

cgam

Investor Day

1 November 2022
Grocers' Hall



Disclaimer

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The value of all investments and the income there from can go down as well as up and the investor may not get back the amount invested. Past performance is not necessarily a guide to future performance. Investors should also note that changes in rates of exchange may cause the value of investments to go up or down.

This presentation was prepared on 26th October 2022, and fund performance data is updated to 30th September 2022. Other market data may be less up to date, nevertheless the managers consider such data to be representative of prevailing market conditions.

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CGAM INVESTOR DAY

Agenda

<i>1. Life begins at 40</i>	<i>Chris Clothier</i>	<i>10.00 am</i>
<i>2. The Money Illusion</i>	<i>Alastair Laing</i>	<i>10.20 am</i>
<i>3. Volcker's Ghost</i>	<i>Peter Spiller</i>	<i>10.40 am</i>
<i>4. Coffee break</i>		<i>11.05 am</i>
<i>5. Keynote speech</i>	<i>Janan Ganesh</i>	<i>11.30 am</i>
<i>6. Q&A</i>		<i>12.00 pm</i>
<i>7. Drinks</i>		<i>12.30 pm</i>

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Life begins at 40

Chris Clothier



LIFE BEGINS AT 40

Four new team members have joined the team...

Emma Moriarty



Lisa Bajardi



Sindy Somanader



LIFE BEGINS AT 40
...including our Chief Morale Officer

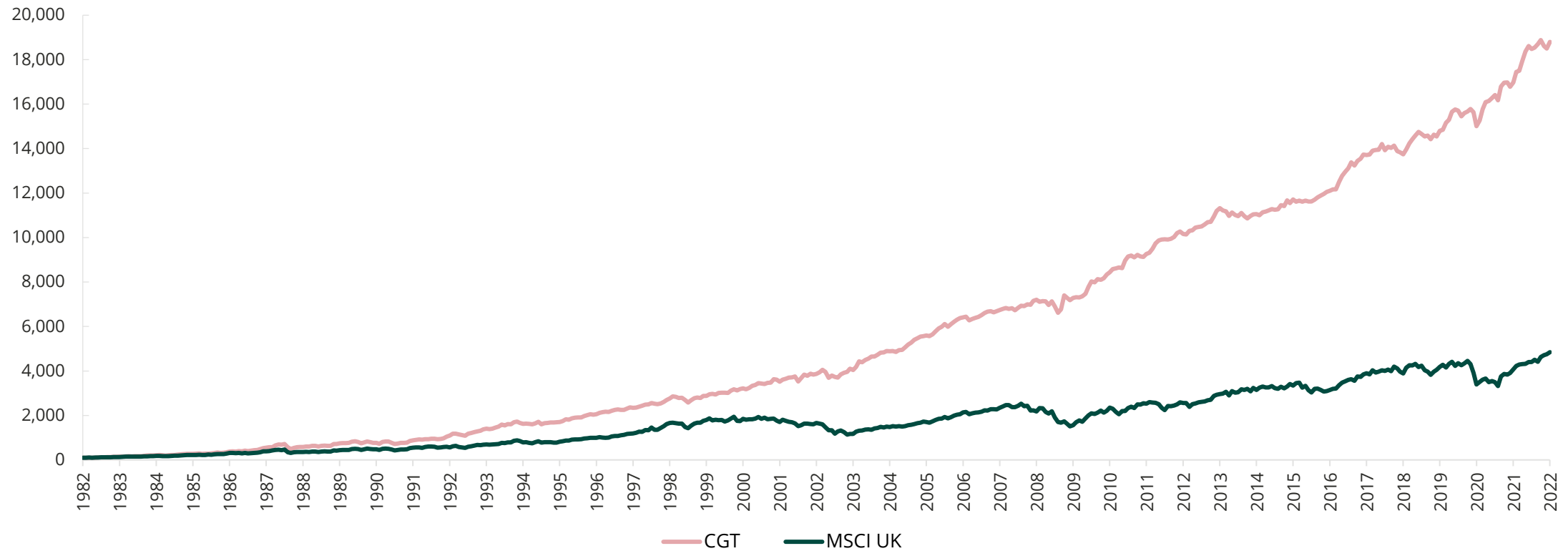
Finn



LIFE BEGINS AT 40

A good start

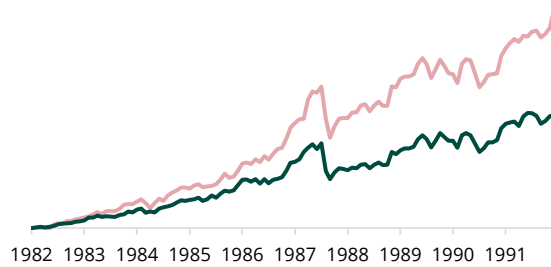
NAV Total Return History (Rebased) Apr 1982 to Apr 2022



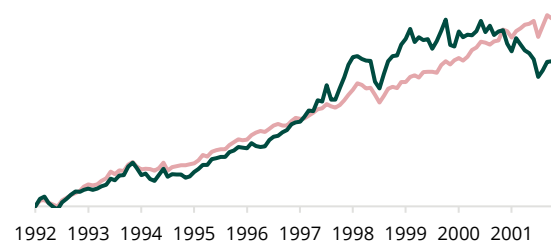
LIFE BEGINS AT 40

The story by decades

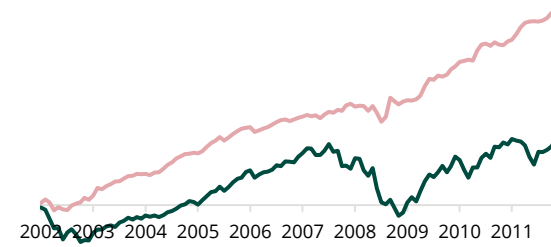
80's - The Go Go Years



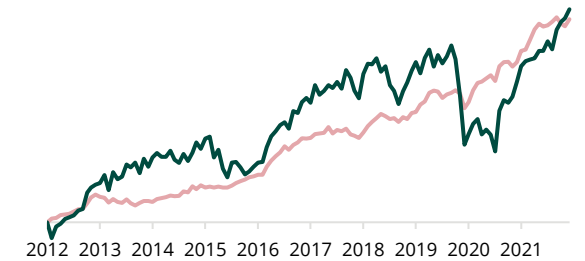
90's - The Bubble Inflates



00's - The Bubble Bursts



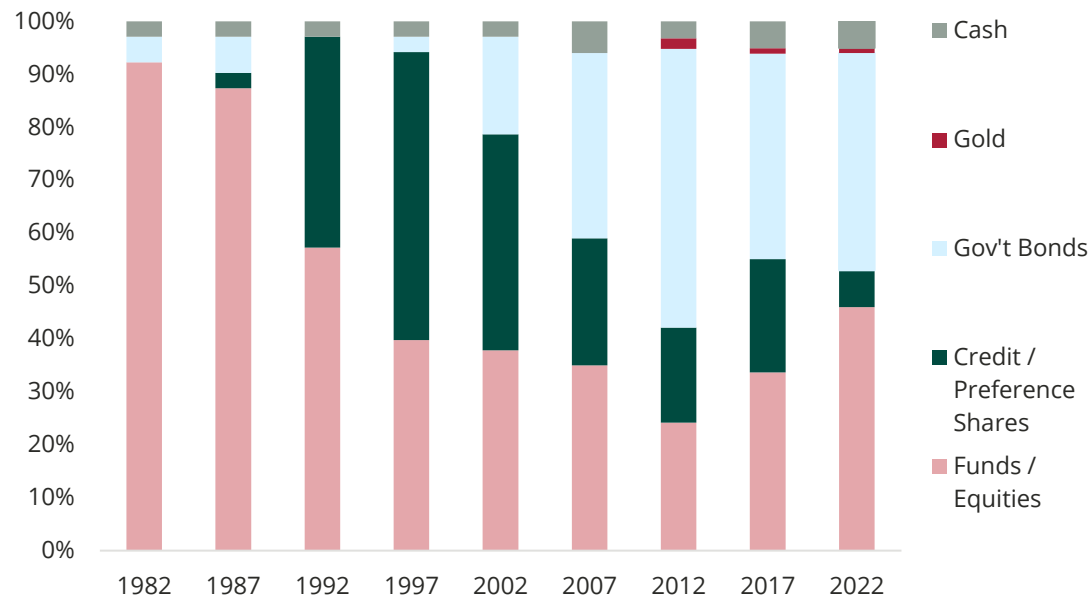
10's - The Bubble Inflates Again



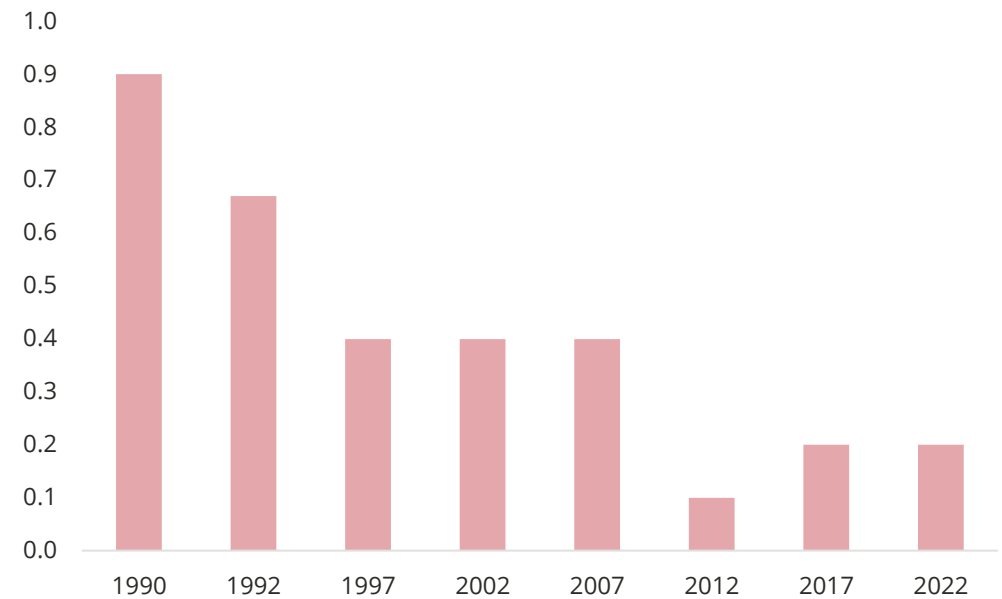
LIFE BEGINS AT 40

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

“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



LIFE BEGINS AT 40

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

LIFE BEGINS AT 40

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 legendary investment trust analyst and Personal Assets director, referred 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



LIFE BEGINS AT 40

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 interest 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 vice 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 1984

See Below

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

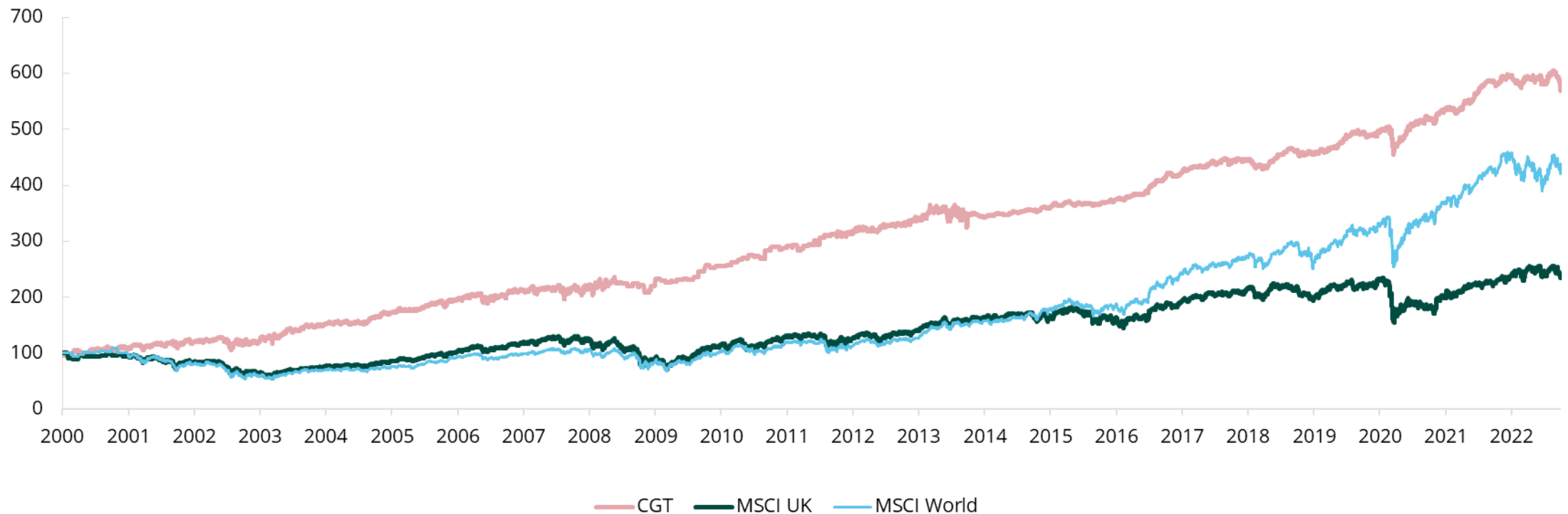
Name of Company { CAPITAL GEARING TRUST Limited. }

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.

LIFE BEGINS AT 40

A simple aim – to preserve, and over time to grow shareholders’ real wealth

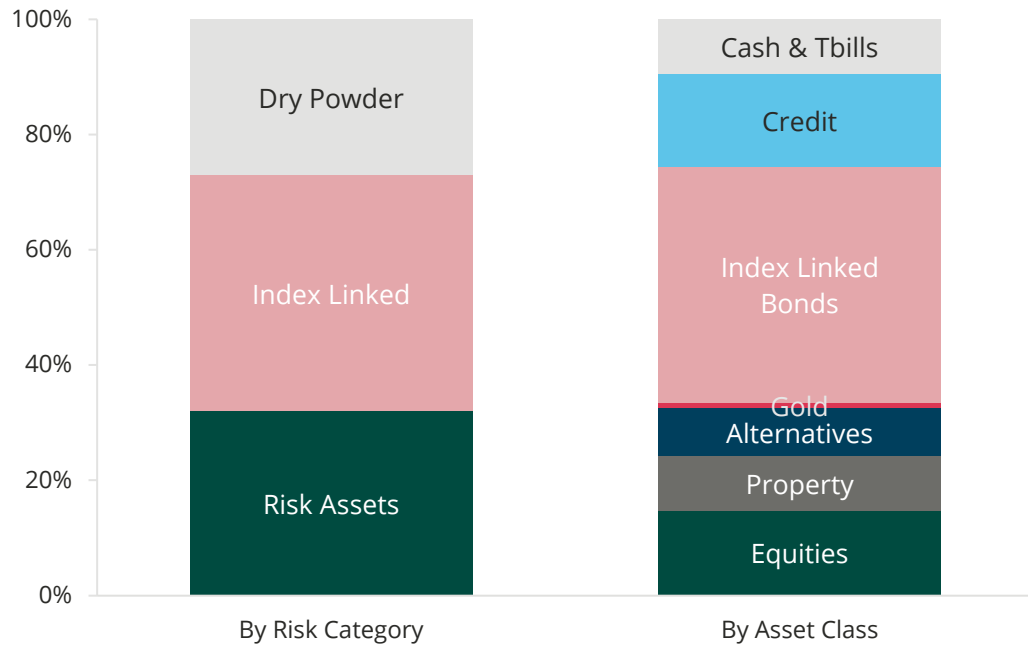
Capital Gearing Trust - NAV Total Return History



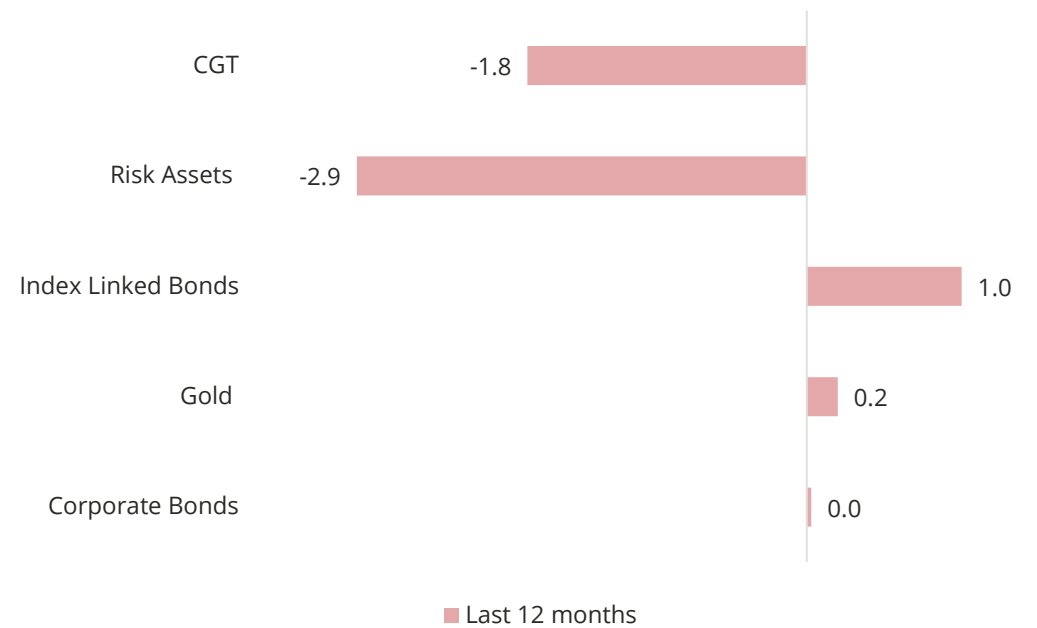
LIFE BEGINS AT 40

Positioning remains defensive with a focus on inflation protection

CGT Asset Allocation September 2022 (%)



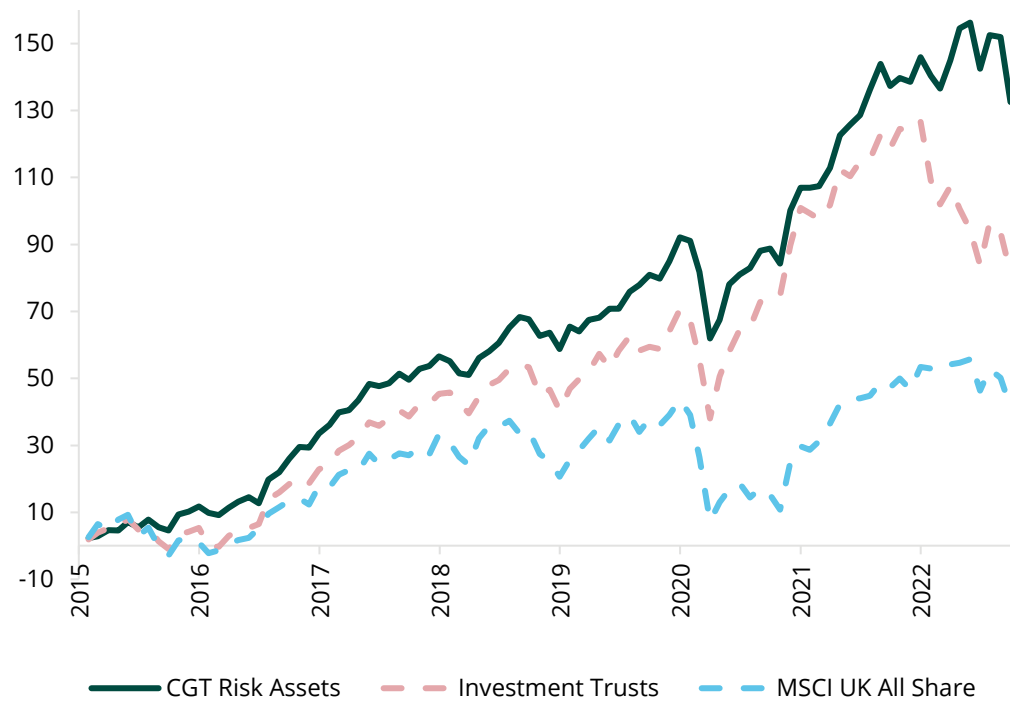
Returns by Asset Class (%)



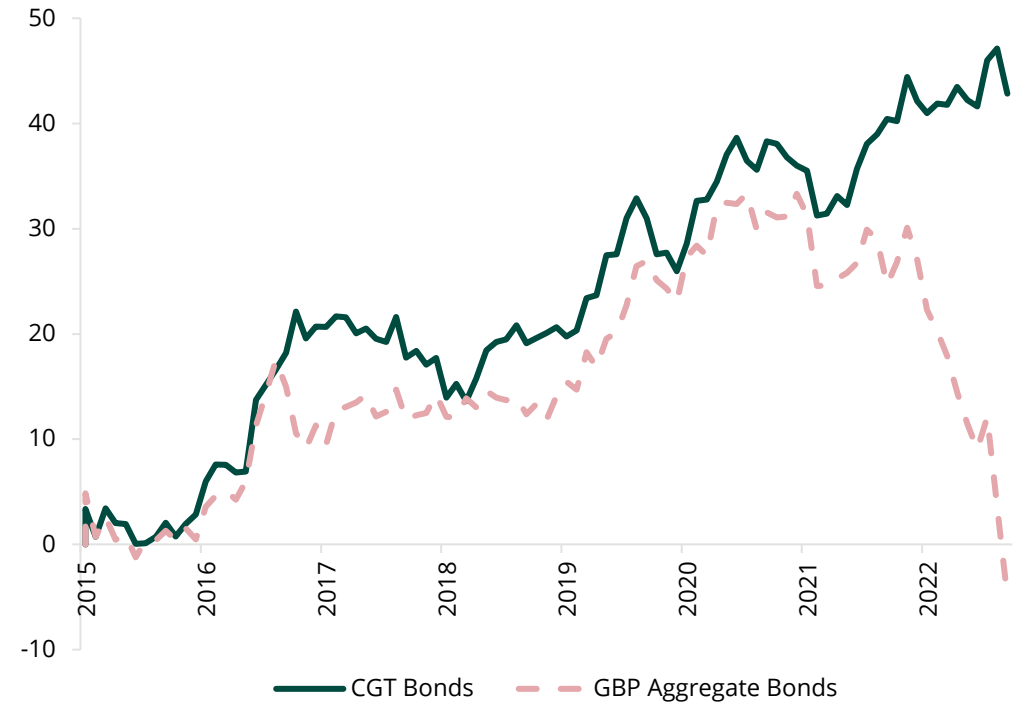
LIFE BEGINS AT 40

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

CGT Risk Assets* Performance to September 2022 (%)



CGT Bonds Only* Performance to September 2022 (%)



*Risk Assets include equities, property, alternatives and gold. Bonds include Credit and sovereign bonds (excluding T-Bills and Cash)

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The Money Illusion

Alastair Laing



THE MONEY ILLUSION

It is November 2021 and you are worried about inflation, what do you do?

THE MONEY ILLUSION

It is November 2021 and you are worried about inflation, what do you do?

UK Inflation Linked Bond 2073 - Price (£)

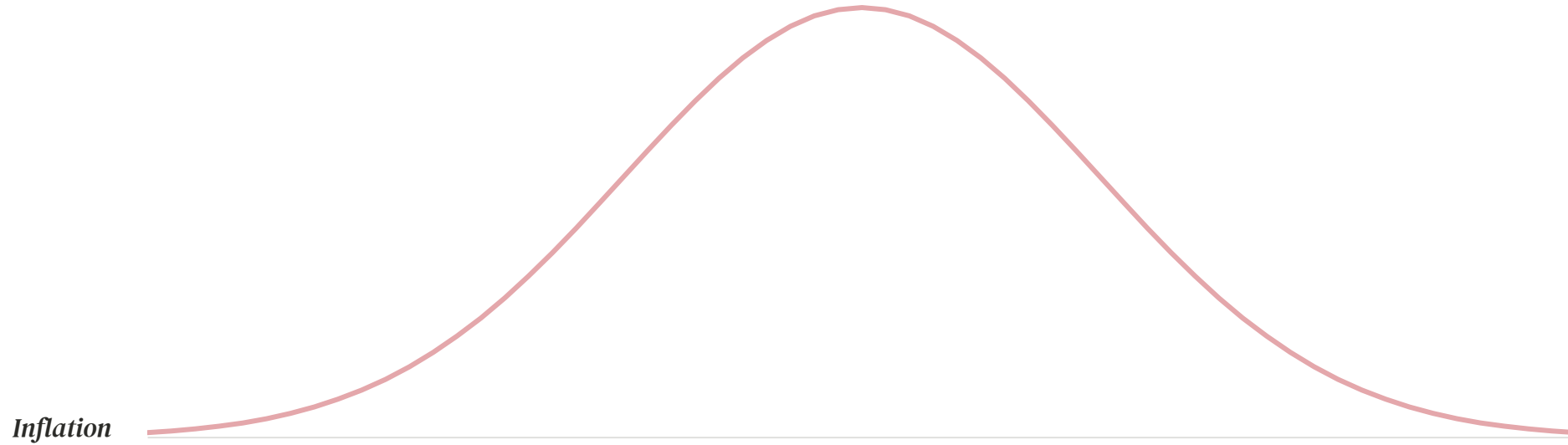


There are widespread misconceptions about how inflation impacts asset prices:

- Equities are **not an inflation hedge...** they actually love disinflation
- Be very **sceptical** of real assets claims
- Valuation **really** matters

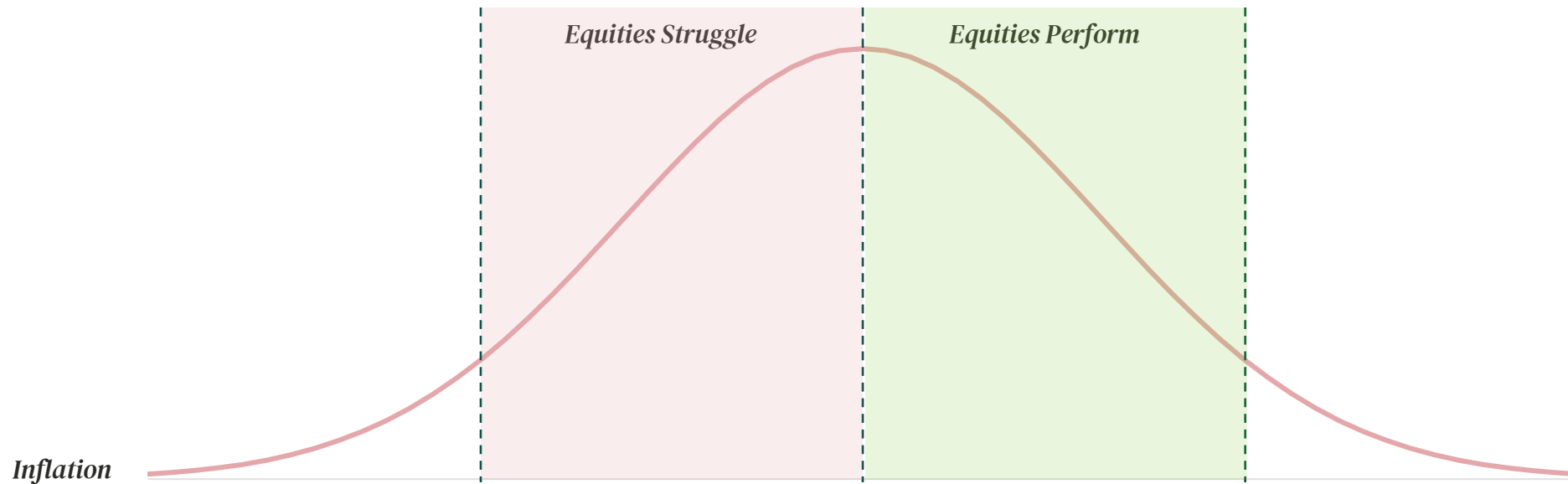
THE MONEY ILLUSION

Equities are not an inflation hedge



THE MONEY ILLUSION

Equities are not an inflation hedge



“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

Inflation and Asset Prices

“Real assets are **physical assets that have an intrinsic worth due to their substance and properties.** Real assets include **precious metals, commodities, real estate, land, equipment, and natural resources**”.

INVESTOPEDIA

Hand drawn by J. G. S. (likely J. G. Smith)



Back 'A'

1st fl.

2nd fl.

Upper Storey

Lower Storey

Ground Floor



Back 'B'

Upper Storey

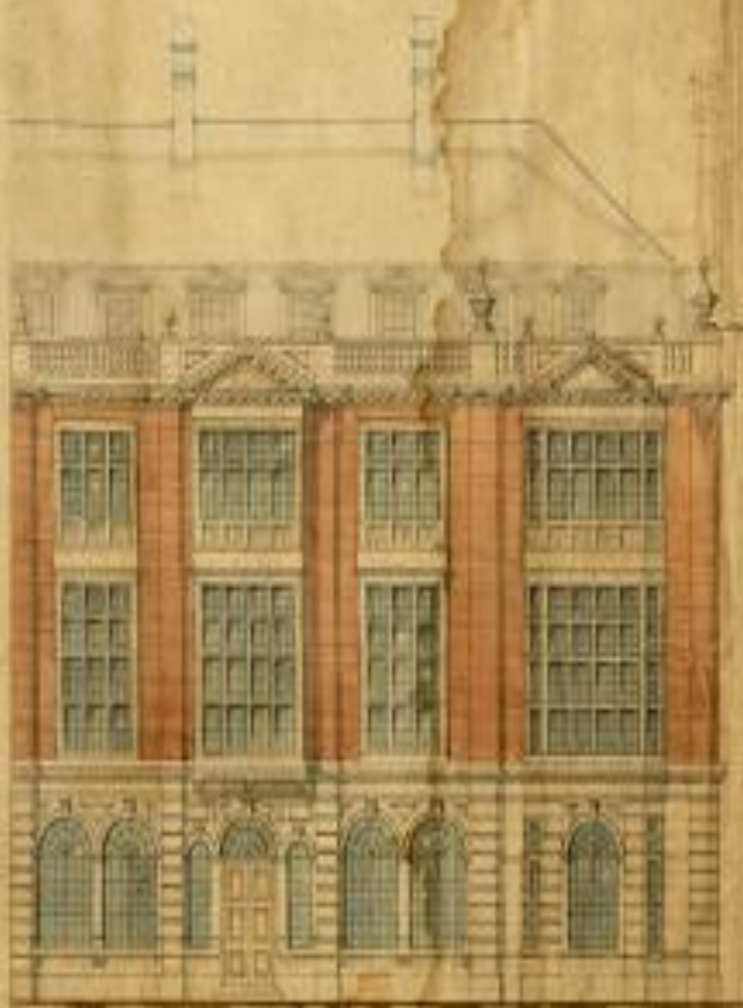
Lower Storey

Ground Floor

Upper Storey

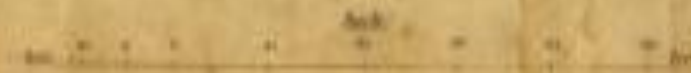
Lower Storey

Ground Floor



Back 'C'

Note that in this drawing the Drawing referred to is the Contract by the City of London & Corporation of London



THE MONEY ILLUSION

Be very skeptical of real asset claims

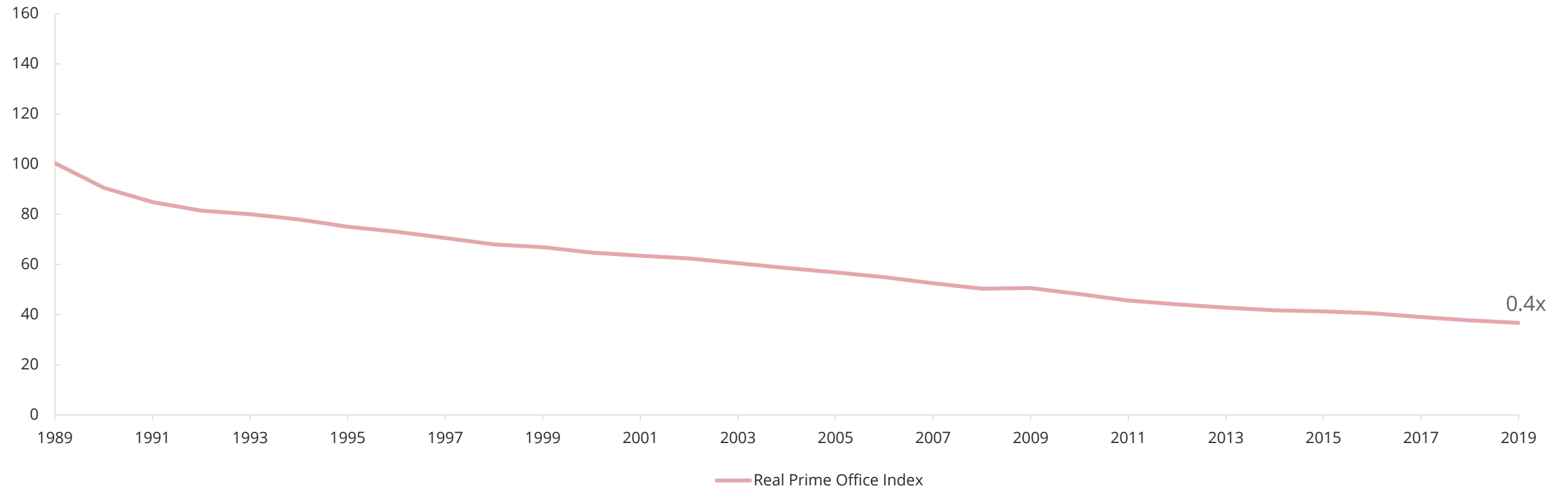
Prime Central London Rent (£/sq ft), 1989 to 2019



THE MONEY ILLUSION

Be very skeptical of real asset claims

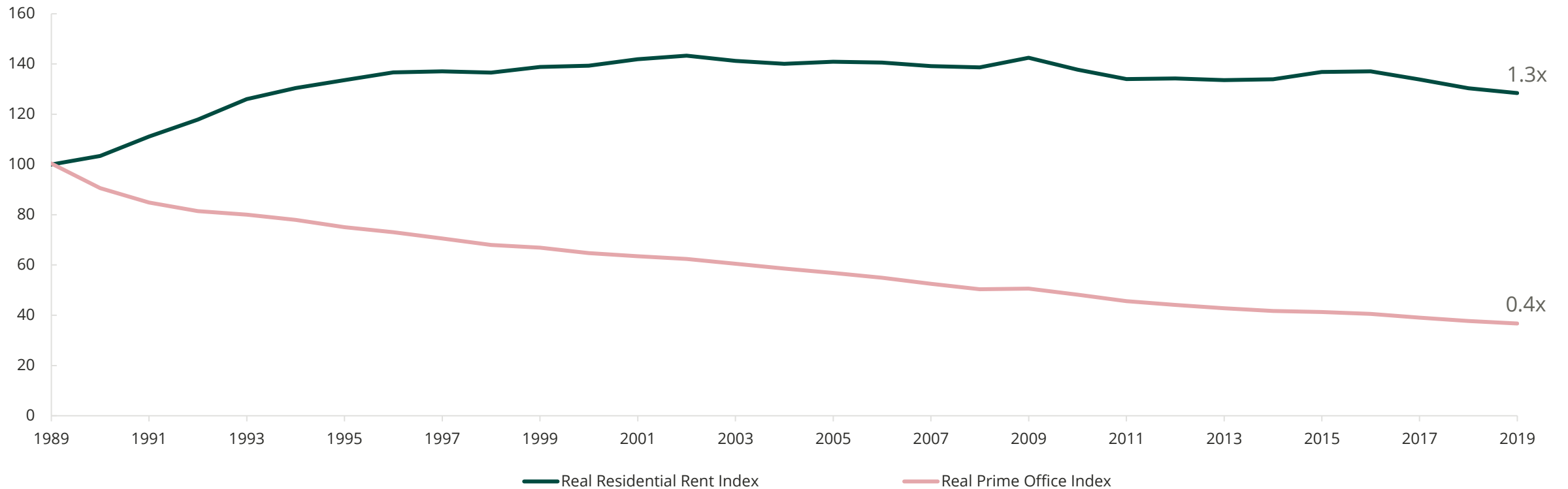
Real rent per sq ft evolution (£/sq ft), 1989 to 2019



THE MONEY ILLUSION

Be very skeptical of real asset claims

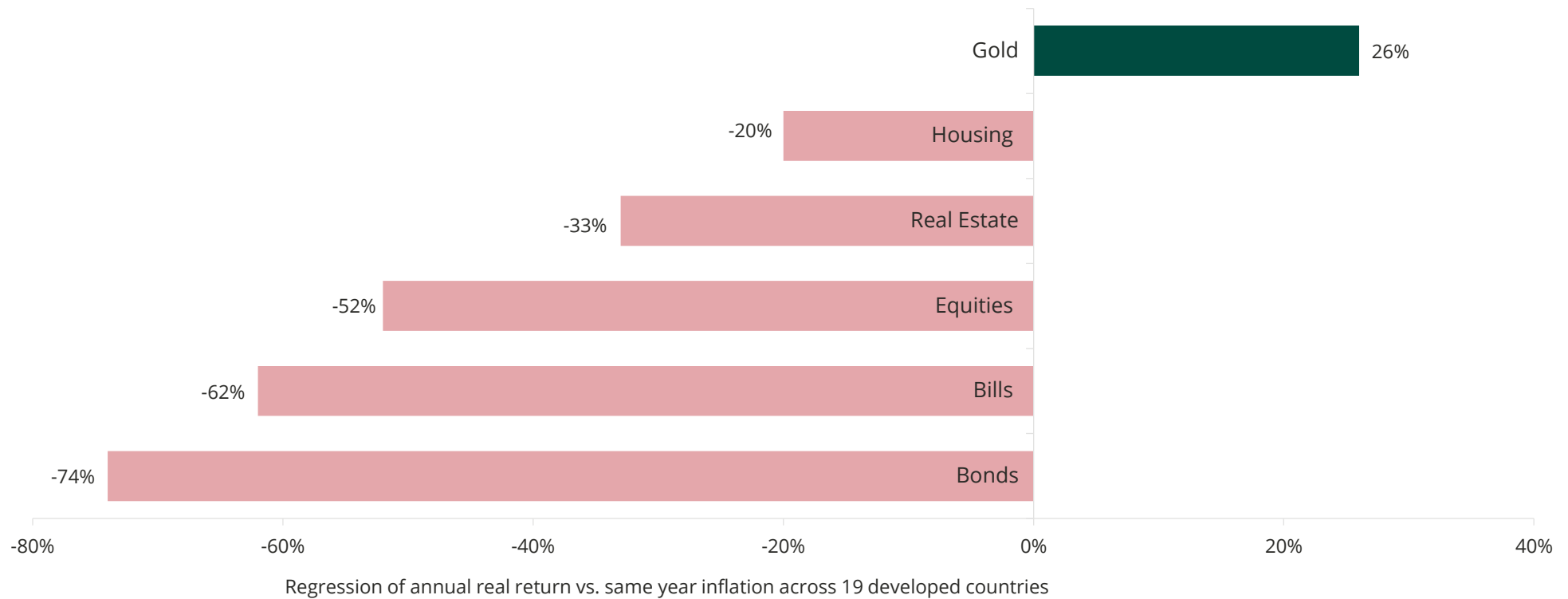
Real rent per sq ft evolution (£/sq ft), 1989 to 2019



THE MONEY ILLUSION

Very few asset classes have consistently performed well during rising inflation

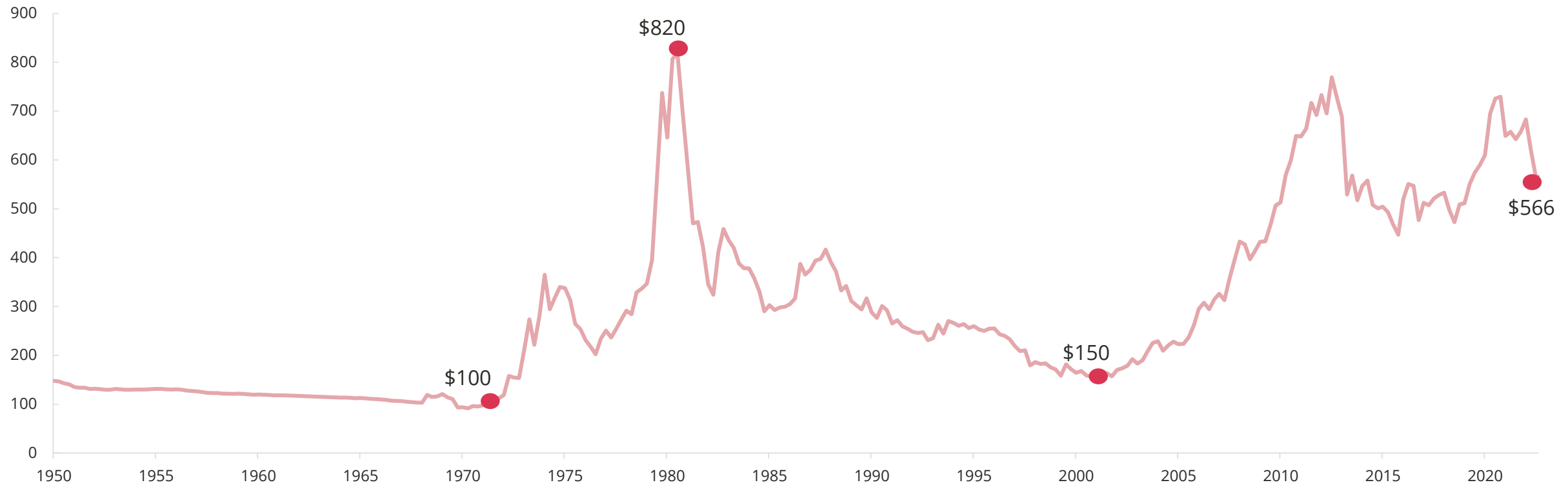
Real Return vs. Inflation 1900-2012



THE MONEY ILLUSION

Inflation may be one factor influencing the gold price but other factors are overwhelmingly more important

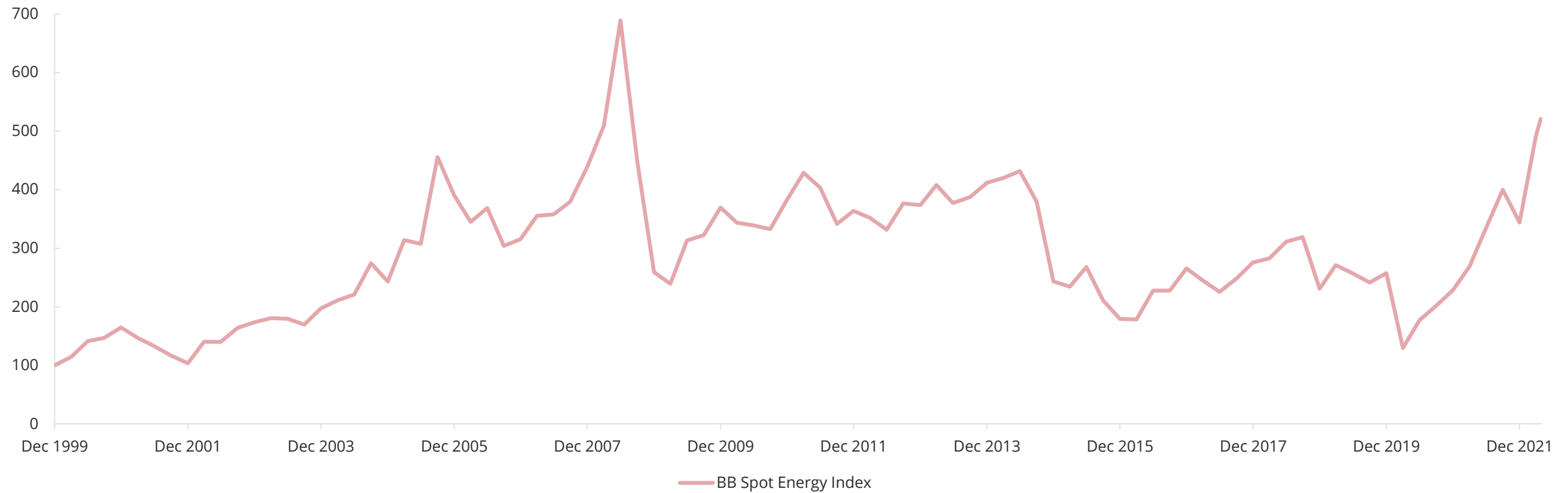
Real gold price - 1950 to 2022



THE MONEY ILLUSION

Are commodities the answer?

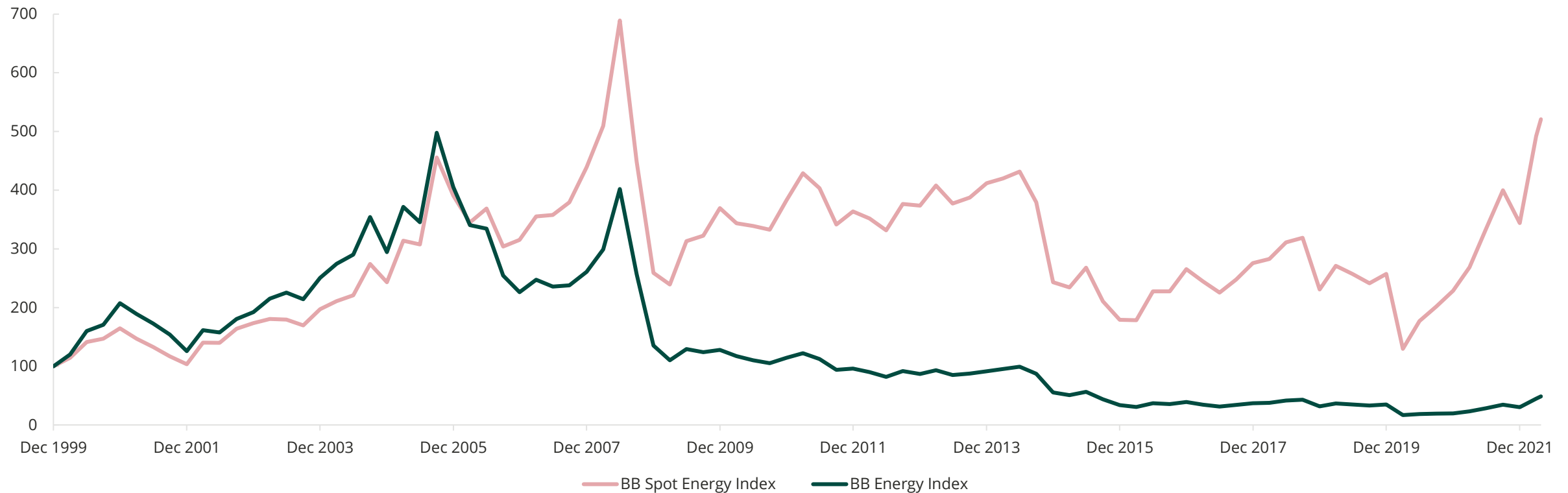
Bloomberg Energy Spot Index (Base = Jan 2000)



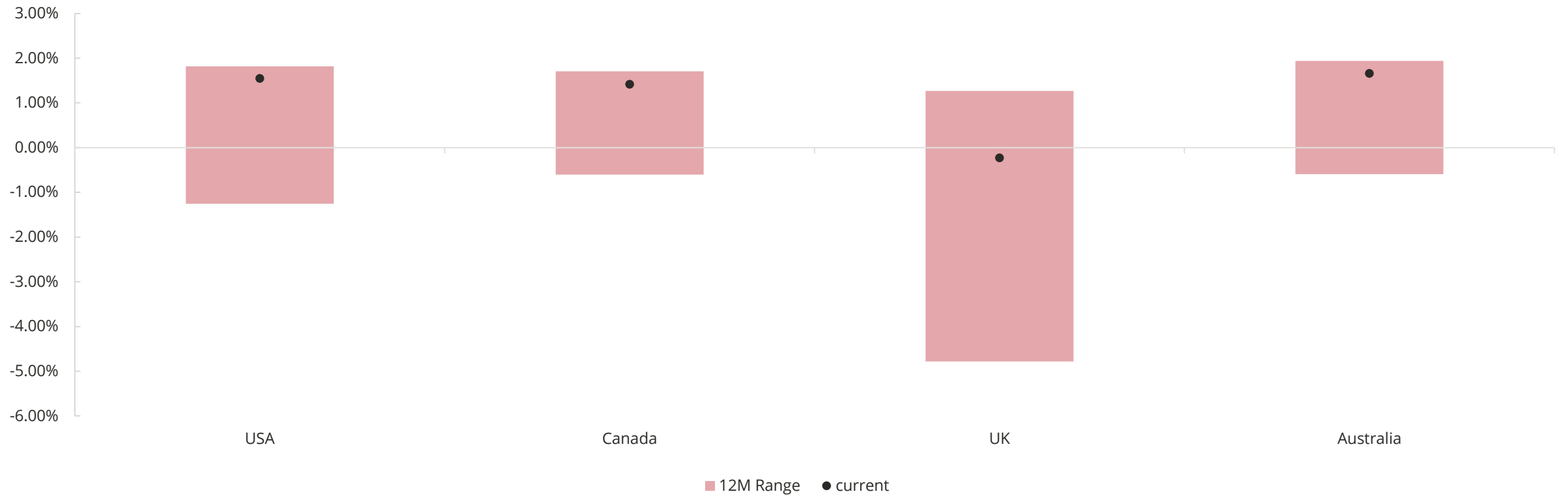
THE MONEY ILLUSION

Commodity trading makes most sense if you also own a supertanker!

Bloomberg Energy Spot vs. Bloomberg Energy Futures Indexes (Base = Jan 2000)



THE MONEY ILLUSION

Valuation really matters**Developed Government Bond 10 Year Real Yields**

TINA

**THERE IS ~~NO~~
ALTERNATIVE**

AN



THE MONEY ILLUSION

What assets are we focusing on at present?

Real Interest Rates

- *Recent additions have been made to UK index linked adding to the global portfolio of inflation linked bonds*

Yen Assets

- *The Yen is offering exceptional value and Japan could come to be seen as a safe haven in an inflationary world*

Energy Equities

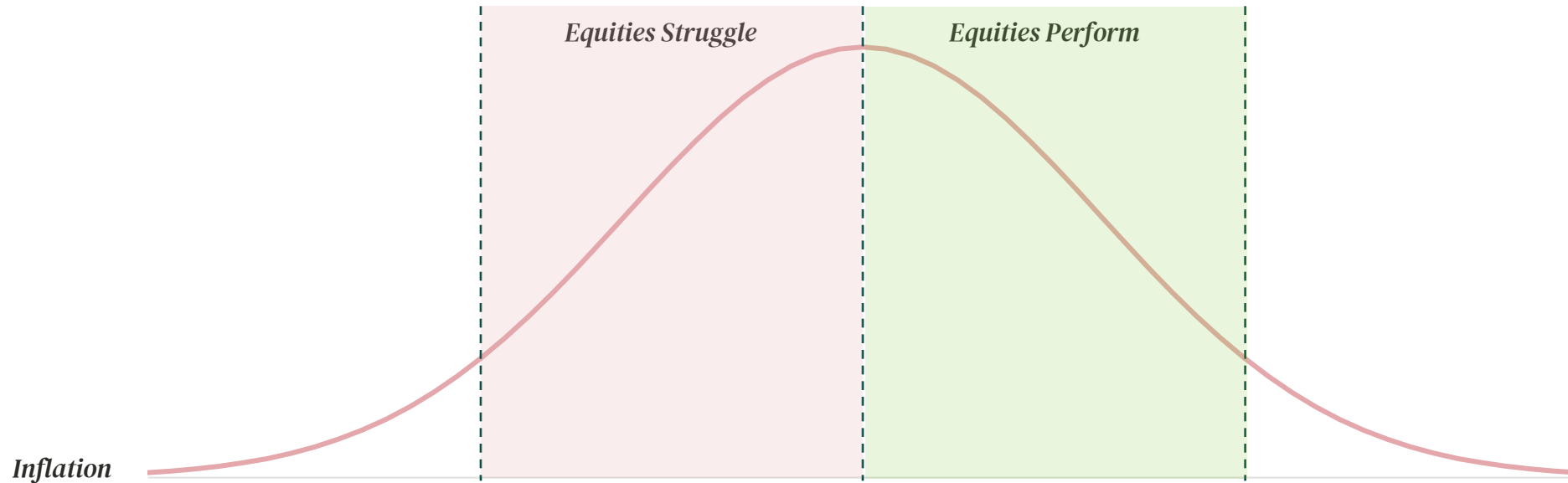
- *Supply constrained due to under-investment, Ukraine and OPEC + cuts*
- *Undemanding valuations due to ESG selling constraints*

Sterling credit

- *Combination of pension fund selling and BoE selling has led to high spreads even in short dated, economically insensitive sterling credit*

THE MONEY ILLUSION

If equities are negatively correlated to inflation is today a buying opportunity?



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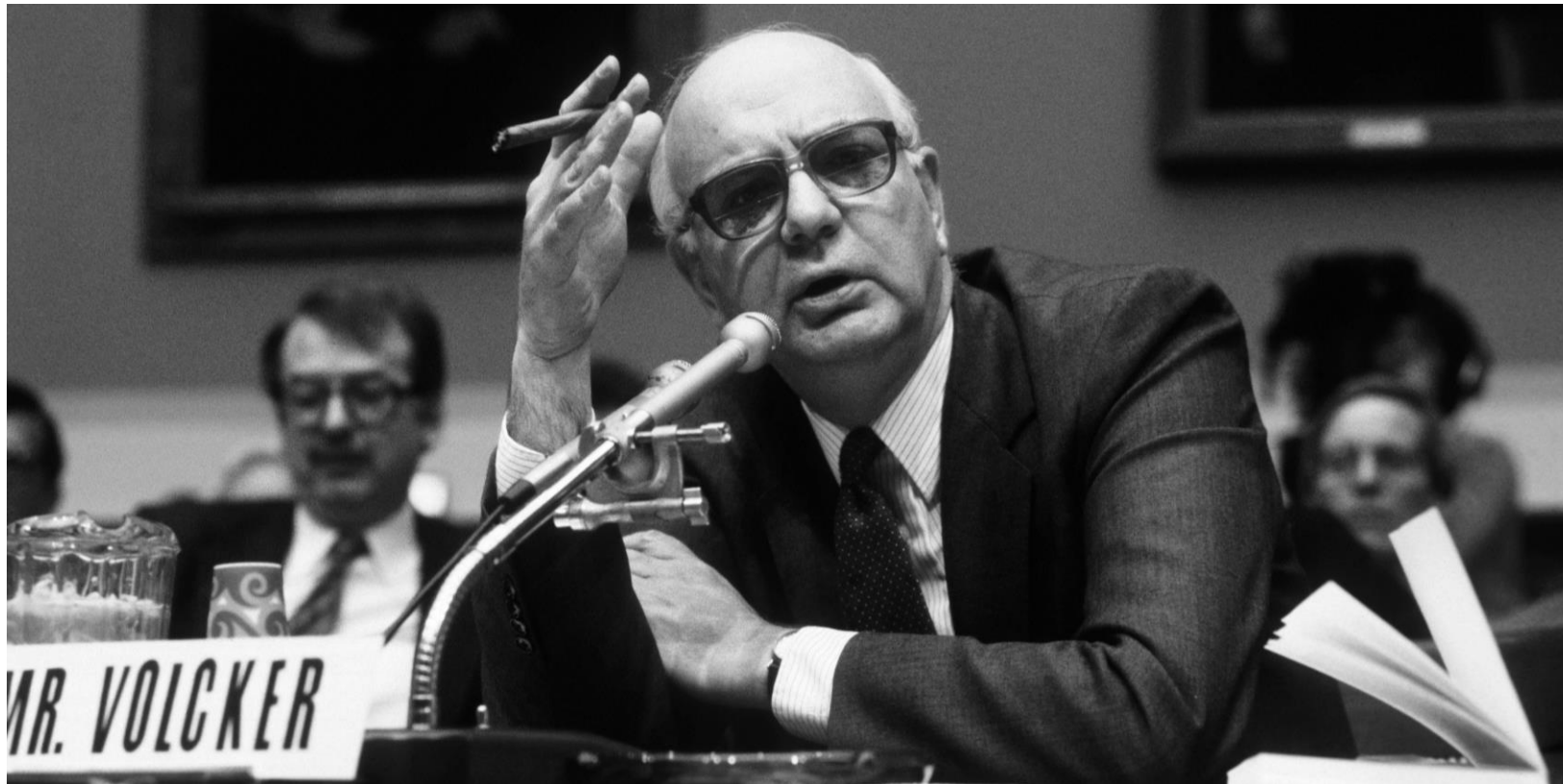
Volcker's Ghost

Peter Spiller



VOLCKER'S GHOST

The current inflationary environment continues to evoke the ghost of Paul Volcker



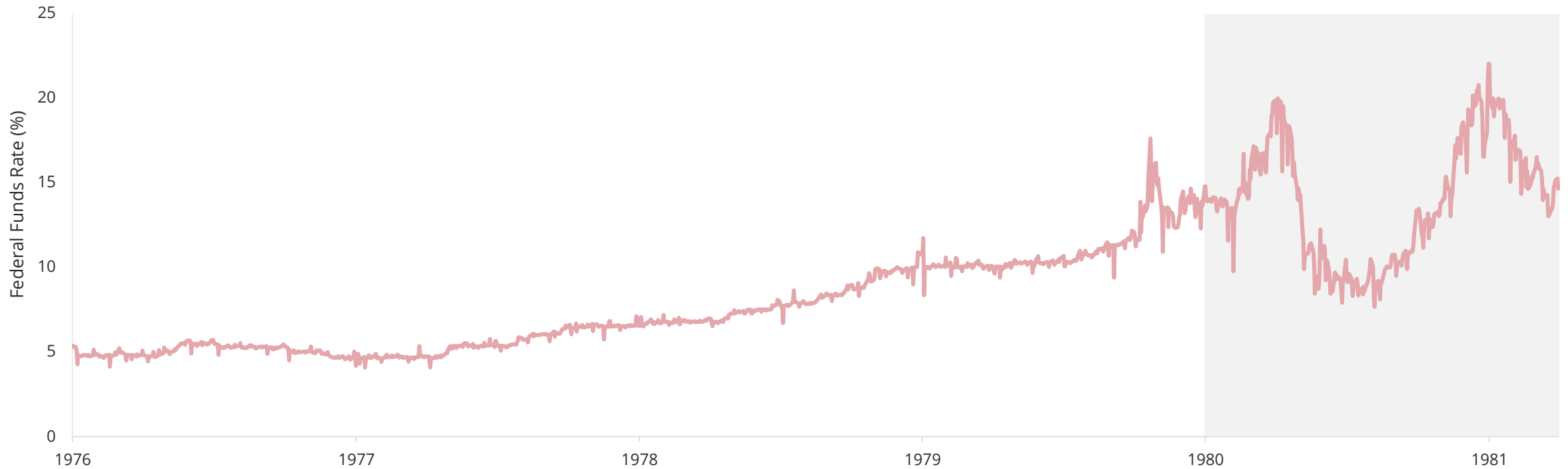
“It was the biggest inflation and the most sustained inflation that the United States ever had.”

PAUL VOLCKER

VOLCKER'S GHOST

It is important to remember that Volcker's tightening programme had *two* phases

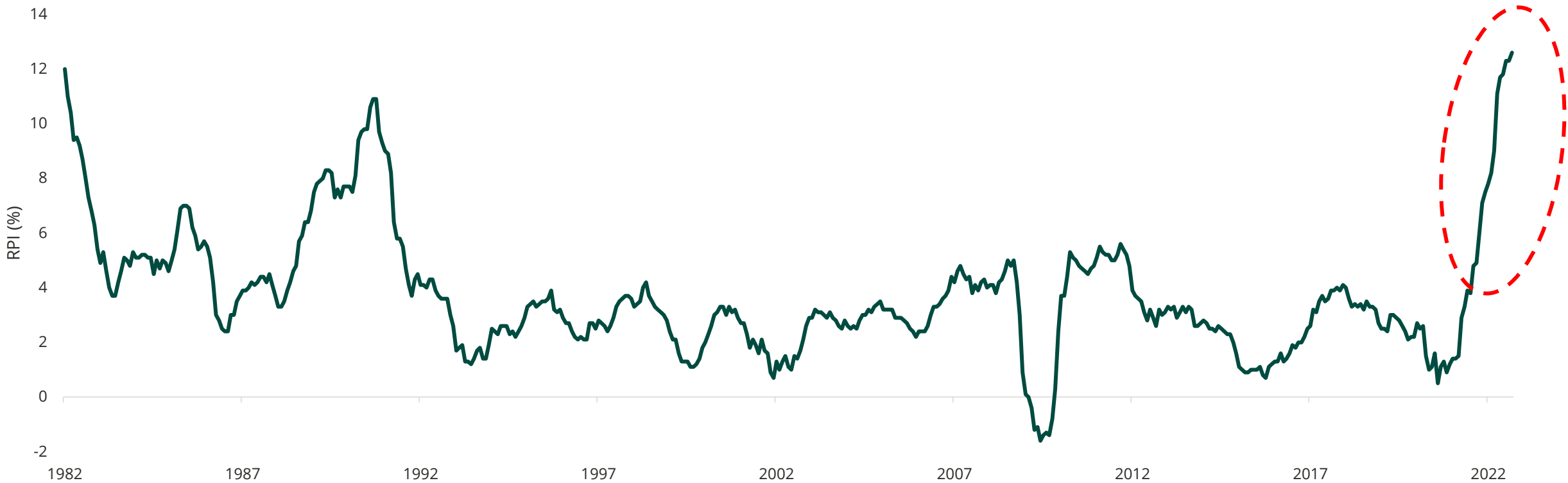
Effective Federal Funds Rate, 1976-1981



VOLCKER'S GHOST

UK inflation is now at 40-year highs, but we may only be in the first act

UK Retail Price Index, year-on-year change



MACROECONOMIC OUTLOOK

Inflation and interest rates have been low for the past 30 years, but we believe that we are now in a new regime, which looks closer to the 1960s

Old regime

- *Demographics* X
- *Globalisation* X
- *Technology* ?

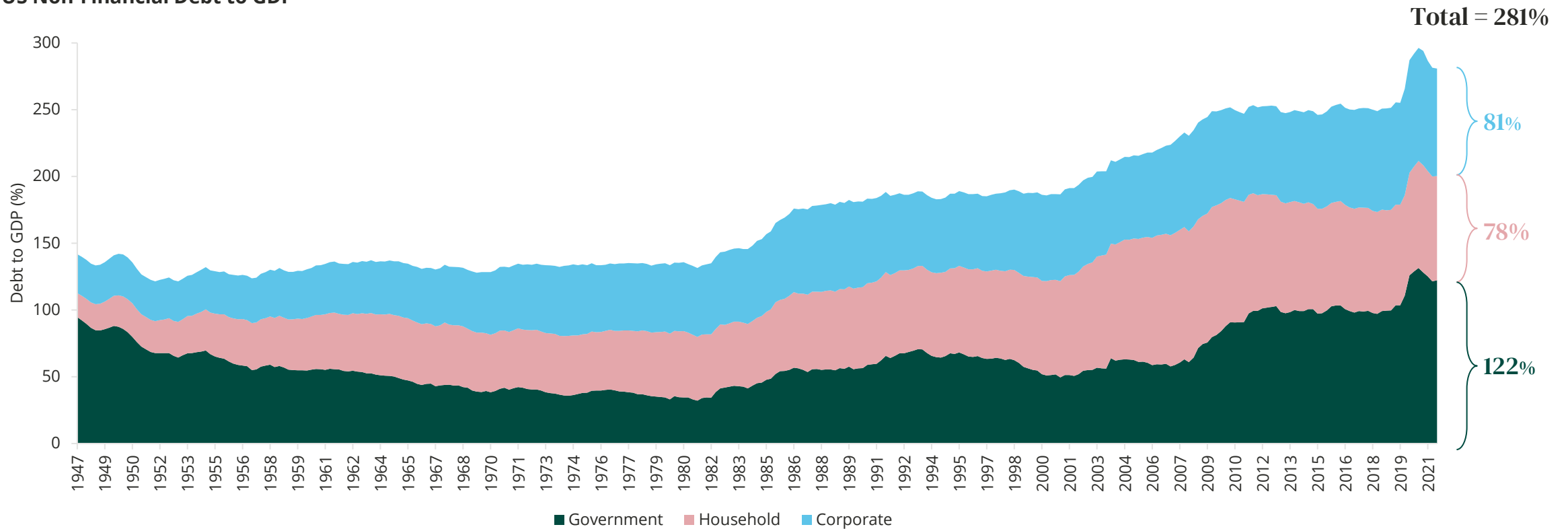
New regime

- *Green inflation* ✓
- *Protectionism* ✓
- *Labour strengthening* ✓
- *Defence spending* ✓

VOLCKER'S GHOST

The *entire financial system* is characterised by high levels of indebtedness, which will limit the extent of central bank tightening

US Non-Financial Debt to GDP



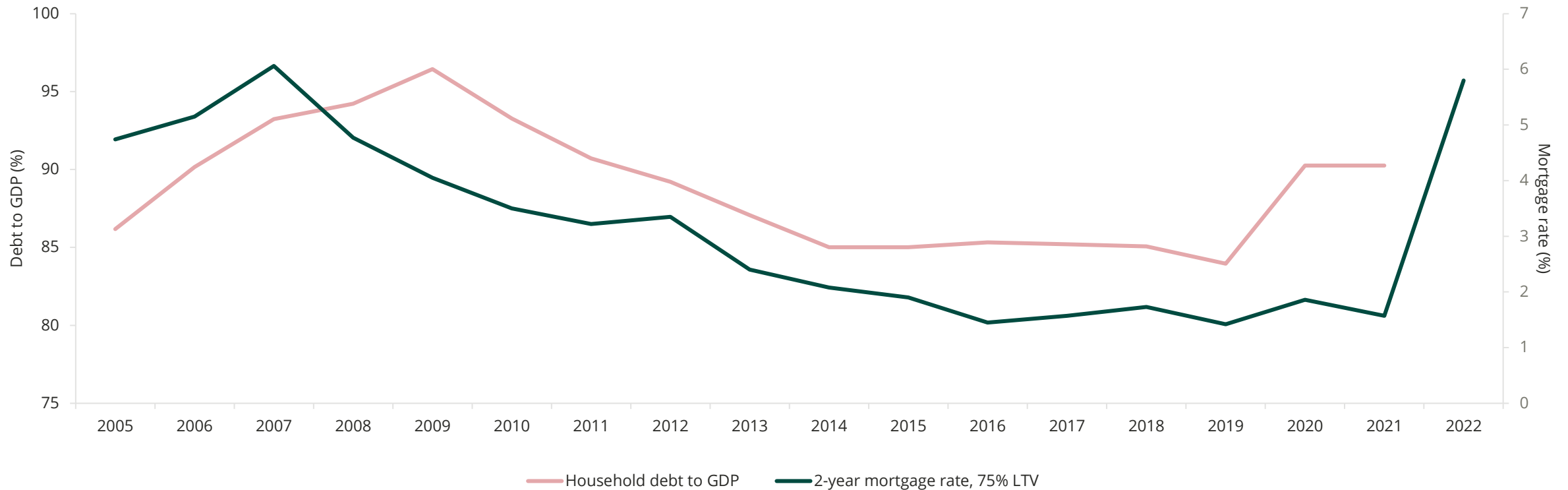
“What you find is there’s **never just one cockroach in the kitchen** when you start looking around.”

WARREN BUFFETT

VOLCKER'S GHOST

The last time household debt and mortgage rates were this elevated was the eve of the global financial crisis

UK household debt to GDP versus 2-year fixed mortgage rate



VOLCKER'S GHOST

Corporates have also come out of the pandemic with elevated debt levels

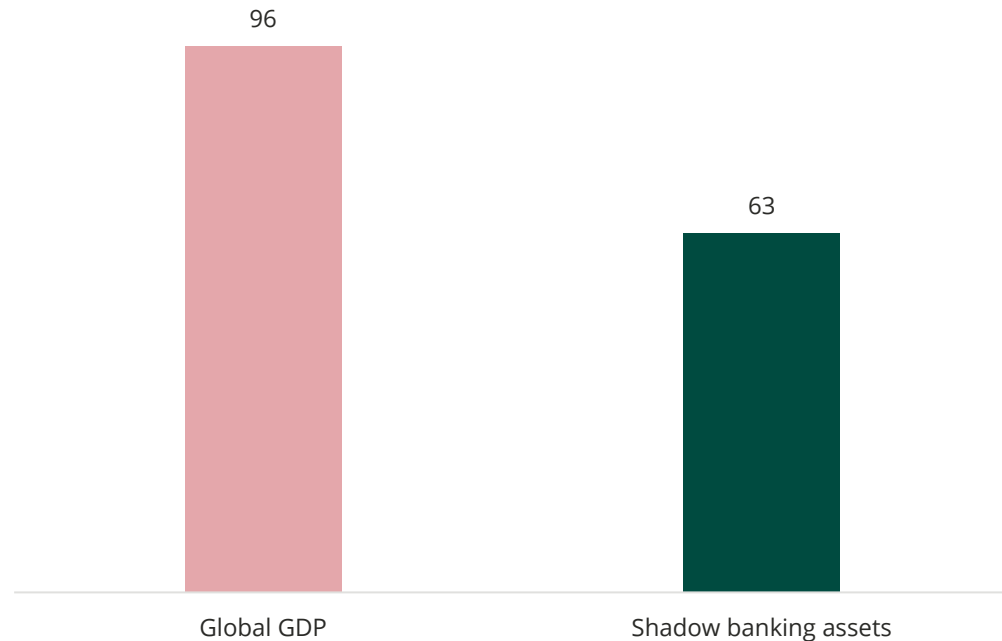
US and UK corporate debt to GDP



VOLCKER'S GHOST

Persistent easy monetary policy has led to extraordinary leverage within the global financial system

Value of global shadow banking assets relative to global GDP (USD trillions)



Shadow banks manage more than \$63 trillion in assets, a number that has doubled across the past decade, and which represents approximately two thirds of global GDP.

There is a **positive aspect to inflation**. Current debt levels are likely not sustainable at current interest rates and levels of income.

But with enough inflation, debt can resume a more appropriate relationship with asset values and incomes, and **the economy will begin to stabilise and inflation can finally be addressed**.

VOLCKER'S GHOST

With central banks' hands tied, we expect 'Volcker 2.0' but not for some years



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Keynote Speaker Janan Ganesh

Financial Times Columnist & Associate Editor

