CG AM

Quarter 1 2021 Bullet Points

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

- 0% return on the quarter compared to MSCI UK All Cap of 5.5%
- Risk assets (c.47% of the portfolio) returned 3.6% generating all of the gains
- Gains from risk assets were strongest within equity funds were broadly spread but were particularly strong within UK Small/ Microcap funds
- All other classes of risk asset delivered positive returns
- Index-linked delivered negative returns of 4.6% in the quarter
- Losses were most acute (5-11%) among the funds more minor index-linked holdings (Japan, Sweden & Australia) due to the strength of sterling against these currencies
- Losses of 4.7% on US TIPS arose both from rising bond yields at the long end combined with sterling strength vs. US Dollar
- We are finding limited opportunities in the GBP credit and zeros market currently so this part of the portfolio is slowly reducing in size
- The portfolio remains defensive overall with an objective of capital preservation and inflation protection

Real Return Fund

- Returns of -4.3% in the quarter compared to -3.4% for the Global Index linked ex UK index in the quarter
- In currency terms the relative overweight to the US dollar was a source of outperformance as sterling rose more strongly against the Euro (6%) than against the Dollar (0.8%)
- There were no material changes to asset allocation or duration over the quarter. Modest addition to Japanese index-linked were made and gains on Swedish index-linked were trimmed
- However losses, in local currency terms, were greater for US TIPS in general and for the Real Return Fund in particular owing to its duration being longer than the index
- Nominal bonds sold off dramatically over the quarter, largely related to the Democratic win of the Georgia run-off elections which the market judged would result: in greater fiscal stimulus resulting in higher treasury issuance, with concomitant reduction in required monetary stimulus to support the market
- It was the worst quarter for long US treasury bonds since 1980
- Inflation expectations in the US rose significantly (10y breakevens rose 38bps in the quarter to 237bps) cushioning much of the 83bps rise in 10 year nominal yields over the same period which meant that TIPS dramatically outperformed conventionals
- We had expected that such a sell-off in long nominal bonds would elicit a response from the Fed
- This proved to be incorrect with the Fed seemingly more focused on general financial conditions than absolute levels of the yield curve

Dollar Fund

- Unhedged share class returned -4.2% for the quarter compared to the index which returned -2.9%
- Hedged share class returned -3.3% in the quarter compared to the index which returned -2.0% for the period
- Underperformance was due to the fund's duration of 10.0 years, which is nearly 2 years longer than the index
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- The front end of the yield curve is very steep, pricing in 4 Fed rate hikes before the end of 2023, given the Fed's focus on maximising employment, we judge this to offer an opportunity and have sold sub-3 year duration bonds and reinvested in belly of curve
- Despite believing that the long end of the real curve offers good value, we remained concerned that it could sell off in sympathy with the nominal curve which, when coupled with the Fed's apparent indifference to rising nominal yields, renders us cautious for the time being