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

- C. -0.4% return in the quarter and 10.6% over the past year
- Risk assets (c.45% of the portfolio) showed strong relative performance, returning -0.8% in the quarter compared to -8.6% for the investment trust index
- Risk asset outperformance helped by high exposure to the power and energy sectors (c.8% of the portfolio) which returned 12% in the quarter. Holdings are predominantly renewable energy infrastructure (5.3% of portfolio) which modestly increased over the quarter after participating in two placings by Greencoat Renewables and TRIG. The balance of the exposure is largely held in energy ETFs
- Performance was also helped by our substantial UK equity exposure, which was the strongest of the developed market equity indices in the period
- The property holdings (reduced to c.17% of the portfolio) delivered -3.7% driven by weak performance in German residential, down 10.8% over the quarter. We consider they offer excellent value at these lower levels
- Index-linked bonds (36% of the portfolio) were flat in the quarter (4% over 12 months), a strong relative performance against a very weak broader bond market, with high CPI prints in the US and Europe meaning that inflation accruals offset higher bond yields
- Credit spread widening gave us an opportunity to increase the credit weighting to 7% through additions to short dated, investment grade corporate credit. The 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

- Returns of -0.7% in the quarter and 8.1% over the last 12 months
- GBP Hedged share class delivered -2.9% in the quarter and 4.4% over 12 months
- Eurozone CPI hit 7.5% for the March flash estimate. Despite this exceptionally high number the ECB response has been very moderate leading to a weakening of the Euro vs. US dollar
- European index linked performed strongly. Germany (10% of the portfolio) and Denmark (1%) contributed positively however the absence of exposure to Italy or France was a headwind when compared to the index
- By contrast, February US CPI of 7.9% was seen as evidence that the Federal Reserve is behind the curve, resulting in a sharp sell-off of conventional treasuries and rising nominal & real yields
- The Fed conceded its transitory inflation stance and accelerated tightening, with a 50bps hike expected in May coupled with a more aggressive quantitative tightening cycle than in 2018
- Breakevens (and nominal bond yields) suggest that the market believes the Federal Reserve will tame inflation beyond 18 months or so
- We remain concerned that inflation will prove more sticky and persistent beyond this horizon given evidence of wage acceleration, rising housing costs and sustained commodity price increases
- Positioning of the portfolio remained largely unchanged with duration of 8.2 years

Dollar Fund

- Unhedged share class returned 4.3% for the quarter compared to the index which returned 4.1%
- Hedged share class returned 1.7% in the quarter compared to the index which returned 1.6% for the period
- Over the summer the ten year nominal yield troughed at 1.1%, an amazingly low figure against YOY inflation prints in excess of 5%
- Real yields hit their low of the year at -1.2% offering a good opportunity to shorten duration
- Duration was shortening from 9.8 years to 8.5 years (vs 8.4 years for the index)
- The shortening of duration was achieved by selling long bonds and reinvesting proceeds into the belly of the curve
- Since the summer the nominal bond yield has backed up to c.1.5% which has been associated with a back up in real yields to -0.9%
- Breakevens expanded modestly from 2.3% to 2.4% but remain at levels suggesting the market believes inflation is transitory
- US CPI which hit 5% YOY in May, running far higher than forecasts at the start of the year
- Energy price rises will also cause inflation to remain sticky in the short term with 1 year breakevens hitting 3%
- The federal reserve continues to view the current inflationary impulse as transitory and the modest breakevens (and nominal bond yields) suggest this view is largely accepted in the market
- We are concerned inflation could prove more sticky given evidence of wage acceleration, rising housing costs and commodity price increases
- Given the back up in real yields and low breakevens we have considered lengthening duration but have not done so yet