

CG Portfolio Fund

Q3 2022 Report

- **Dollar Fund**
- **Real Return Fund**
- **Absolute Return Fund**
- **Capital Gearing Portfolio Fund**

Volcker's Ghost

Inflation, indebtedness, and the cost of stability

The current inflationary environment across developed economies has, understandably, given rise to comparisons with the last period of prolonged inflation during the 1970s and early 1980s. These comparisons all point to Paul Volcker's decision as chair of the Federal Reserve to raise interest rates to double digit levels, which was ultimately credited with bringing an end to sustained high inflation.

It is important to remember that Volcker's tightening programme had two stages. The first was characterised by a combination of tight monetary policy, involving the targeting of money supply, combined with imposing additional controls on the extension of credit. These included voluntary credit constraints, special deposits, and increases in margin requirements. The result was to restrict consumption severely, meaning that headline inflation began to fall rapidly. Consequently, credit controls were eased within a few months of taking effect.

However, the underlying inflation was not defeated and began to rise again, leading to a second phase. By this point, inflation had finally become politically more important to the American public than unemployment, and the long experience of inflation had purged balance sheets so that powerful medicine could be applied. Interest rates were increased to even higher levels, commensurate with real yields of 4.5%. At these levels, higher interest rates caused a deep recession that was able to curb inflation in a more enduring way.

The question must be asked: are we going back to the 4.5% real interest rates that we saw in early 1980s? Our answer is resoundingly no. Recently, Anglo-Saxon countries have seen significant tightening of monetary policy. Surprisingly to us, this seems to have anchored markets' inflation expectations: forward expectations in the Treasury markets remain consistent with the 2% inflation target being achieved as soon as the short-term distortions from Covid and the war in Ukraine pass. This is the case despite the fact that central banks now face a trade-off between their monetary policy and financial stability objectives. Their ability to raise interest rates will be constrained by the extraordinary amount of debt that has built up over the previous decades of easy monetary policy.

Debt is now at high levels in every sector: across households, corporates and especially governments. This characterises large parts of the financial system, although it is extremely difficult to analyse precisely where the excess leverage lies. Who would have thought that UK pension funds would be a source of instability? The fragility of the current debt structure and the sensitivity of the real economy and financial system to interest rate changes suggest that we need not fear that interest rates would need to go back to Volcker-era levels.

The exact sources of future debt crises are difficult to identify, but it is a fair guess that shadow banking, private equity, zombie companies, real estate markets, and residential mortgages are all candidates. In the UK, residential mortgages will be an immediate issue because of the short-term financing of UK housing. A two-year fixed mortgage rate has more than tripled from around 1.6% nine months ago to its current level of around 6.0%. There will be considerable pressure on mortgage holders as their two-year fixed terms expire, and on average, they have one year to go. Just as importantly, new buyers look unlikely to be able to support house prices at current levels relative to the average income. Consequently, we anticipate considerable falls in real house prices, with nominal prices supported by inflation as time goes by. However, this adjustment will come with considerable concern for financial stability.

Volcker's Ghost

Inflation, indebtedness, and the cost of stability

Looking ahead, it seems likely that in a situation which echoes that of 1980, central banks will be forced to back off their tightening programmes by financial distress in parts of the economy before they can be confident that they have overcome the momentum of inflation. If we go forward six to nine months, we expect headline inflation to be more modest, because of the anniversary effects of energy prices, food prices, shortages of semiconductors and shipping. Central banks' approaches will probably be influenced by the very low rates of headline inflation that will prevail next summer, notwithstanding that wage increases may still be too high. If that is true, and we remain in an environment that is characterised by expansionary fiscal policy, a fully-employed economy, and a monetary policy stance that is constrained by a fragile financial system, then we should expect to see core inflation continue to accelerate.

There is a positive aspect to inflation. The accumulation of debt and associated asset bubbles need to be addressed, but this will be much easier if the adjustment process does not involve very substantial falls in nominal asset values. More broadly, current debt levels are not likely to be sustainable at current interest rates and levels of income. The least painful policy to address that imbalance is financial repression, which requires elevated levels of inflation. In this situation, we would expect to see moderately positive nominal rates of interest that will not fully compensate lenders for the inflation that is eating away at the value of the loans that they have made. At the same time, borrowers will benefit from the declining real value of their debt. With enough inflation, debt can resume a more appropriate relationship with asset values and incomes, and the economy will begin to stabilise. Only then would it be possible to employ real interest rates of 4.5% to defeat inflation.

Volcker's ghost continues to haunt the current moment, reminiscent of a Greek tragedy. Unfortunately, it seems likely that we are still only in the first act. It will be an interesting journey.

Peter Spiller

Emma Moriarty

September 2022

Fund information as at:
30th Sept 2022

Fund price:
£175.93

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	£812m
Class Size	£393m
Dividend Yield	< 2%
Management Fee < £1bn	0.25%
Management Fee > £1bn	0.15%
Total Expense Ratio	0.34%

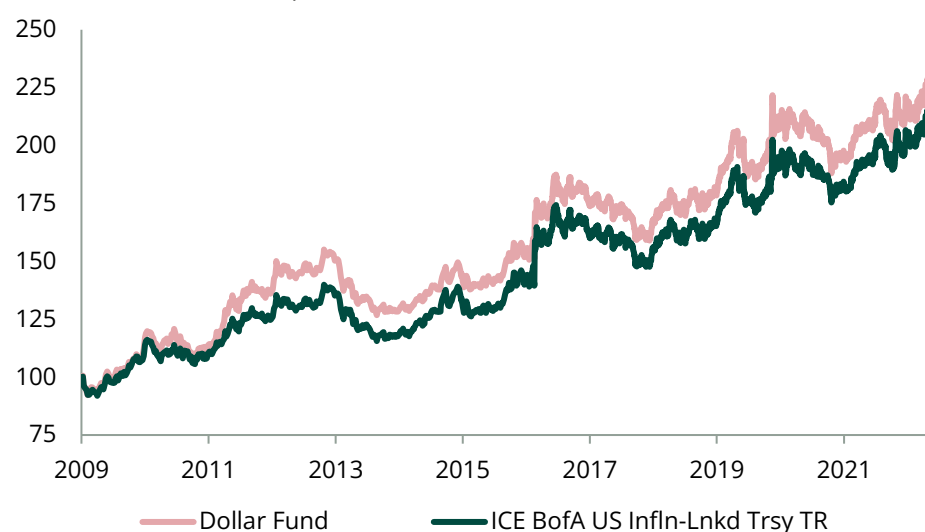
Return history (total returns)

1 month	-4.7%	2021	6.0%
3 months	1.8%	2020	8.6%
6 months	1.3%	2019	4.9%
Year to date	0.4%	2018	4.9%
1 year	2.4%	2017	-6.3%

Largest holdings

US I/L 0.75% 15/02/45	6.7%
US I/L 1.375% 15/02/44	6.5%
US I/L 0.625% 15/02/43	4.9%
US I/L 0.75% 15/07/28	4.9%
US I/L 1.00% 15/02/46	4.8%

Performance since inception (total return)



Credit ratings

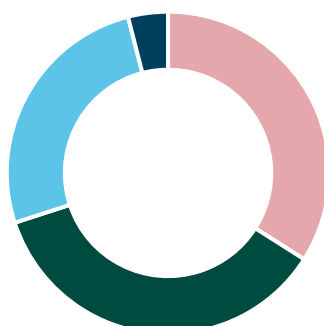
AAA	100%
AA	0%
A	0%
BBB	0%
BB and below	0%

Characteristics

Number of bonds	33
Yield to Maturity (real)	1.7%
Average Maturity	11.1 Yrs
Average coupon (real)	1.1%
Composite rating	AAA

Maturity analysis

10+ Years	34%
5-10 Years	36%
0-5 Years	26%
Cash	4%



Duration history

30 Sep 22	9.7
30 Sep 21	8.5
30 Sep 20	10.3
30 Sep 19	8.9
30 Sep 18	7.4
30 Sep 17	6.8

Dollar Fund

September 2022

Bond markets and equity markets are begging for the Federal Reserve to pivot. For now, the Fed does not appear to be listening. Indeed, the Fed is doing its best to tell the market that nothing of the kind will happen. Eight Federal Reserve Governors gave speeches in the first two weeks of October with a concerted message that the Fed was going to raise rates to a little over 4.5% in early 2023 and hold those rates there until they saw how the economy responded. September's core CPI reading of 6.6% has only served to reinforce their stance. By contrast, the OIS market and Fed Funds Future markets are indicating expectations of one to two rate cuts over 2023.

The Fed's reaction function appears to have changed. They are now prepared to make decisions without waiting to see the lagged impacts of policy changes on inflation and unemployment. In 2020, Chair Jerome Powell set out the doctrine at Jackson Hole that rates should not be raised until full employment was reached, inflation was above target and likely to remain above target for some time. Today the Fed has adopted a symmetric but opposite stance: monetary policy will remain restrictive until they see real progress in reducing inflation. Gone is the notion of "a light hand on the tiller", and instead the Fed seems intent on careening from one side of the channel to the other. Such extremes of approach, whether in terms of accommodation or restriction, must surely increase the probability of a collision. The hoped for "soft landing" seems an ever more remote prospect. Of the more binary outcomes, we would judge a "hard landing" more probable than a "dovish pivot", though neither should be ruled out.

The portfolio offers a reasonable each-way bet against either outcome, with better returns in the case of a recession. If the Fed pivots, it seems unlikely that inflation will be brought under control,¹ in which case investors will earn a nominal return of perhaps 6% (made up of inflation of 4% plus a real yield of 2%). Under this scenario, real yields seem unlikely to rise materially, given the starting point of low breakeven rates of inflation. Conversely, a hard landing could see real yields fall by 100

to 200 bps, resulting in capital gains of 10 to 20%.

Bond markets around the world have had a turbulent quarter and, unfortunately, the Dollar Fund was not immune. In sterling terms, the fund was up 1.8% on the unhedged class but down 7.0% on the hedged class. Its longer duration meant that the fund underperformed the index. Performance relative to UK Index Linked told a happier story with the index down 9.6% over the quarter. Such a savage de-rating of UK Index Linked brings into focus a separate question: should an investor with sterling liabilities consider reallocating from TIPS to UK linkers?²

For many years, due to the strongly negative yields, we have felt that UK linkers were uninvestable: held to maturity they guaranteed losses in real terms. They were a true anti-investment. Today, 10-year linkers offer yields of 0.6% real. Adjusted for the structural peculiarities of RPI, that equates to an effective CPI real yield of around 1.5-1.7%. Given the economic fragility of the UK from higher mortgage rates and energy prices, these real returns are attractive and come with no currency risk to the sterling-denominated investor. In our multi-asset funds, we have responded to this better value by increasing our allocation and duration to UK linkers. We have mostly funded this from sale of assets other than TIPS. Our overall allocation to index linked bonds has increased markedly. In an uncertain world, risk-free real returns in our domestic currency *and* in the global reserve currency hold a high level of appeal.

1. For more details see the [Dollar Fund Q2 report](#).

2. Nothing in this report should be construed as a recommendation to buy or sell any of our funds or any other security.

Fund information as at:
30th Sept 2022

Fund price:
£91.29

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	£812m
Hedged Class Size	£337m
Dividend Yield	< 2%
Management Fee < £1bn	0.25%
Management Fee > £1bn	0.15%
Total Expense Ratio	0.34%

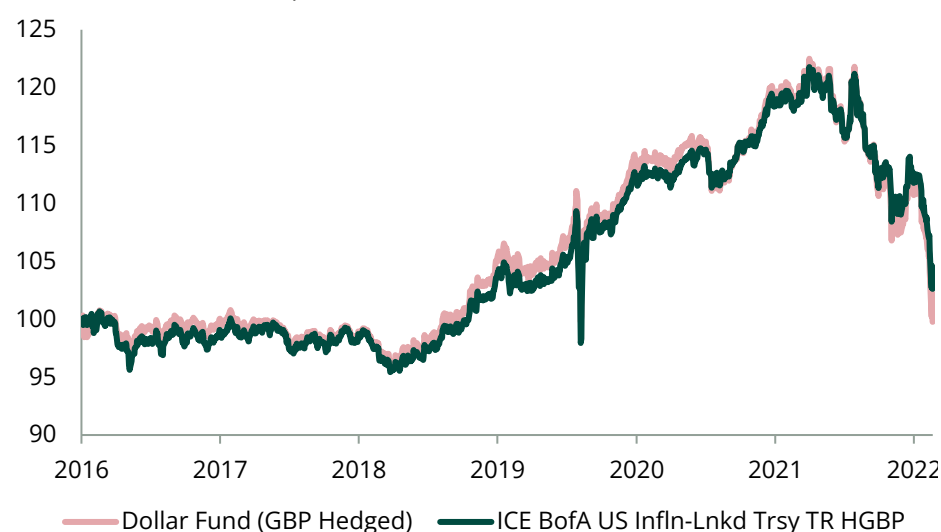
Return history (total returns)

1 month	-8.9%	2021	5.2%
3 months	-7.0%	2020	10.5%
6 months	-14.9%	2019	7.4%
Year to date	-18.0%	2018	-2.6%
1 year	-15.9%	2017	1.4%

Largest holdings

US I/L 0.75% 15/02/45	6.7%
US I/L 1.375% 15/02/44	6.5%
US I/L 0.625% 15/02/43	4.9%
US I/L 0.75% 15/07/28	4.9%
US I/L 1.00% 15/02/46	4.8%

Performance since inception (total return)



Credit ratings

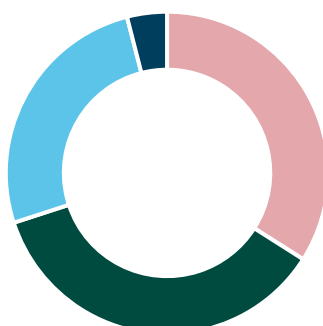
AAA	100%
AA	0%
A	0%
BBB	0%
BB and below	0%

Characteristics

Number of bonds	33
Yield to Maturity (real)	1.7%
Average Maturity	11.1 Yrs
Average coupon (real)	1.1%
Composite rating	AAA

Maturity analysis

10+ Years	34%
5-10 Years	36%
0-5 Years	26%
Cash	4%



Duration history

30 Sep 22	9.7
30 Sep 21	8.5
30 Sep 20	10.3
30 Sep 19	8.9
30 Sep 18	7.4
30 Sep 17	6.8

Fund information as at:
30th Sept 2022

Fund price:
£91.14

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	£580m
Class Size	£126m
Dividend Yield	< 3%
Management Fee < £500m	0.30%
Management Fee > £500m	0.20%
Total Expense Ratio	0.39%

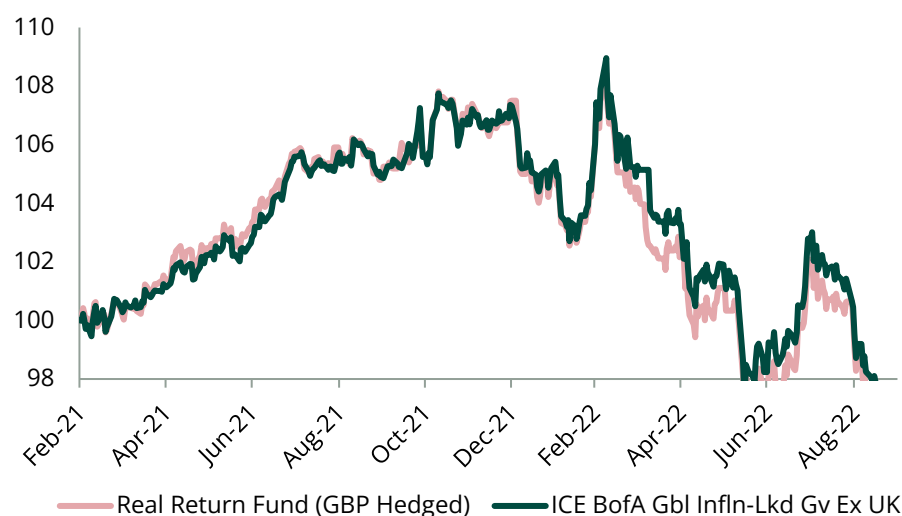
Return history (total returns)

1 month	-7.4%	2021	N/A
3 months	-5.6%	2020	N/A
6 months	-12.1%	2019	N/A
Year to date	-14.6%	2018	N/A
1 year	-12.5%	2017	N/A

Largest holdings

US I/L 1.375% 15/02/44	4.4%
US I/L 2.375% 15/01/27	4.1%
US I/L 0.75% 15/02/45	4.1%
US I/L 0.625% 15/02/43	3.9%
US I/L 2.00% 15/01/26	3.9%

Performance since inception (total return)



Credit ratings

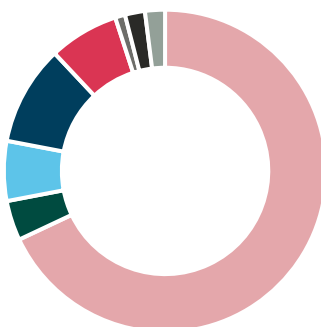
AAA	100%
AA	0%
A	0%
BBB	0%
BB and below	0%

Characteristics

Number of bonds	58
Yield to Maturity (real)	1.1%
Average Maturity	9.8 Yrs
Average coupon (real)	1.0%
Composite rating	AAA

Asset allocation

USA	68%
Sweden	4%
Japan	6%
Germany	10%
Canada	7%
Denmark	1%
Australia	2%
Cash	2%



Duration history

30 Sep 22	8.5
30 Sep 21	8.6
30 Sep 20	8.6
30 Sep 19	7.6
30 Sep 18	6.4
30 Sep 17	6.2

Fund information as at:
30th Sept 2022

Fund price:
£209.98

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	£580m
Class Size	£454m
Dividend Yield	< 3%
Management Fee < £500m	0.30%
Management Fee > £500m	0.20%
Total Expense Ratio	0.39%

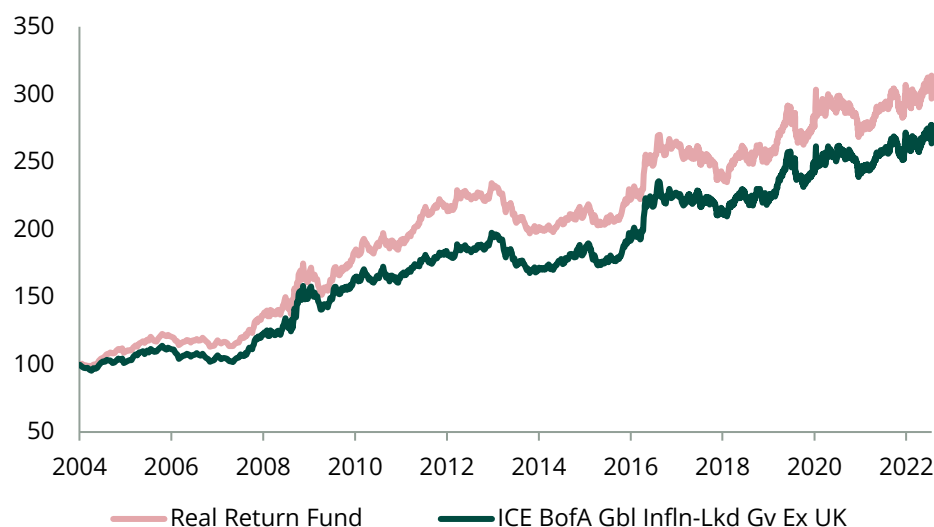
Return history (total returns)

1 month	-4.2%	2021	4.1%
3 months	1.3%	2020	8.0%
6 months	0.3%	2019	2.6%
Year to date	-0.4%	2018	3.5%
1 year	1.1%	2017	-4.4%

Largest holdings

US I/L 1.375% 15/02/44	4.4%
US I/L 2.375% 15/01/27	4.1%
US I/L 0.75% 15/02/45	4.1%
US I/L 0.625% 15/02/43	3.9%
US I/L 2.00% 15/01/26	3.9%

Performance since inception (total return)



Credit ratings

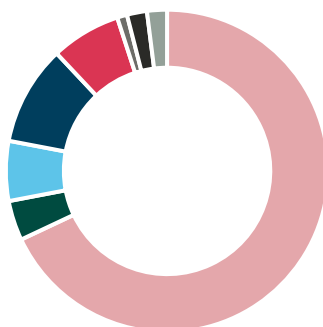
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BB and below	0%

Characteristics

Number of bonds	58
Yield to Maturity (real)	1.1%
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Asset allocation

USA	68%
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Australia	2%
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Duration history

30 Sep 22	8.5
30 Sep 21	8.6
30 Sep 20	8.6
30 Sep 19	7.6
30 Sep 18	6.4
30 Sep 17	6.2

Real Return Fund

September 2022

In his magisterial review of the long run history of prices, David Hackett Fischer describes inflationary episodes as occurring in 'great waves'.¹ Each wave tends to move through a series of distinct stages. The first stage is one of 'silent beginnings and slow advances': an extended period of price stability which masks growing inflationary pressures under the surface. These unseen inflationary pressures are normally caused by underlying demographic factors such as rapid population growth, which increases the demand for resources. In the second stage, the wave builds, often triggered by unanticipated external events, such as 'wars of ambition that arose from the hubris of the preceding period'. As early as the 14th century, historical sources highlight the astonishing global synchronisation of price shocks and the associated financial instability, revealing the invisible economic web that integrates apparently unconnected markets and regions. In the third stage, prices become highly unstable, declining and then surging again with increasing volatility as individuals and governments respond to inflation by making decisions that drive prices even higher.

Whilst acknowledging that historical determinism does not have a great track record, Hackett Fischer's thesis does seem to describe the current experience quite well. Following this thesis, we may now be moving into the third stage of more institutionalised inflation, so should expect a period of more volatile prices centred around an elevated mean.

It is quite possible that we are close to a short-term peak in inflation, with many volatile components likely to pull headline inflation down over the coming months. These include food and energy, whose costs remain high but have come down from their peaks earlier in the year. Many of the bottlenecks that built up over the pandemic, such as in semiconductors and shipping, have eased or even gone into surplus. Interest rates are rising rapidly, causing demand to contract, and suggesting that the economic outlook is likely to be muted.

All of this indicates that headline CPI will soon turn downwards. Indeed, the peak may already have passed in the US, where the September annualised inflation level was 8.3%, almost 1% lower than in June. However, in the same month core CPI (which strips out food and energy) continued to rise, hitting 6.6% its highest level in 40 years. It seems quite likely in the coming months that headline inflation will drop well below core CPI, giving the impression that inflation is under control, even though the underlying inflationary pressures in the economy remain strong. The impression of weakening inflation combined with a recessionary economic backdrop may give central banks cover to cut interest rates again at some point next year, which would provide the fuel for the next leg of inflationary impulse. Were this scenario to occur, it would be a close match to Hackett Fischer's thesis.

It would likely be a scenario in which index linked bonds would perform well, recouping recent losses. Real interest rates across all Anglo-Saxon jurisdictions look unsustainably high and breakevens are undemanding. A prospective interest rate cut would boost nominal bonds and index linked should rally in sympathy. An interest rate cut against a backdrop of modest CPI but mid single-digit core inflation would provide the monetary policy fuel to power the wave from its trough condition back to its peak.

Great waves go through many cycles of cresting and troughing. The first crest may have broken, but it would be dangerous to assume that it is the last.

1. David Hackett Fischer, *The Great Wave*, Oxford University Press 1996 – required reading in CGAM's offices!

Fund information as at:
30th Sept 2022

Fund price:
£136.45

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	£1,080m
Dividend Yield	< 1.5%
Management Fee	0.35%
Total Expense Ratio	0.45%
Comparator Index	GBP SONIA

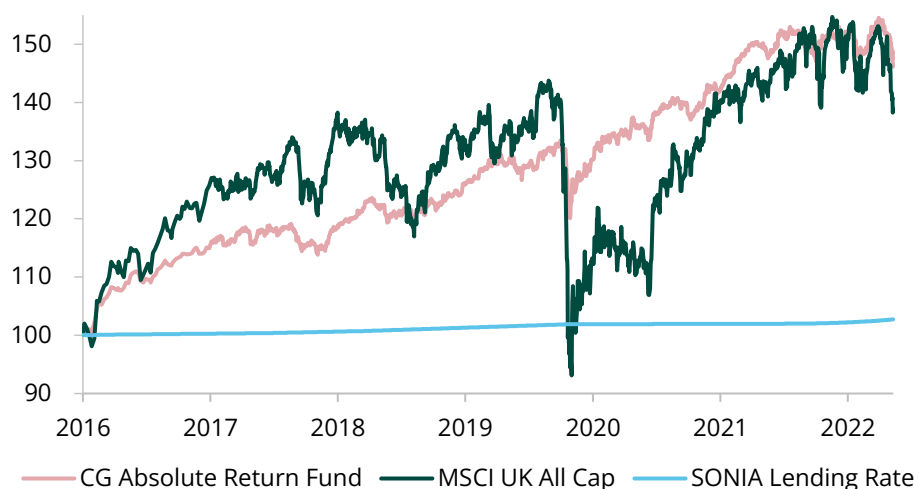
Return history (total returns)

1 month	-4.5%	2021	8.9%
3 months	-1.0%	2020	7.2%
6 months	-3.7%	2019	8.2%
Year to date	-3.7%	2018	1.5%
1 year	-1.6%	2017	6.3%

Largest fund/equity holdings

Ishares MSCI JP ESG Screened ETF	3.5%
SPDR MSCI Europe Energy ETF	3.1%
Grainger	1.6%
Vonovia	1.5%
Greencoat UK Wind	1.4%

Performance since inception (total return)



Largest bond holdings

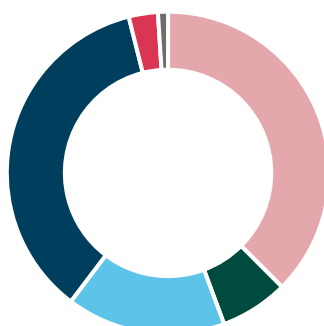
UK I/L 0.125%	22/03/24	6.0%
UK I/L 2.50%	17/07/24	4.5%
US I/L 0.75%	15/02/45	1.9%
US I/L 1.375%	15/02/44	1.8%
US I/L 1.00%	15/02/46	1.1%

Currency exposure

GBP	50%
USD	25%
SEK	3%
EUR	7%
JPY	11%
Other	4%

Asset allocation

Index Linked Gov't Bonds	38%
Conventional Gov't Bonds	7%
Pref Shares / Corp Debt	16%
Funds / Equities	36%
Cash	3%
Gold	1%



Fund/equity breakdown

Property	11%
Equities	11%
Infrastructure	6%
Loans	3%
Energy & Commodity	4%
Private Equity / Hedge	1%

Absolute Return Fund

September 2022

The impact of recent government policies on UK financial markets has been like watching a drunken dynamite fisherman. An erratic and poorly coordinated event is shortly followed by a violent explosion in the liquid pool of assets that is the gilt market. As the ocean boils, the ecosystem within it suffocates. Fortunately, a majority of our portfolio is far enough away from the blast zone to have avoided the worst of the fallout, but frustratingly not all of it. Any asset that had effectively been priced as a spread over government bonds was in the suffocation zone. Our property and infrastructure holdings, which we held as high-yielding equities in place of poor value UK and European government bonds, have been collateral damage of recent events.

The most significant impact was on our property holdings (12% of the portfolio) where returns were -12% in the period, with falls in value concentrated in September. Property companies became a significant part of the portfolio in the wake of the Covid bear market of 2020, when stunning value emerged and we bought in scale. To that end, a year ago property represented 20% of the portfolio. By early 2022, alternative property companies had materially eroded from significant discounts to premia, so as the froth started to build, we became sellers. With hindsight, we did not sell aggressively enough. In what can only be described as a mistake, our property holdings were too high when this unanticipated explosion occurred, which has set the portfolio back.

Our infrastructure holdings (7% of the portfolio) performed better in the period, returning -2%. These modest losses have turned out to be the tip of the iceberg. After the government's clumsy introduction of a power price cap on renewable energy generators, our infrastructure holdings have also continued their weakness post period-end. Our holdings of power and energy equities had been central to the significant outperformance of our risk asset portfolios (compared to broader equity markets indices) over the last year. Sadly, a part of that outperformance was handed back in September and October.

As we survey the aftermath of this unexpected explosion, it is worth considering whether there are now opportunities in these markets after serious falls. Using current share prices to calculate implied yields, alternative property companies have been repriced to a range around c.6% net initial yields. In many cases, rents can be expected to rise at or close to the rate of inflation. These two factors combined suggest that property companies could deliver c.10% annual returns if inflation averages 4% over the next few years. These returns are attractive, but not sufficiently high for us to make additions at these levels.

In the short term, the only additions of consequence have been to our gilt holdings. Fortunately, we did not hold UK index linked bonds of any duration before the gilt market explosion. During the last few weeks, we have added 4% to our gilt holdings, mostly at reasonably short durations. That said, we have invested as long as the index linked 2050s, albeit in small size. It is exciting to be able to invest into the gilt market again, after many years of being priced out. It is a natural asset for a conservative sterling investor to hold. However, our excitement is tinged with a sense of regret that the recent disruption will have long term negative consequences for the UK. It is unwise to go dynamite fishing when drunk. Not only do you indiscriminately kill everything in the sea, but you might end up inadvertently blowing up your own boat.

Fund information as at:

30th Sept 2022

Share prices:

P shares £37,717

V shares £183.44

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	£372m
Dividend Yield	< 1%
Management Fee	0.75%
Total Expense Ratio	0.85%
Comparator Index	3m Libor

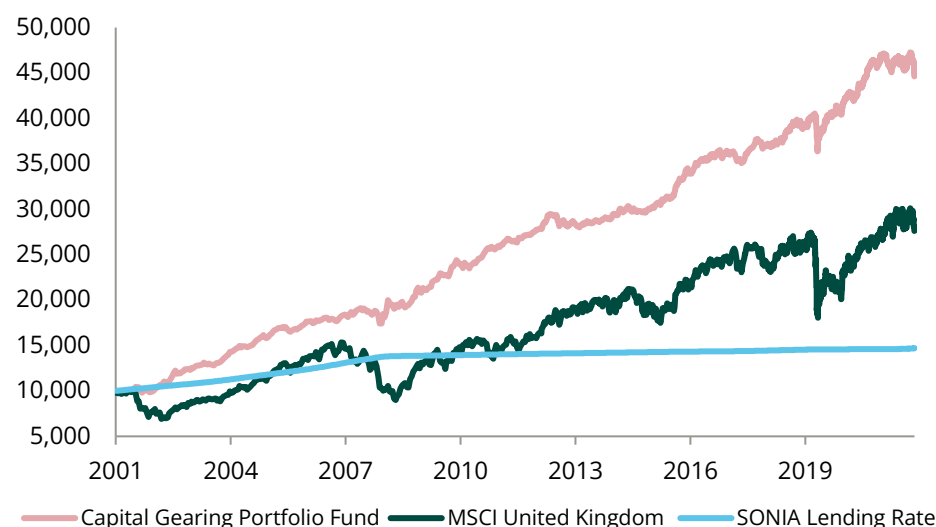
Return history (total returns)

1 month	-4.7%	2021	10.3%
3 months	-1.2%	2020	7.3%
6 months	-3.9%	2019	7.6%
Year to date	-4.7%	2018	1.5%
1 year	-2.7%	2017	4.9%

Largest fund/equity holdings

Ishares MSCI JP ESG Screened ETF	3.7%
SPDR MSCI Europe Energy UCITS ETF	3.1%
North Atlantic Smaller Co's	2.5%
Vonovia	1.7%
Grainger	1.3%

Performance since inception (total return, P Shares)



Largest bond holdings

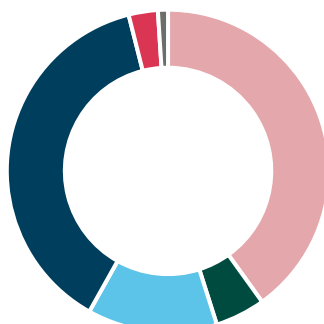
UK I/L 0.125% 22/03/24	6.6%
UK I/L 2.50% 17/07/24	3.8%
US I/L 2.375% 15/01/27	2.7%
US I/L 1.375% 15/02/44	2.0%
US I/L 0.75% 15/02/45	1.9%

Currency exposure

GBP	49%
USD	26%
SEK	3%
EUR	7%
JPY	11%
Other	4%

Asset allocation

Index Linked Gov't Bonds	40%
Conventional Gov't Bonds	5%
Pref Shares / Corp Debt	13%
Funds / Equities	38%
Cash	3%
Gold	1%



Fund/equity breakdown

Property	11%
Equities	12%
Infrastructure	6%
Loans	3%
Energy & Commodity	5%
Private Equity / Hedge	1%

Capital Gearing Portfolio Fund

September 2022

The last decade in financial markets can be summarised by two mantras: 1. don't fight the Fed; and 2. there is no alternative ("TINA", for short) – to equities, that is. Of course, the two are intimately related. Confronted with a profound economic slump and governments that were unwilling or unable to provide fiscal stimulus, it fell upon central banks to do the macroeconomic heavy lifting. Fed Chair Jerome Powell is fond of reminding us that monetary policy works through financial conditions and the goal of the last decade was to ease financial conditions. In practice "financial conditions" means three things: interest rates, credit spreads and equity valuations. The "easy" financial conditions that followed were characterised by high prices and correspondingly low prospective returns.

This backdrop was the source of the TINA narrative. In a search for yield, confronted with low returns, investors were forced out along the risk curve substituting government bonds with credit, credit with quality equities, and quality equities with speculative equities. To quote 19th century economist Walter Bagehot, "John Bull can stand many things, but he cannot stand 2%". In one sense, the TINA approach was perfectly rational: for the past decade the prospective return on equities was higher than on bonds and the equity risk premium was high relative to its historical average. Our concern with the narrative was and is one of duration. Equities are the longest duration assets – becoming longer still at higher valuations. It follows that a small increase in investors' required rates of return results in large capital losses. The weakness of equities this year is a consequence of rising interest rates, which has increased investors' return requirements. Should investors start to forecast an earnings recession, equities will take another leg down.

What of the Fed? Today its stance is the mirror of the last decade. With the Core PCE price index at a 40-year record high, the Fed wants tighter financial conditions to restore its credibility. It is rare to see Fed Governors commenting explicitly on the equity market; when they do investors should pay attention. In August, Neel Kashkari (President, Minneapolis Fed) said that he was "not excited to see the stock market rallying after our last FOMC meeting".¹

More recently, Mary Daly (President, San Francisco Fed) was uncharacteristically blunt in her assessment of the chance of rate cuts in 2023: "I don't see that happening at all".² The Fed put appears to have turned into a call.

Just as the Fed's stance has changed so too has TINA given way to TALA: "there are lots of alternatives". 10-year UK linkers yield around 0.6% real,³ 10-year TIPS yield 1.6%, 5-year gilts pay 4% (with much of the return coming as tax-free capital gains) and your corporate credit portfolio yields 5.7% with a sub 18-month duration. In the event of a recession, these government bonds should perform well. The credit portfolio may suffer: spreads will widen and the portfolio could suffer defaults. The short duration of the credit portfolio should protect us from the former and the preponderance of economically insensitive credits should provide insulation against the latter. In addition, corporate credit spreads in the UK are much higher than in other jurisdictions due to the unwind of the BoE's balance sheet and the liquidity challenges facing UK pension funds.

For the last 10 years "don't fight the Fed" was excellent advice. We believe that it remains so. Today the Fed is telling investors that it wants asset prices to be lower. Investors should listen.

1. See [Transcript: Neel Kashkari on the Fed's commitment to fighting inflation](#).
2. See [Fed's Daly says futures market wrong in seeing 2023 rate cuts](#).
3. When adjusted for the idiosyncrasies of RPI that equates to a CPI real yield of c. 1.5-1.7%

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