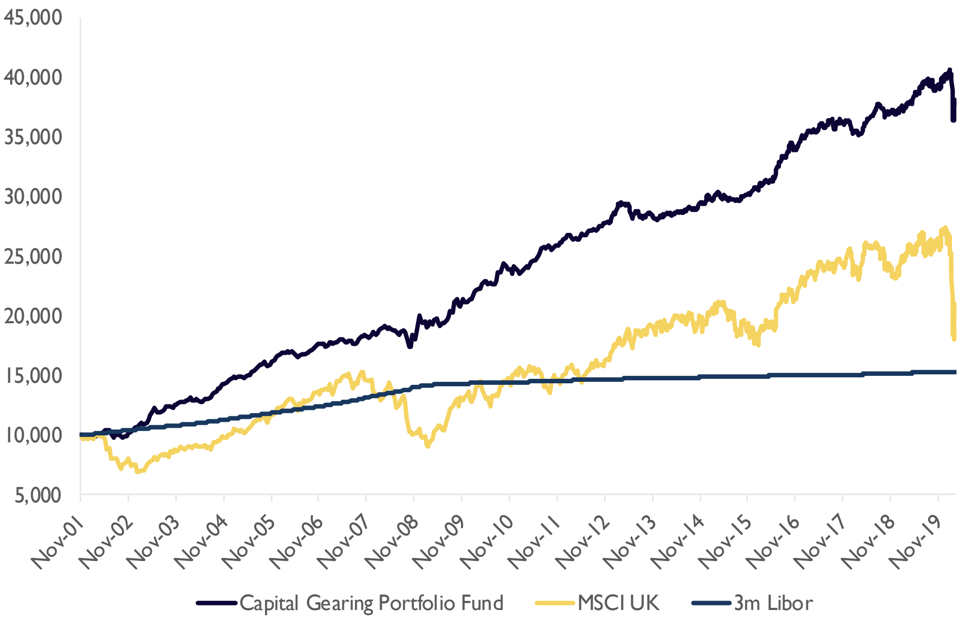
Return history

1 month	-4.4%	2019	7.7%
3 month	-4.3%	2018	1.5%
6 month	-4.1%	2017	4.9%
Year to date	-4.3%	2016	13.3%
1 year	0.6%	2015	4.0%

Largest fund/equity holdings

North Atlantic Smaller Co	3.4%
Vanguard FTSE Japan ETF	3.1%
Vonovia	1.7%
Pershing Square Holdings	1.6%
Ishares FTSE 100 ETF	1.5%

Performance since inception (total return, P Shares)



Largest bond holdings

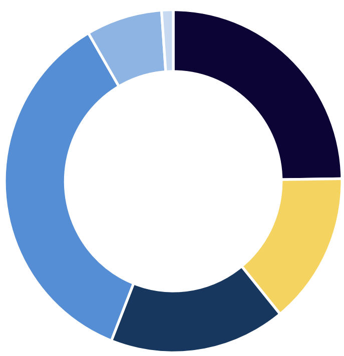
UK I/L 0.125% 22/03/24	3.2%
US I/L 2.375% 15/01/27	2.1%
UK I/L 0.00% 26/05/20	1.9%
US I/L 1.75% 15/01/28	1.9%
US I/L 2.00% 15/01/26	1.7%

Currency exposure

GBP	60%
USD	25%
SEK	4%
EUR	5%
JPY	4%
Other	2%

Asset allocation

Index Linked Gov't Bonds	25%
Conventional Gov't Bonds	14%
Pref Shares / Corp Debt	17%
Funds / Equities	36%
Cash	7%
Gold	1%



Fund/equity breakdown

Equities	17%
Property	13%
Loans	4%
Infrastructure	1%
Private Equity/Hedge Fund	1%

Thoughtful Investing

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