Quarter 2 2021 Bullet Points

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

- 5% return in the quarter compared to MSCI UK All Cap of 5.6%
- Risk assets (c.46% of the portfolio) returned 7.6%, ahead of the MSCI UK All Share and investment trust index which were both 5.6%
- The strongest risk assets gains within the conventional equity holdings were in UK Small/ Microcap funds with North Atlantic and Oryx International delivering close to 20% returns
- The property holdings (c.21% of the portfolio) delivered 9% returns with notable strength in Swedish commercial property
- In alternatives the funds participated in 2 new IPOs (Digital9 Infrastructure, Cordiant Digital) and built up a substantial new position in GCP Infrastructure when it fell briefly to a discount to NAV
- In renewable energy infrastructure Next Energy and JLEN were added to the portfolio on their ejected from the FTSE 250 which caused weakness on forced index selling
- Index-linked bonds (30% of the portfolio) returned 3.4% in the quarter, with TIPS returning 4.3% due to a combination of bond strength and modest sterling weakness
- We are finding limited opportunities in the GBP credit and zeros market currently so this part of the portfolio is slowly reducing in size as it runs off
- The portfolio remains defensive overall with an objective of capital preservation and inflation protection

Real Return Fund

- Returns of 3.4% in the quarter compared to 2.8% for the Global Index linked ex UK index in the quarter
- In March a new GBP hedged share class of the Real Return fund was launched and returned 3.3% in the period
- There were no material changes to asset allocation or duration over the quarter
- Ongoing relatively small additions were made in the Japanese 9 and 10 year area
- The Swedish overweight position was helpful due to currency strength
- The US overweight was the key contributor to relative outperformance, with TIPS delivering 3.8% due mostly to falling yields with a small currency benefit
- Following the worst quarter for long US treasury bonds since 1980 in Q1, there was a sharp reversal in Q2 which has continued after the quarter end with the nominal US ten year interest rate falling from 1.75% to 1.25%
- Breakevens were broadly flat, moving modestly lower from 2.35% to 2.25%
- US CPI hit 5% YOY in May, running far higher than forecasts at the start of the year
- US CPI has already accrued 2.1% in the first 5 months of 2021 with momentum building
- 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 sustained commodity price increases

- The inflationary indicators in most other markets point to future increases, although currently the US is experiencing by far the highest current inflation rate
- Weighted average duration remains at 9 years a little longer than the index

Dollar Fund

- Unhedged share class returned 4.1% for the quarter compared to the index which returned 3.6%
- Hedged share class returned 4.3% in the quarter compared to the index which returned 3.7% for the period
- There were no material changes to duration which sits at 9.8 years compared to 8.4 years for the index
- Following the worst quarter for long US treasury bonds since 1980 in Q1, there was a sharp reversal in Q2 which has continued after the quarter end with the nominal US ten year interest rate falling from 1.75% to 1.25%
- The prevailing narrative for the fall in yields is that economic growth has ceased to surprise on the upside, and could be medium terms risks from the rampant Delta variant of the Corona virus
- Breakevens were broadly flat, moving modestly lower from 2.35% to 2.25% which would be consistent with a moderation of economic growth
- Offsetting this narrative of loss of momentum was US CPI which hit 5% YOY in May, running far higher than forecasts at the start of the year.
- US CPI has already accrued 2.1% in the first 5 months of 2021 with momentum apparently building into the second half of the year
- 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
- We have some concern that nominal yields have fallen too low and persistent inflation will cause them to rise

If this occurs the relatively low breakevens should allow TIPS to outperform nominal bonds, however the strong recent returns would moderate whilst this process occurred