Gleneagle Asset Management Limited
Gleneagle Investment Trust (Equity Fund)

January 2023 Review

Summary

January saw markets rebound strongly, with the ASX 200 up 6.9%, the S&P 500 up 6.2% and the Nasdaq up 10.6%. After such a poor finish to the end of 2022, we were positioned much more defensively and thus did not participate in the full extent of the rally. The portfolio, however, still finished up 3.8%.

Market outlook

Sharp market rallies such as we just saw tend to only occur in bear markets. It is a combination of FOMO and bearish positioning that drives short covering that can see prices surge, and then later the bear market resumes, ultimately sending prices lower. During the recessions of 2000 and 2008 we saw many 20% rallies in the S&P 500, and in the 2000-2002 bear market the Nasdaq rallied over 50% twice before prices ultimately went lower.

The only problem is that market bottoms also tend to start the same way. We are thus faced with the question – Have the markets bottomed or are we still likely to go lower? Right now, it is difficult to forecast and will be largely driven by the upcoming data releases; if inflation continues to come down then we may have seen the lows, but, if it persists, then the Fed may be forced to end the party.

Markets are often driven by narratives (we finished 2022 on a low as the Santa rally failed to materialise.) The prevailing narrative was that the US was heading into a recession, the Fed was going to be hiking to rein in inflation, earnings were going to continue to deteriorate and thus risk assets were likely to continue to suffer. During the month of January, as prices rebounded, the narrative shifted. Inflation was coming down faster than expected, the recession was likely to be a soft landing and the Fed would come to the rescue and be cutting rates in the later part of the year. Nothing drives narrative change like price action.

The most unloved stocks of 2022 arguably had the biggest rallies. Cathy Wood's ARKK, which was the posterchild of the tech run-up, lost 81% of its value from the highs of 2021 until then end of 2022. In January it was up over 50% (so now only down 71% from the highs). The mega cap Tesla, which lost 75% of its value as I write, has rebounded 100% (now only down ~50% from the highs). These kinds of moves grab the attention of the media and traders alike and it's easy to see why people think the bull market is back.

The volume of call options traded in the US just broke its all time record. The last time we saw such extreme speculative activity was with the Gamestop (GME) blowoff top in 2020. It is thus a warning that speculation is rampant one more.

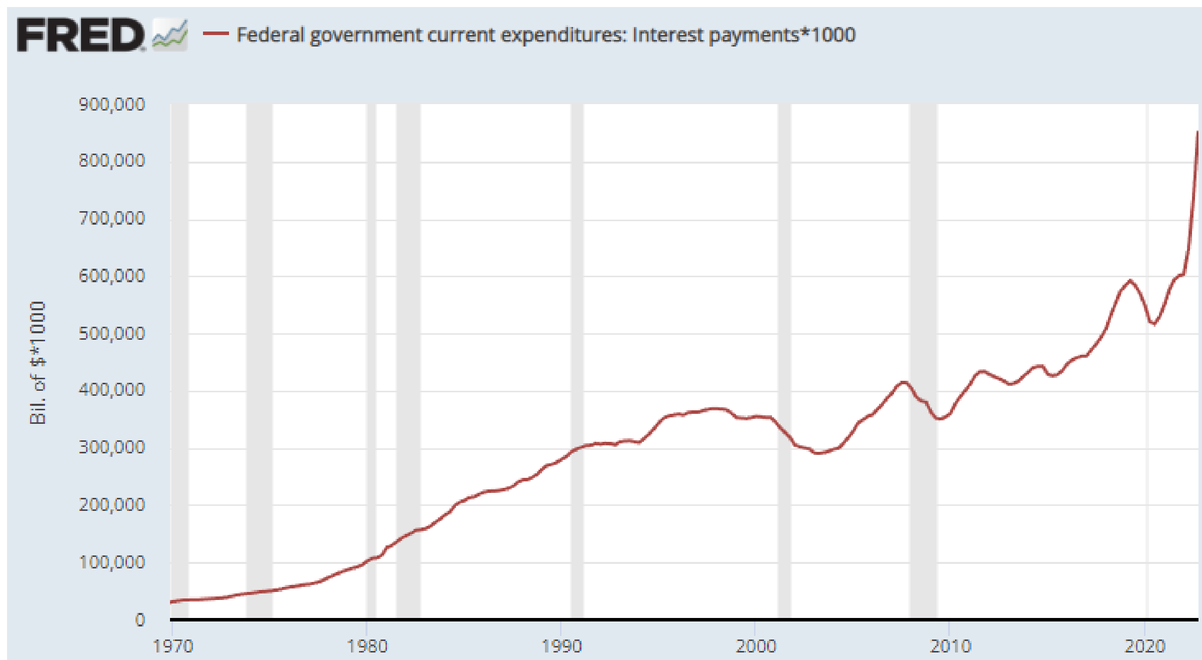
Gold

In the last few months, I've been outlining our bullish thesis on gold and it certainly hasn't disappointed, rising from around US$1615 in early November to a high of US$1950 at the

start of February. We caught a good part of the rally but haven taken profits on the positions now. While the longer-term fundamentals for gold remain sound, the trade has started to become a little crowded and has gone a little too far too fast. The US Dollar has also sold off sharply in recent months and looks like it will rebound in the short term.

One short term bullish catalyst for gold that we are monitoring closely is the up-coming debt ceiling decision. The US hit its statutory limit of $31.4 trillion, and now Congress is in the process of negotiating a raise.

The longer-term bullish catalyst for gold is the ever growing US debt, their rising interest repayments and the fact that foreigners are starting to move away from holding US treasuries. This is not a small topic so I will do my best to give you the short summary. Interest payments on their debt have doubled in just a few short years (see chart below) Around 70% of their debt has a duration of is 3 years or less with a current coupon rate of ~1.6%. As each month passes, part of the debt must be refinanced at the new much higher rate of over 4%. If you look at the Federal budget, currently around 15% of the tax receipts are used to pay the coupon on the debt. If this debt doubles to ~30%, the US is going to struggle to pay for basic things such as Medicare, social security or continue to fund their military. Thus, if the US is forced to refinance at >4% rates for the next 3 years, they will double their cost of capital again. Some will argue that the US will just print more money but given around 40% of the debt is financed by foreign investors, if the US starts to print more just to pay their interest bill, the US dollar will devalue massively, and their interest rates are going to continue to go up and inflation may become unhinged.



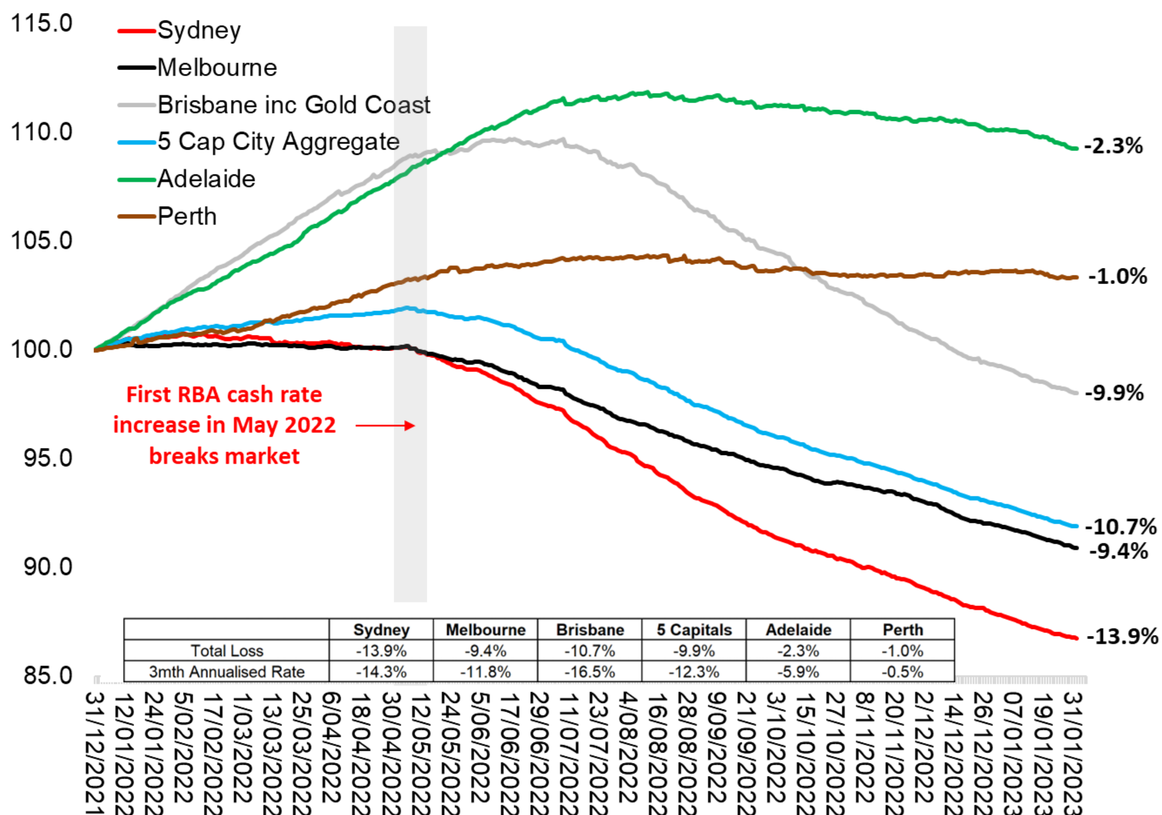
There is thus a credible argument that the Fed must raise rates high enough and hold them long enough to tank their economy such that the short term rates get back down to below 2%. This means the stock market would likely be trading much lower than where it currently is. An alternative route that the US engages is yield curve control which means buying an unlimited amount of bonds at a fixed price – ie go down the Japanese route where they can't stop printing money. In both scenarios, this is negative for the USD and positive for gold. This

will take time to play out and we will be watching closely.

Australia

The ASX 200 is doing quite well, as our Industrial and mining stocks have continued to outperform with the China reopening impulse. While the stock market is performing well, my only concern for our economy is the continued deterioration of the housing sector.

On the 7th February, the RBA hiked interest rates another 25bps and signaled there are more rate hikes to come. The RBA is currently forecasting inflation to be 4.5% by of the end of this year and 3% in the middle of 2025 and thus rate hikes will have to continue. This is not good news for homeowners as it likely means housing prices will continue to deteriorate. In a situation very similar to what is happening to US debt outlined above, many fixed rate mortgages will roll off this year and the next and need to be refinanced at a much higher rate which is going to put many recent home buyers into a lot of pain. This will put a further dampening in on discretionary spending. As a real-world example, three of my friends have now cancelled their Tesla orders in just the last 4 months as belts are being forced to tighten.



	Sydney	Melbourne	Brisbane	5 Capitals	Adelaide	Perth
Total Loss	-13.9%	-9.4%	-10.7%	-9.9%	-2.3%	-1.0%
3mth Annualised Rate	-14.3%	-11.8%	-16.5%	-12.3%	-5.9%	-0.5%

Source: Christopher Joye via twitter

The silver lining is that with real-estate underperforming and unlikely to improve until yields start to come down, we may see our local equities do better on a relative basis as money flows out of housing into the market looking for return.

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

gleneagle
asset management

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