Gleneagle Asset Management Limited
Gleneagle Investment Trust (Equity Fund)

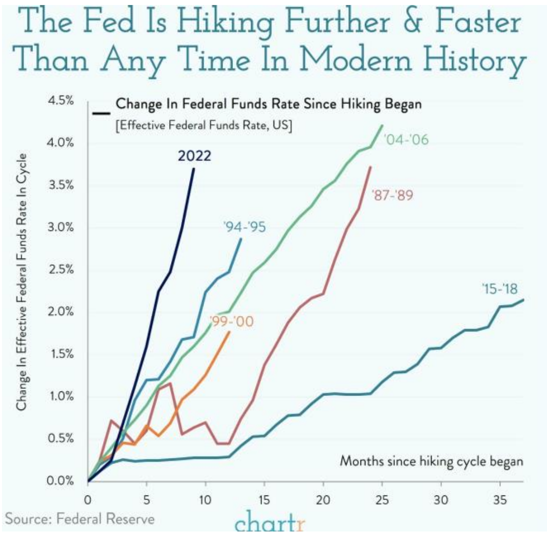
December 2022 Review

Summary

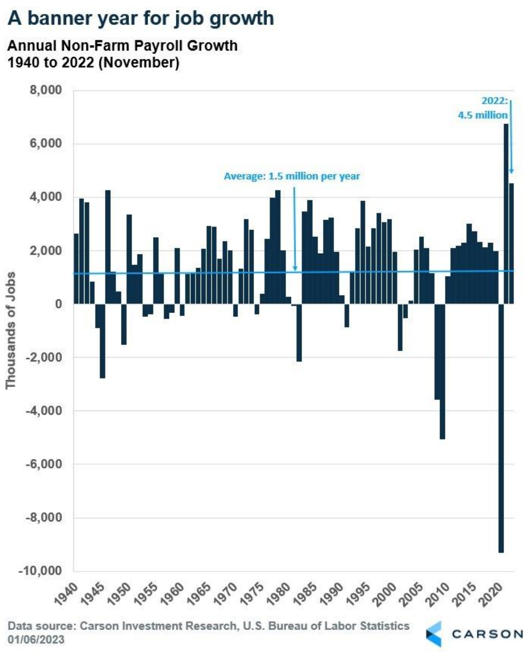
A very poor finish to the year in markets with the Nasdaq down 9%, S&P 500 down 5.4% and the ASX 200 down over 4%. The late Santa rally, which normally kicks in about the 3rd week of December, did not eventuate, and unfortunately, the portfolio suffered ending down 7.1% for the month. However, for a bit of perspective, since taking over the fund on July 1 we are down just 1.1% in what must be described as one of the toughest markets since 2008.

Market outlook

2022 faced a lot of geopolitical shocks, along with the largest monetary tightening in history. As interest rates have gone up and liquidity has been draining from the system, stock prices and bond price fell, but US employment continues to be strong with the latest data showing just a 3.5% unemployed - virtually full employment. This labour market resilience is what will underpin the US economy as consumers are able to continue to spend, with a reminder that around 70% of US GDP is based off consumer spending.



This is both good news and bad news. The good news is that more than 4.5 million jobs were created in 2022. History shows that any time more than 3 million jobs were created in the US, a recession only followed in 1 out of 17 years (with data going back to 1940) which suggests that severe recession fears may be overblown, and we could see a softer landing. The bad news is that Fed chair Powell made it very clear to us in last month's statement that unemployment needs to rise closer to 4.6% if they are to achieve their wage inflation objectives. He has even used the words 'pain' to describe what will be needed, and in human terms this means around 1 million people need to lose their jobs.



If the Fed is to achieve its target employment figure, it will need to keep its foot on the brakes with more interest rate hikes or holding rates at these higher levels which are likely to negatively affect asset prices. Unfortunately, the latest non-farm jobs report show that 200K jobs were added to the economy last month, so currently the employment trend is in the wrong direction for the Fed. Recall that the Fed was slow to act when inflation started to the upside, and they will likely overshoot to the downside. This is perhaps for good reason too, as they would rather ensure inflation does not become entrenched.

We thus think the market might be getting ahead of itself as it is currently starting to price in a Fed 'pivot' or at least a pause. We are still of the view that things might still get worse before they get better. We do agree that we are coming to the end of the tightening cycle and inflation is coming down. Goods inflation has been dropping fast but the Fed is still focusing on wage inflation. The Fed will likely only cut when CPI falls below the fed funds rate, and our estimate for the earliest that might be is April or May.

It's not all bad news though. China has been rapidly reopening after an extended covid lockdown, and this is starting to push commodity prices higher. The Australian Dollar (a proxy to Chinese risk) has been well supported lately, and most commodity producers have been on the rise. In last month's newsletter we highlighted the bullish case for precious metals which continue to do well, and we are positioned accordingly. We believe the China reopening will provide a tailwind for commodities and energy, and we still hold a positive outlook for oil in 23 and 24, despite the US slowdown.

In a nutshell, we believe we are likely to see more market volatility in the coming months. Unemployment must rise. The US could see itself in the depths of a mild recession by March, but, after this, things can start to improve. With any major selloff, sometimes the babies get thrown out with the bathwater, and we have been finding some very good opportunities. 2023 is looking to be a much better year.

Helios

I am happy to report after many months of delays Helios are currently underway with the frack of well 52 #1 (aka well 4). They are doing a 4-stage vertical frack over 1623 feet, which is a far simpler operation than a horizontal frack and greatly increases the chance of success. The frack process is scheduled begin on the 10th of January and should take around a week to complete. After this the fracking fluid is forced back to surface along with oil and gas. As each day passes, the percentage of oil/gas should keep increasing as the fracking fluid depletes, so around 2-4 weeks we should have better idea how much the well can produce. A successful frack should see this stock **materially appreciate** in price over the coming weeks and months and investors will finally be rewarded for their patience. It is also pleasing to note that well 2 and well 3 will be placed on artificial lift, and they will also start generating income from oil and gas sales. Helios has the land, they have oil and gas under a lot of pressure (so much pressure that it's been complicating the drilling), they just need to prove to the market they can bring the hydrocarbons to surface. Strap in for the ride.

If you have any questions or comments, please drop me a line at tim.muirhead@gleneagle.com.au

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