

cgam

A Good Start

*Reflections on the first forty years of running
Capital Gearing Trust*

Capital Gearing Trust – AGM 12 July 2022

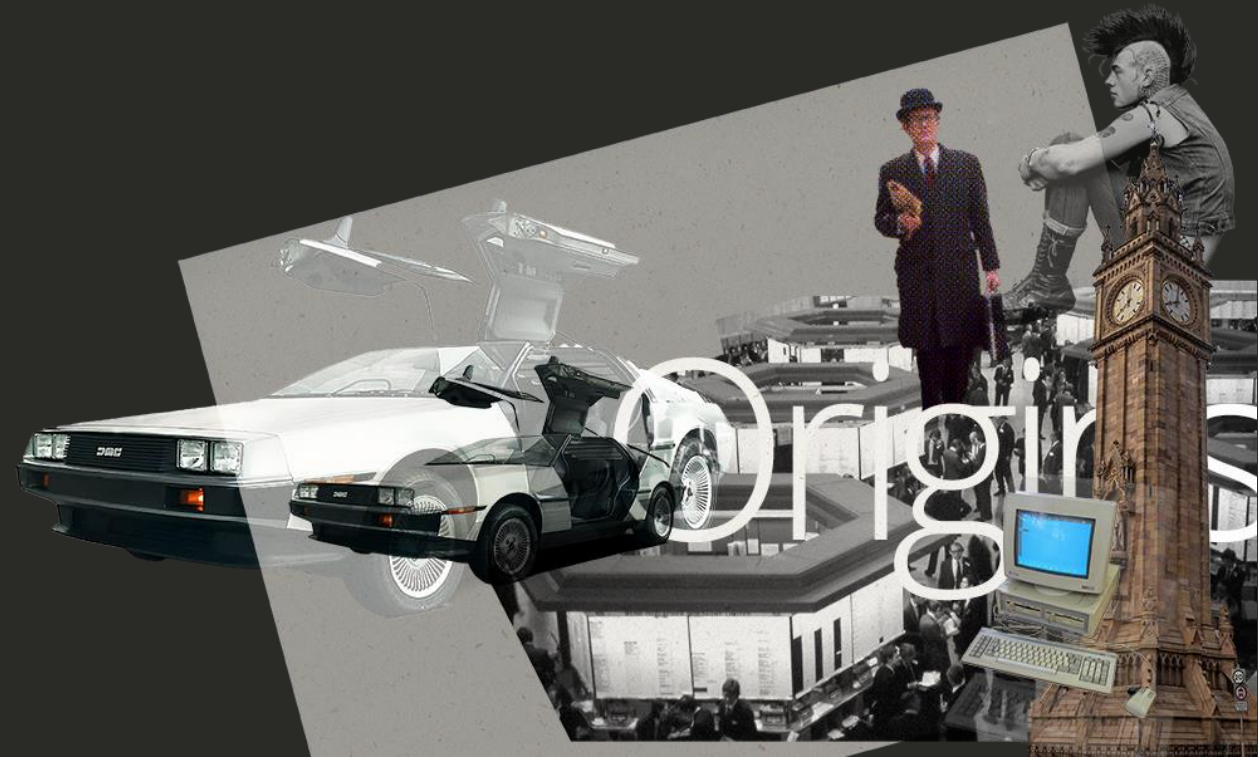


Agenda

- 1. Returns and Approach*
- 2. Lessons Learned*
- 3. The Trust Today*
- 4. The Next 40 Years?*

Returns and Approach

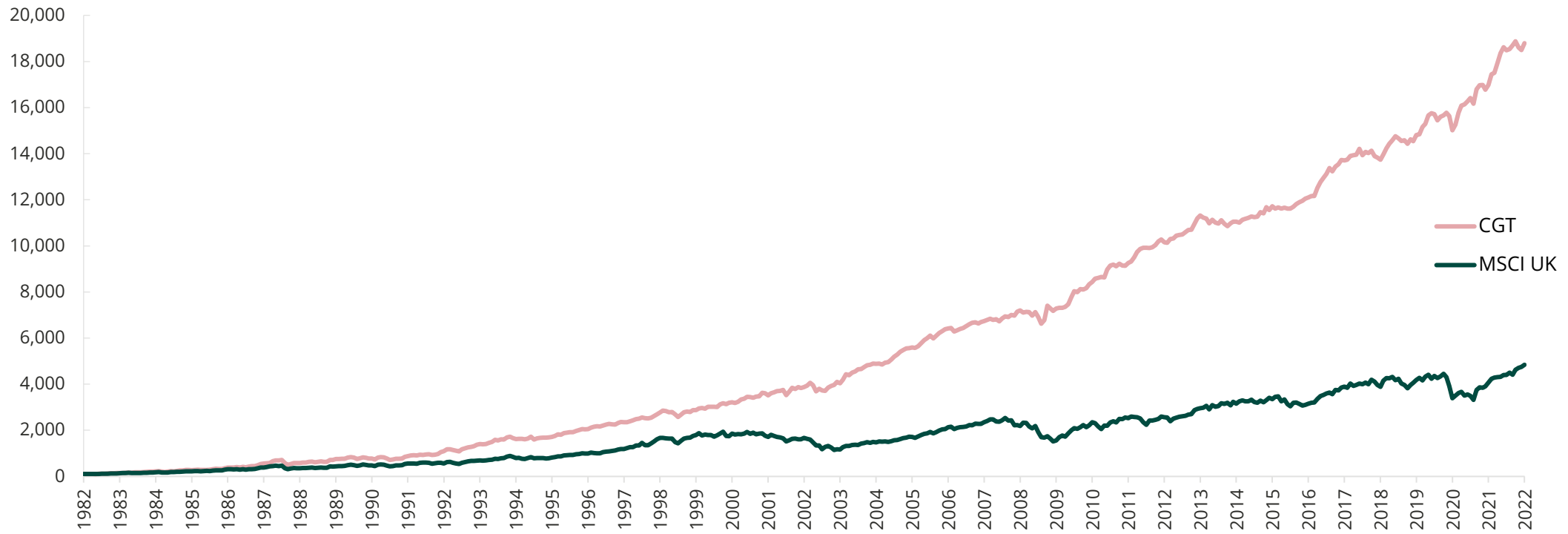
1



RETURNS AND APPROACH

A good start

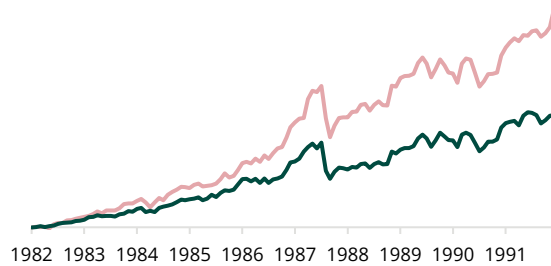
NAV Total Return History (Rebased) Apr 1982 to Apr 2022



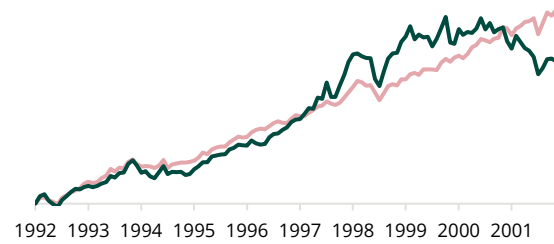
RETURNS AND APPROACH

The story by decades

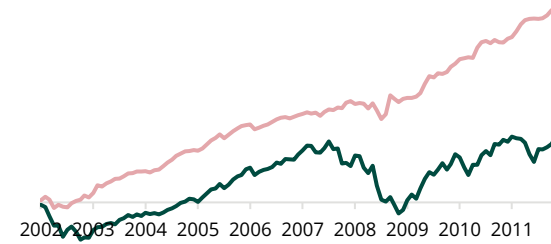
80's - The Go Go Years



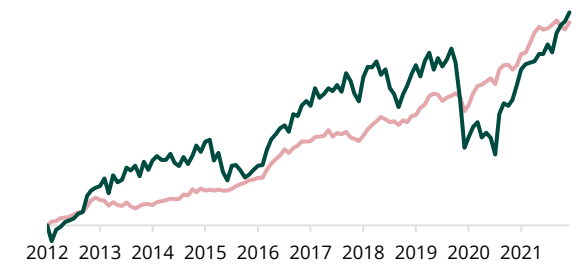
90's - The Bubble Inflates



00's - The Bubble Bursts



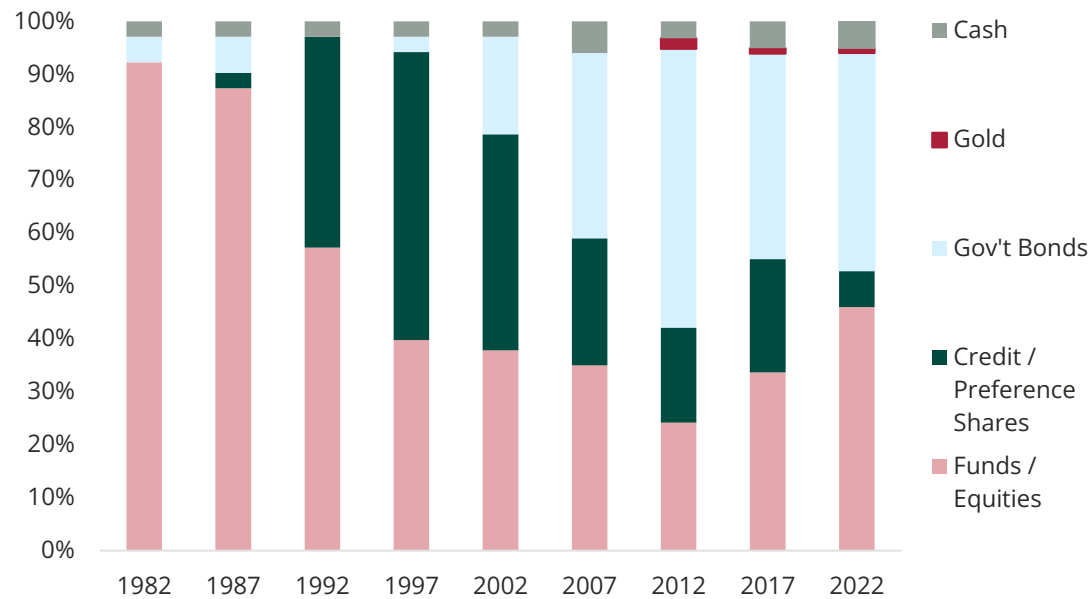
10's - The Bubble Inflates Again



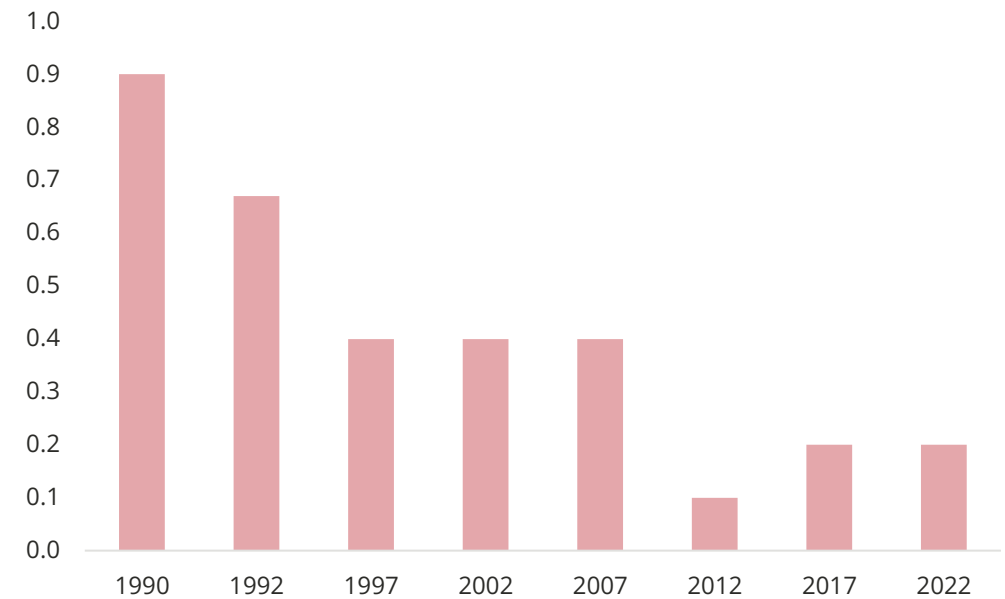
RETURNS AND APPROACH

Delivering equity returns without the equity risk

Asset Allocation 1982 to 2022



Equity Beta 1990 to 2022



*“We have **relied on you** to hold our coats whilst we fish in riskier waters, safe in the knowledge that we can get our coats back when **markets get chilly**”*

EXCERPT FROM A LETTER SENT TO US BY A
CAPITAL GEARING TRUST INVESTOR



Lessons Learned

2



“ESG is the dominant topic amongst investors currently. With environmental and social aspects particularly widely discussed. Governance has received less emphasis; yet it is vital for the long-term interests of investors and for wider society”

PETER SPILLER, WHAT INVESTMENT TRUST 2020



LESSONS LEARNED

Governance matters – a close shave

CGT's story might have been a shorter one had directors not rebuffed a hostile approach

In one of the more bizarre episodes in its history, in 1985 Capital Gearing Trust received a bid approach from an stockbroking firm called Harvard Securities. Harvard had acquired 5% of CGT before launching the bid.

Harvard's Chairman and Chief Executive was Tom Wilmot who claimed CGT's performance "had been pedestrian" in his justification for the approach. Given share price total returns of close to 40% CAGR for the previous 4 years, these claims were highly inaccurate. It seems the objective of the approach was to ramp the shareprice of the small company in which Harvard had a 5% stake.

A long run investigation by the FSA into the

conduct of Tom Wilmot and his two sons in the years between 2003 and 2008 lead to charges of boiler room fraud perpetrated against 1,700 investors. The three men were sentenced to a combined total of 19 years in prison.

Directors play a central role in protecting shareholders' interests and are one of the great strengths of investment trusts. They (should) protect investors from the potentially predatory actions of conflicted parties, including keeping a close eye on the investment manager.

Given the expense of employing directors, investment trust boards should not be large. However they are key to maintaining high standards in the sector.

The view from Fleet Street

A majority of shareholders in Capital Gearing Trust have followed its board's example and have voted against the cash and loan stock offer from Mr Tom Wilmot's Harvard Securities.

Financial Times 12/9/1985

City stockbroker, Tom Wilmot jailed for £27.5mn boiler scam, apologies for scruffy court appearance after his ex-wife "burnt all his clothes"

Daily Mail 26/02/2014

LESSONS LEARNED

Discounts matter – they are a source of risk, a cause of poor liquidity and in most cases need not exist at all

Boards today have much greater power than they think to solve both discount and liquidity issues

Robin Angus, the veteran investment trust analyst and Personal Assets director, refers to the 8th November 1999 as “discount freedom day”. On this day changes in regulation allowed directors much greater powers to issue and buy back shares in their companies. This provided a mechanism for directors to control discounts and improve liquidity in any investment trust with a liquid underlying portfolio.

These powers were hard won. The problems of investment trust discounts, and associated poor liquidity, are well understood. Less frequently discussed but no less problematic were large premia.

After a strong run of performance and good

press coverage in the late 1980's a huge premium emerged in CGT shares. Regulations prevented the issuance of new shares where the directors could not identify who was buying those shares.

This resulted in one shareholder paying more than a 250% premium for their newly acquired shares. Whilst they were very poorly advised in their actions, if they still hold their shares today they have outperformed the UK stock market.

Directors should make much great use of their hard won powers of discount control. The success of the Exchange Traded Fund structure evidences the huge opportunities that that have been missed due to their lack of courage in addressing this obvious issue.

“Now that is what I call a premium!” - CGT share price premium to NAV 1985 to 1992



*“The use of a growing array of derivatives ...
are key factors underpinning the greater
resilience of our largest financial institutions”*

ALAN GREENSPAN, MAY 2005

*“The huge size of the derivative market, in
particular the rapidly growing Collateralised
Debt Obligations and CDO squared products,
creates a highly fragile financial system”*

PETER SPILLER, MAY 2005



LESSONS LEARNED

Leverage matters – the best time to gear is when credit is scarce, not when it is plentiful

Capital Gearing Trust, as the name suggests, made use of debt when interest rates were high

During the 1980's CGT had two distinctive characteristics. The first was primarily investing in other investment trusts. The second was that it used a variety of methods to gear its balance sheet.

The primary mechanism by which this gearing was achieved involved borrowing against the future value of a series of endowment policies written on the lives of more than 400 employees of Capel Cure Myers, CGT's broker. It is hard to imagine collateral and arrangements of this sort being used today!

The debt was very expensive compared to today, with interest rates as high as 11.5%. However the proceeds of the borrowing were used to

purchase assets at extremely low valuations. This allowed CGT to be geared into the 1980's bull market, which was far greater in scale than the 1990's bull market.


Almost the opposite environment has prevailed during this millennium. Very low interest rates have encouraged a huge debt build up. Often investors attracted by very low interests rates have leveraged their assets in the process raising asset prices and reducing the returns available on those assets.

If valuations are low, then risk is low even if volatility is high and vica versa. Paradoxically the best time to borrow may well be when interest rates are very high.

Capital Gearing Trust – Mortgage Document

No. of Company 5574/14/2218 FORM NO. 41.

THE COMPANIES ACT, 1948. 28 FEBRUARY 2014



See Below

PARTICULARS OF A MORTGAGE OR CHARGE CREATED BY A COMPANY REGISTERED IN ENGLAND.
Pursuant to Section 95.

Name of Company { CAPITAL GEARING TRUST Limited. }

The fee payable on registration of a Mortgage or Charge is 10/- if the amount secured does not exceed £200, and £1 if it exceeds £200.

The Trust Today

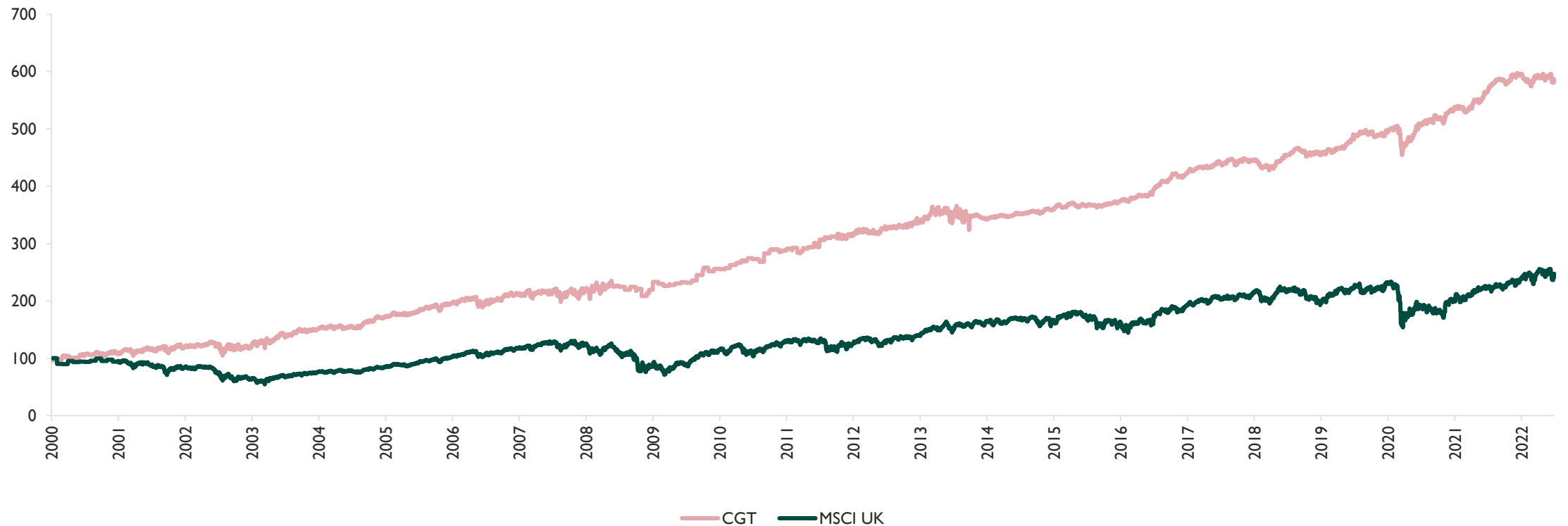
3



CGAR – TRACK RECORD

A simple aim - to preserve, and over time to grow shareholder's real wealth

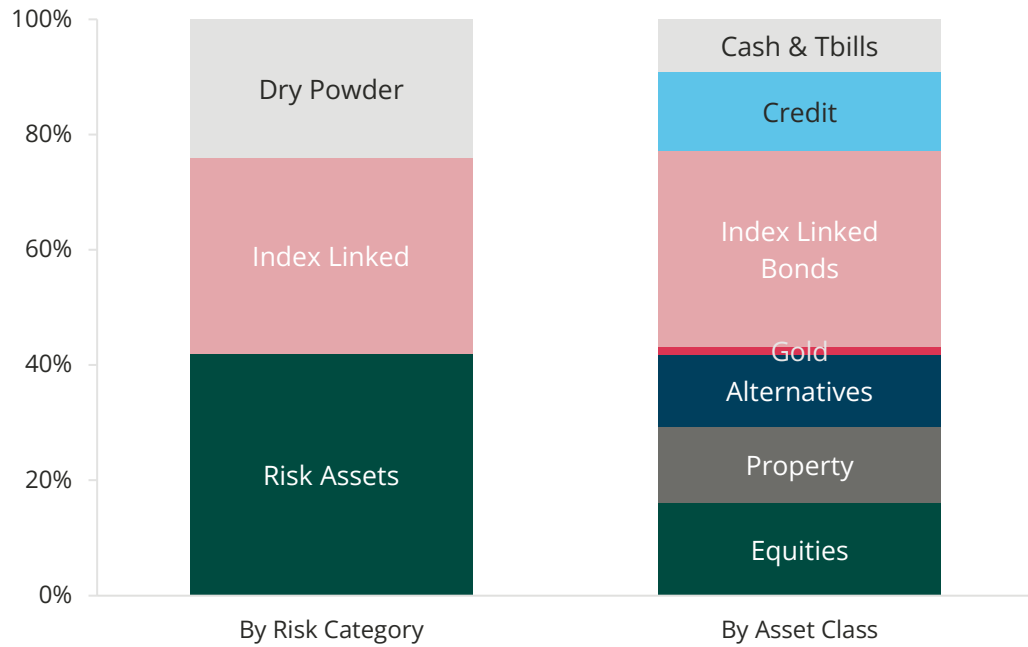
Capital Gearing Trust - NAV Total Return History



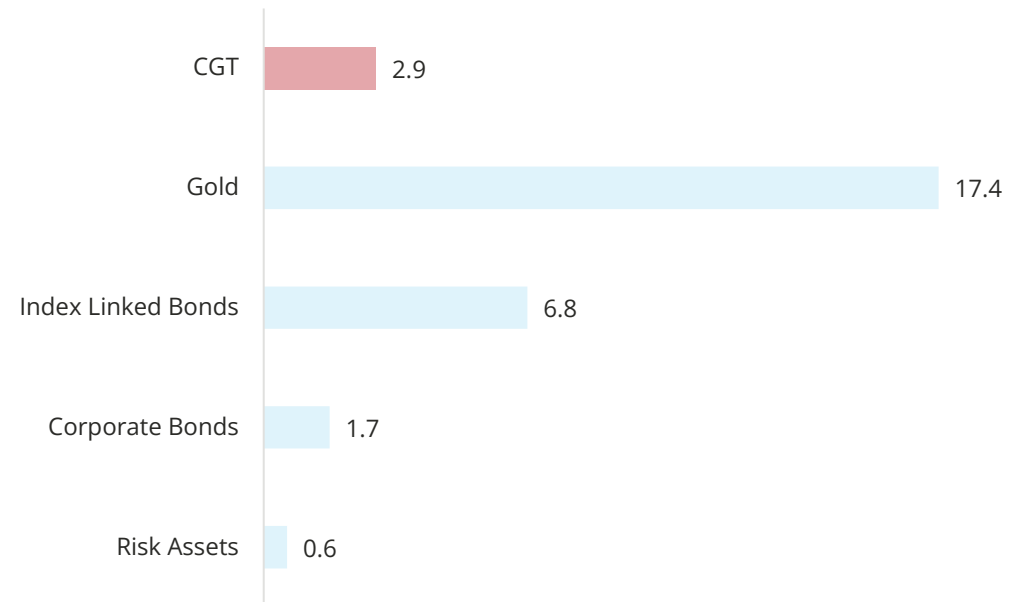
THE TRUST TODAY

Positioning remains defensive with a focus on inflation protection

CGT Asset Allocation June 2022 (%)



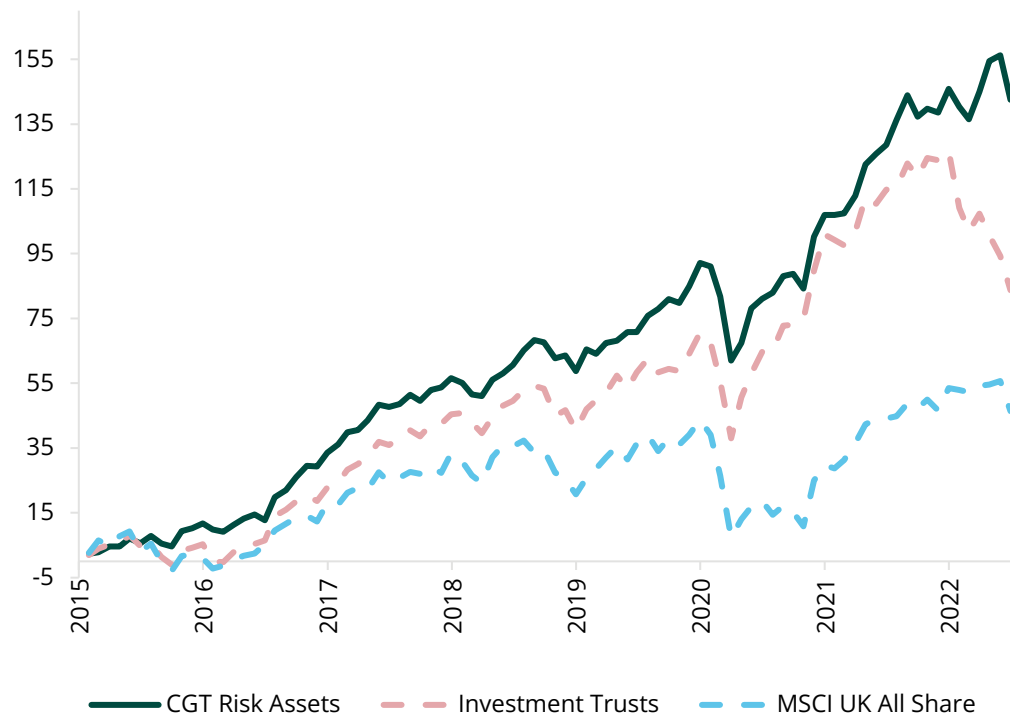
Returns by Asset Class over last twelve months (%)



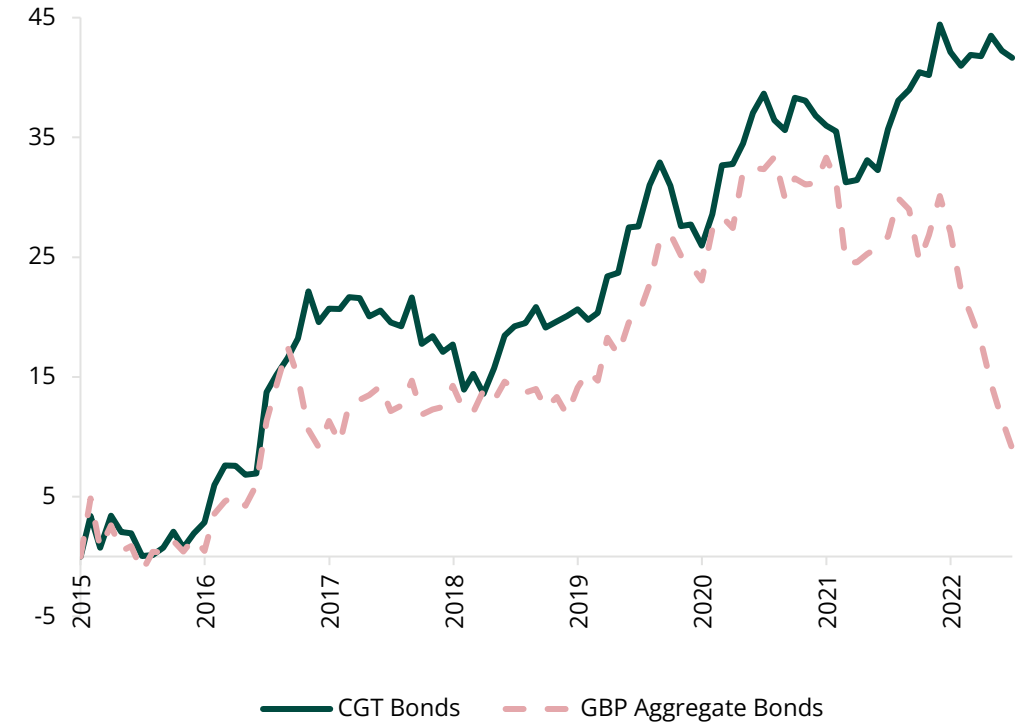
THE TRUST TODAY

Both the equity and bond portfolios outperformed their benchmarks contributing to the stability of returns

CGT Risk Assets* Performance to June 2022 (%)



CGT Bonds Only* Performance to June 2022 (%)

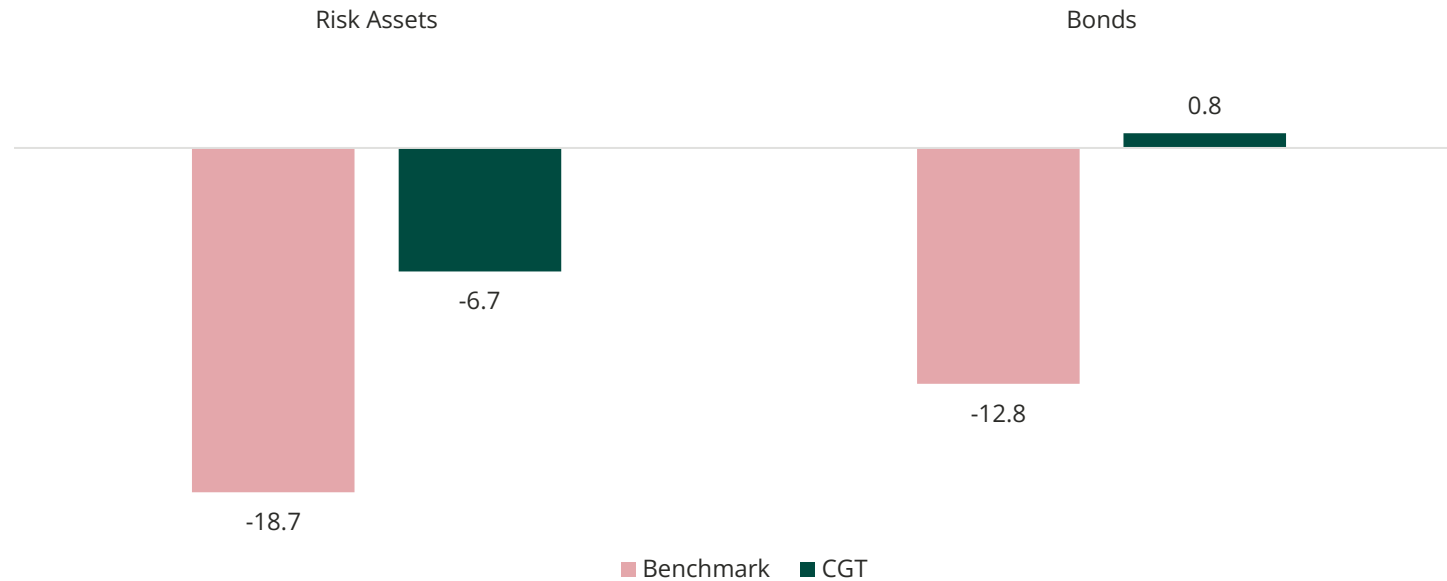


*Risk Assets include equities, property, alternatives and gold. Bonds includes credit and sovereign bonds (excluding treasury bills and cash)

THE TRUST TODAY

This year has proved to be a good test to demonstrate the defensive characteristics of the portfolio

CGT YTD June 2022 Performance vs. Benchmarks*

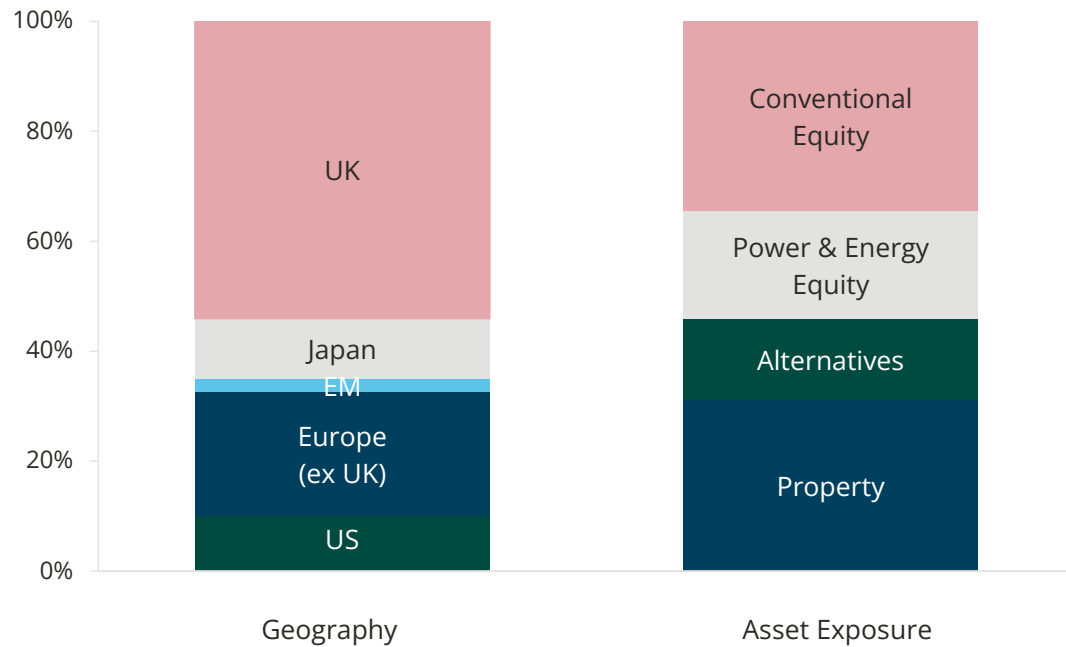


*Bond benchmark = GBP Aggregate, Risk Assets Benchmark = Investment Trust Index ; Risk Assets include equities, property, alternatives and gold. Bonds includes credit and sovereign bonds (excluding treasury bills and cash)

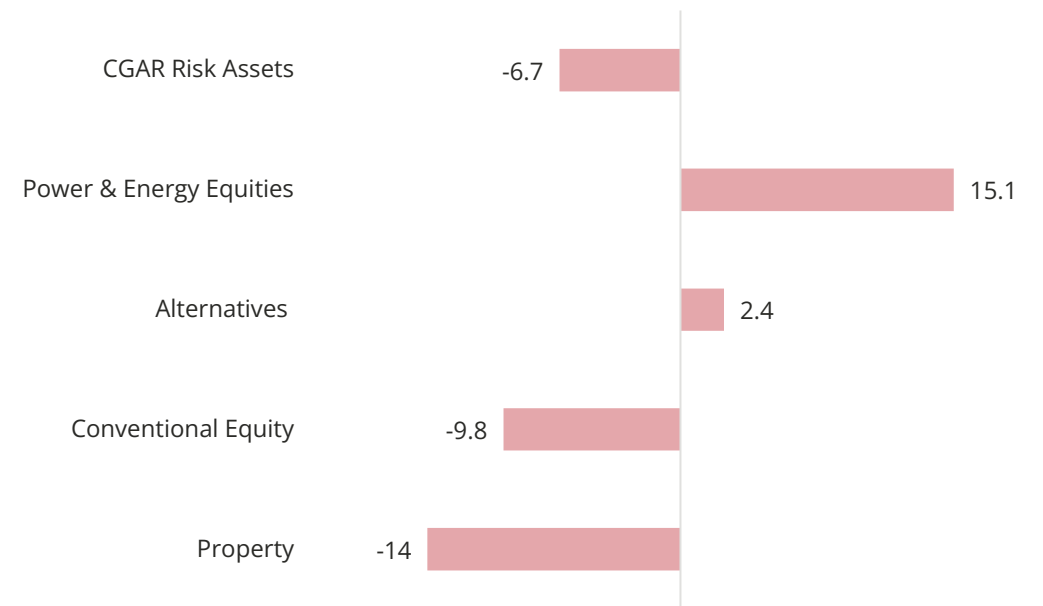
THE TRUST TODAY

A substantial allocation to Power & Energy delivered equity outperformance in the period

Risk Assets – Geographic Exposure and Asset Exposure



YTD June 2022 Risk Asset Performance (%)



OUTLOOK

What areas are we currently focused on?

Real Interest Rates

- *Real rates have turned positive in the US and look attractive in both relative and absolute terms*

Japanese Yen

- *Extraordinary value, particularly should inflationary concerns rise*

Credit

- *Selling pressure from both investment banks and mutual funds has given rise to attractive spreads in high quality credits*

Energy & Renewables

- *Geopolitical tensions and dearth of CAPEX should be supportive of prices*
- *Renewable infrastructure provides direct access to inflation linked government cashflows*

The Next 40 Years?

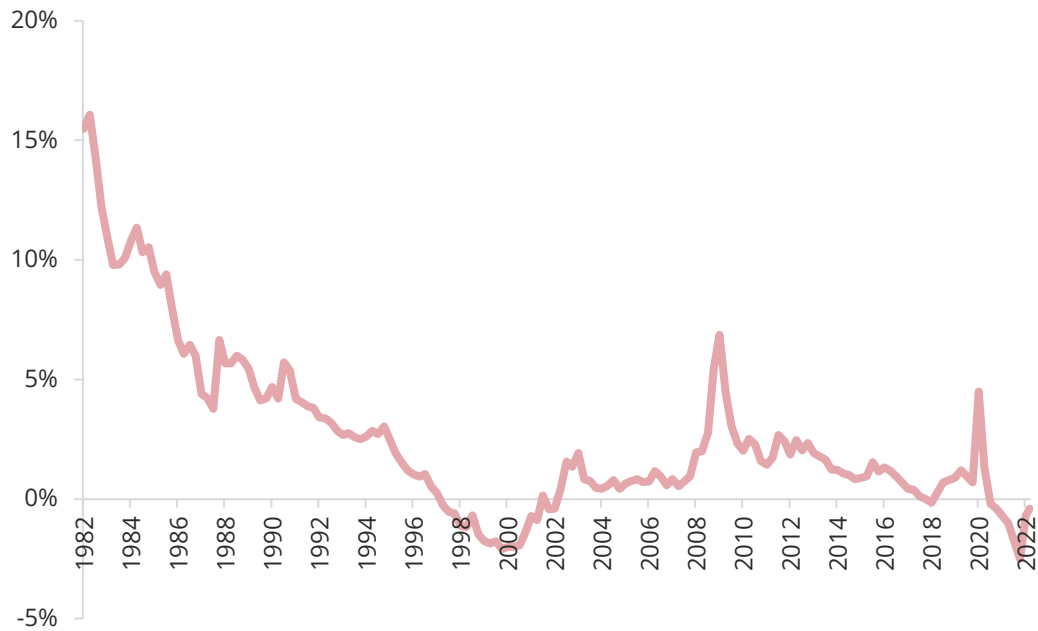
4



THE NEXT 40 YEARS?

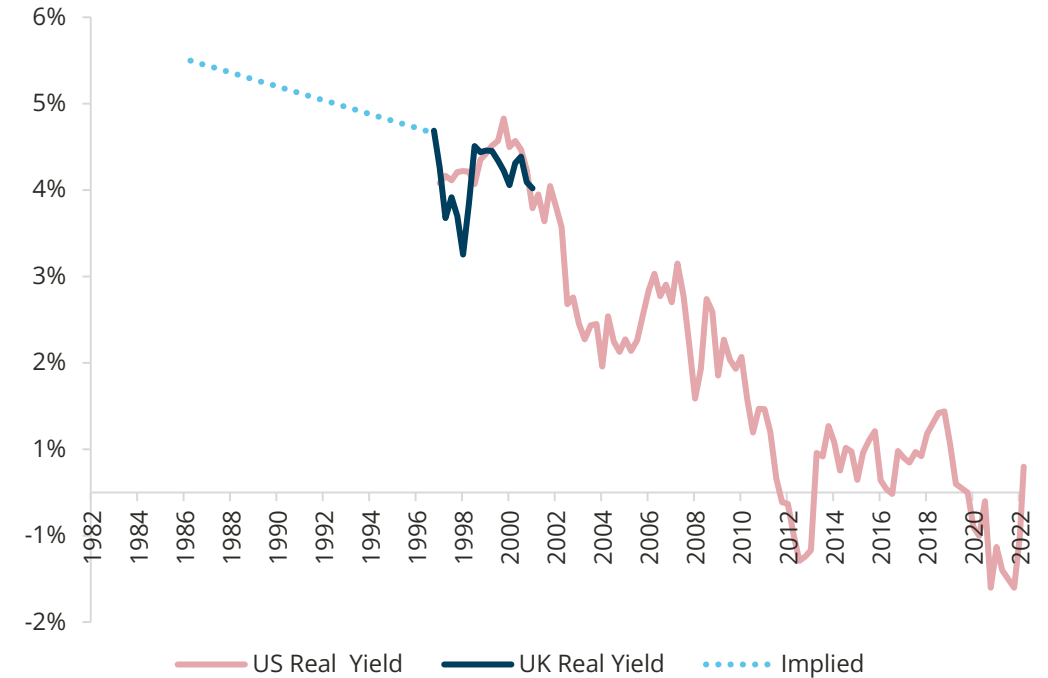
“My advice to any fund manager is to start their career in 1982”¹

S&P 10 Year Real Return Model – 1982 to 2022



Model based on: Dividend + Earnings Growth + Valuation Change

10 Year US Real Yields – 1982 to 2022

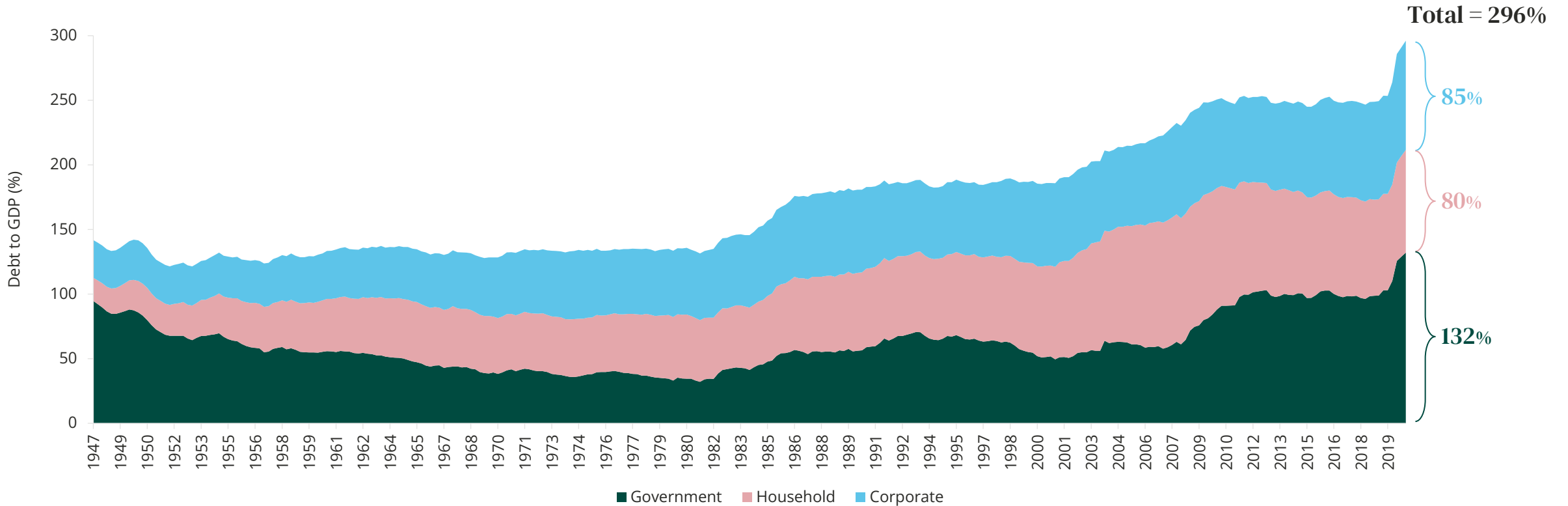


1 - Advice from Peter Spiller to Alastair Laing on joining CGAM in 2011

THE NEXT 40 YEARS?

The road to hell is paved with IOUs

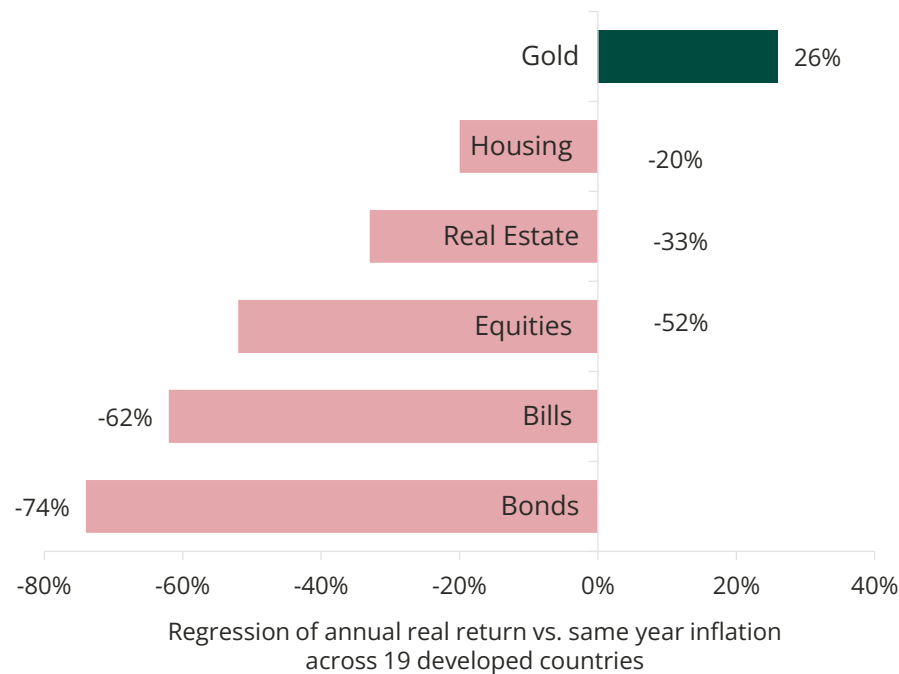
US Non-Financial Debt to GDP



THE NEXT 40 YEARS?

We are acutely aware of the historical impact of inflation on asset prices - including those that are deemed to be real

Real Return vs. Inflation 1900-2011



"For a variety of reasons reviewed here, inflation tends to raise investors' required real rate of return on equity and to lower real capital income for tax-related reasons. As a result there is a strong negative correlation between inflation and real and nominal stock prices."

John Tatom, November 2011

Inflation and Asset Prices

“This change reflects our view that a robust job market can be sustained without causing an outbreak of inflation”

JEROME POWELL / JACKSON HOLE, AUGUST 2020

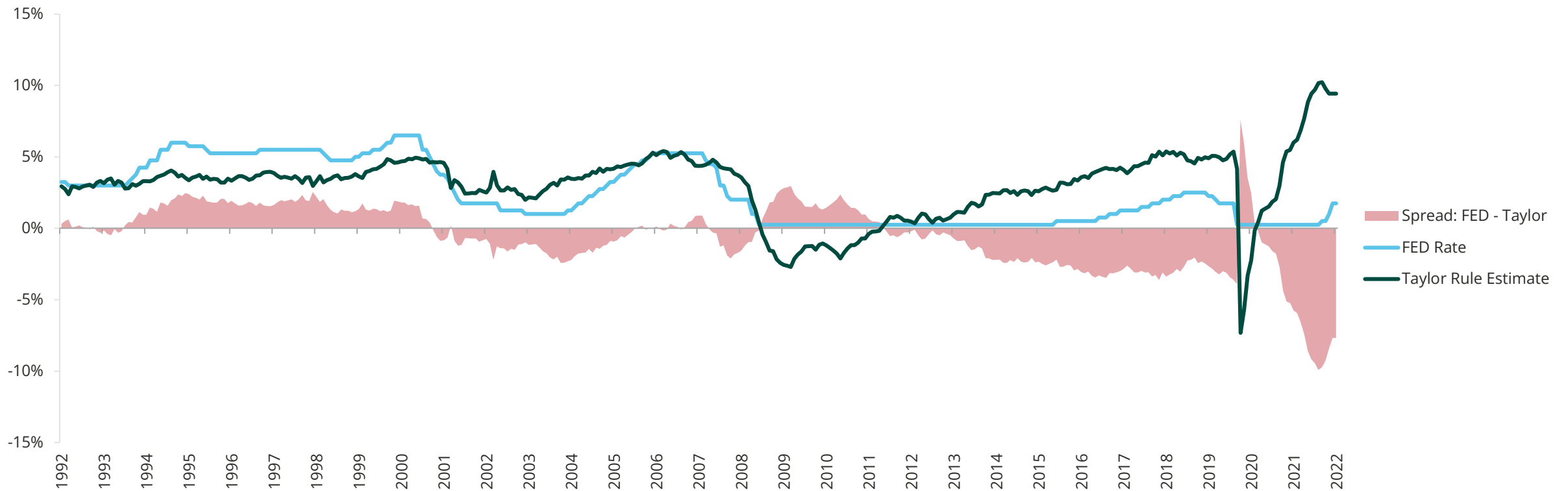
“Monetary finance will not be deemed an issue so long as inflation does not rise. This mindset significantly increases the risk of inflation becoming problematic”

PETER SPILLER / CGT ACCOUNTS APRIL 2020

THE NEXT 40 YEARS?

The US economy is close to full employment, inflation is high and yet monetary policy remains at emergency levels

Taylor Rule vs. Fed Funds – Last 30 years



THE NEXT 40 YEARS?

Providing security in my old age!

Peter Spiller, CIO



Alastair Laing, Co-Manager



Chris Clothier, Co-Manager



Hassan Raza, CFA
Investment Analyst



Chris Taylor, COO



Lydia Groves, Operations Analyst



Richard Goody, Risk & Compliance
Director



Jason Barlow, Risk & Operations
Manager



Investments

Operations

Risk & Compliance

Contact us

Chris Clothier

+(44) 203 906 1632

cclothier@cgasset.com

CG Asset Management
20 King Street London
EC2V 8EG

info@cgasset.com

www.cgasset.com