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

- 3% return in the quarter compared to MSCI UK All Cap of 2%
- Risk assets (c.44% of the portfolio) returned 4%, ahead of the MSCI UK All Share, MSCI Global and the Investment Trust Index
- Notable gainers include the Japan ESG screened ETF, which makes up close to 5% of the portfolio and gained 7% in the period responding positively to the Japanese election
- After an extended corporate engagement, Gabelli Value Plus + plc de-listed and returned capital during the quarter, ending a profitable investment and intervention
- The property holdings (c.19% of the portfolio) had another strong quarter delivering 3% returns, notwithstanding some weakness in German residential
- Key property performance driver was the accepted bid for GCP Student Living in the quarter, which was one of the larger individual holdings
- After a strong period of property gains, we have been reducing exposure with some rotation into certain infrastructure positions with similar characteristics
- A very busy period of placings, with participation in 11 different share issues with a concentration in the infrastructure sector
- Index-linked bonds (30% of the portfolio) returned 4% in the quarter, due to a combination of strong inflation accruals and sterling weakness
- Two large credit holdings matured delivering very strong returns over the life of the bonds - Pershing Square Holdings 5.5% 2022 (called early) and JZ Capital 6% 2021 convertible bond
- Corporate credit spreads remain so tight that this part of the portfolio is reducing in size
- The portfolio remains defensive overall with the dual objectives of capital preservation and inflation protection

Real Return Fund

- Returns of 3.7% in the quarter compared to 3.5% 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 1.4% in the period
- The US overweight was the key contributor to relative outperformance, with the TIPS portfolio delivering 4.5% due to both falling yields and currency gains
- Responding to the strong TIPS gains, portfolio duration was shortened via disposals of long bonds and reinvestment into the belly of the curve
- TIPS duration today stands at 9.4 years approximately a year longer than the TIPS benchmark duration
- Ongoing relatively small additions were made in the Japanese 9 and 10 year area
- Relative performance also helped by the short duration of the Canadian holdings
- US CPI remains quite sticky at 5% YOY in May with one year forward breakevens at 3% over the next 12 months
- 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 cost of living increases, although currently the US is experiencing by far the highest current inflation rate
- Weighted average duration is 8.7 years - a similar length to the index

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