Capital Gearing Trust/ CG Absolute Return Fund / Capital Gearing Portfolio

- The fund returned -2.2% in Q2 and +2.9% over the last 12 months
- Risk assets (c.43% of the portfolio) showed strong relative performance, returning -5.8% in the quarter compared to -11.7% for the Investment Trust Index. Discounts have started to emerge in investment trusts, and so we sold some ETF holdings to be positioned to engage in interesting discount opportunities. We have not increased our aggregate exposure to conventional equities, but will reconsider this should equity markets decline further
- Risk asset outperformance was helped by a 4.2% gain in infrastructure (8% of the portfolio). We believe these assets will continue to benefit from tailwinds in an elevated power price environment, and added to existing positions by taking placings in both Bluefield Solar Income Fund and Downing Renewable & Infrastructure Trust
- UK property returns (c.9% of the portfolio) benefited from a bid for one of our largest holdings, Secure Income REIT. Profits were also taken in Supermarket REIT
- European property holdings (c.6%) were a drag on performance. This was primarily driven by weak returns from German residential, down 23% over the quarter. We think they offer excellent value at these lower levels
- Overall, property exposure is expected to decline further (currently 15%) as cash proceeds from the Secure Income REIT merger are realised
- Index-linked bonds (34% of the portfolio) were up 1.4% in Q2 (6.8% over 12 months), a strong relative performance against a very weak bond market. A sharp rise in yields was offset by a strengthening dollar, and presented an opportunity to extend the duration in TIPS (19% of the portfolio) to 10.1 years
- Value in the credit market is emerging, with the weighting increased to 13% through additions in investment grade corporate credit. We also added Ocado Aug 26s and Jan 27s to our junk bond holdings. These purchases were financed from existing cash balances and from maturing treasury bills
- The portfolio remains defensive overall, with an objective of capital preservation and inflation protection

Real Return Fund

- The Fund returned -1.0% in Q2 and +3.5% over the last 12 months
- The GBP Hedged share class returned -6.9% in Q2 and -5.9% over the last 12 months
- German index-linked (10% of the portfolio) were -1.7% over the quarter, however the absence of exposure to Italy (-6.2%), France (-5.6%) and Spain (-3.5%) when compared to the index contributed to the fund's modest outperformance versus the benchmark
- Eurozone CPI rose to 8.1% in May, prompting a more hawkish ECB to follow suit with other central banks by announcing plans to lift rates above zero by September 2022
- Conversely, the BoJ renewed its pledge to keep monetary policy loose, with the resulting weakness in the Yen driving down returns in Japan by 2.3% over the quarter
- US CPI printed at 8.6% in May: the increase was broad-based with shelter, fuel and food all driving the largest YoY increase since 1982
- The Fed moved to reaffirm its credibility with a 0.75% increase in June. FOMC projections now suggest the policy rate will rise to 3.4% by the end of 2022 (from 1.75% today), though bond markets believe the Fed will be forced into cutting soon thereafter
- Although breakevens on TIPS (c.70% of the portfolio) imply a frontloaded response from policymakers will restrain inflation within two years, we remain concerned that inflation will persist beyond this horizon. This view is supported by evidence of wage acceleration, rising housing costs and elevated energy prices
- The Fed believes that the channel for policy transmission is through financial conditions which need to be substantially tightened if inflation is to be tamed. This will translate in the form of higher bond yields, higher credit spreads and lower equity prices
- Flattening of the yield curve suggests the bond market is pricing an increasing risk of recession in the medium-term, and equity prices have responded. Notably, the S&P 500 and Nasdaq Composite indices declined 16% and 22% over the quarter respectively
- Given the current tightness in the labour market, we believe stagflation is a more probable outcome than a soft landing
- Positioning of the portfolio remained largely unchanged, with duration extended modestly from 8.2 to 8.8 years this quarter

Dollar Fund

- Unhedged share class returned -0.5% for Q2 and +4.9% over the last 12 months
- Hedged share class returned -8.5% and -8.0% over 12 months
- US CPI printed at 8.6% in May: the increase was broad-based with shelter, fuel and food all driving the largest YoY increase since 1982
- The Fed moved to reaffirm its credibility with a 0.75% increase in June. FOMC projections now suggest the policy rate will rise to 3.4% by the end of 2022 (from 1.75% today), though bond markets believe the Fed will be forced into cutting soon thereafter
- The market reaction caused 10-year nominal yields to rise to 3.5% settling at 3% by quarter-end. 10-year real yields turned positive, settling at 0.65% at quarter-end
- Although breakevens imply a frontloaded response from policymakers will restrain inflation within two years, we remain concerned that inflation persist beyond this horizon. This view is supported by evidence of wage acceleration, rising housing costs and elevated energy prices
- The Fed believes that the channel for policy transmission is through financial conditions which need to be substantially tightened if inflation is to be tamed. This will translate in the form of higher bond yields, higher credit spreads and lower equity prices
- Flattening of the yield curve suggests the bond market is pricing an increasing risk of recession in the medium-term, and equity prices have responded. Notably the S&P 500 and Nasdaq Composite indices declining 16% and 22% over the quarter respectively
- Given the current tightness in the labour market, we believe stagflation is a more probable outcome than a soft landing
- However, absolute and relative value is beginning to emerge in real yields, and we have begun to express this via underweighting the short end
- Portfolio duration has increased modestly, to 9.5 years