SOMERSTON ASSET MANAGEMENT

SOMERSTON MULTI ASSET FUND

INVESTMENT LETTER No.25 AS AT 30 JUNE 2023

The Somerston Multi Asset Fund (USO class) rose by +2.0% in the month and rose by +1.8% over the last three months.

The MSCI World Equity Index rose by +5.7% during the month and a composite of UK, German and US Government bonds fell by -1.28% in the month. Our composite reference index rose by +3.6% in the month and rose by +4.2% over the last three months.

Performance (%) US0 Class

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2017				0.9	2.7	-0.9	0.6	0.6	-0.5	0.6	-1.2	1.9	**4.5**
2018	4.8	-3.7	-1.0	-1.0	0.8	-0.2	0.9	0.3	0.0	-2.3	1.8	-0.4	**-0.2**
2019	1.1	-0.6	2.8	1.3	-1.8	5.6	0.7	0.6	-0.6	2.1	2.8	3.3	**18.5**
2020	-0.3	-5.9	-8.5	6.9	2.4	1.8	7.4	3.1	-2.2	-1.0	5.2	5.2	**13.6**
2021	-0.3	0.8	-0.1	2.3	2.5	-0.2	2.2	0.5	-5.1	5.2	-1.7	3.2	**9.3**
2022	-5.9	-1.1	2.6	-3.5	-1.4	-4.1	4.3	-3.8	-4.9	1.3	3.7	-1.5	**-14.0**
2023	2.5	-4.0	2.9	1.1	-1.3	2.0							**3.0**

Total return since inception 35.8%

Top Ten Equity Holdings

Name	% Fund
Adobe Inc	3.7%
Alphabet Inc-Cl A	3.2%
Thermo Fisher Scientific Inc	2.4%
Diageo Plc	2.4%
Microsoft Corp	2.2%
Danaher Corp	2.1%
Unitedhealth Group Inc	2.1%
Assa Abloy Ab-B	2.1%
Sgs Sa-Reg	2.0%
Pepsico Inc	2.0%
Total for Top Ten	**24.2%**

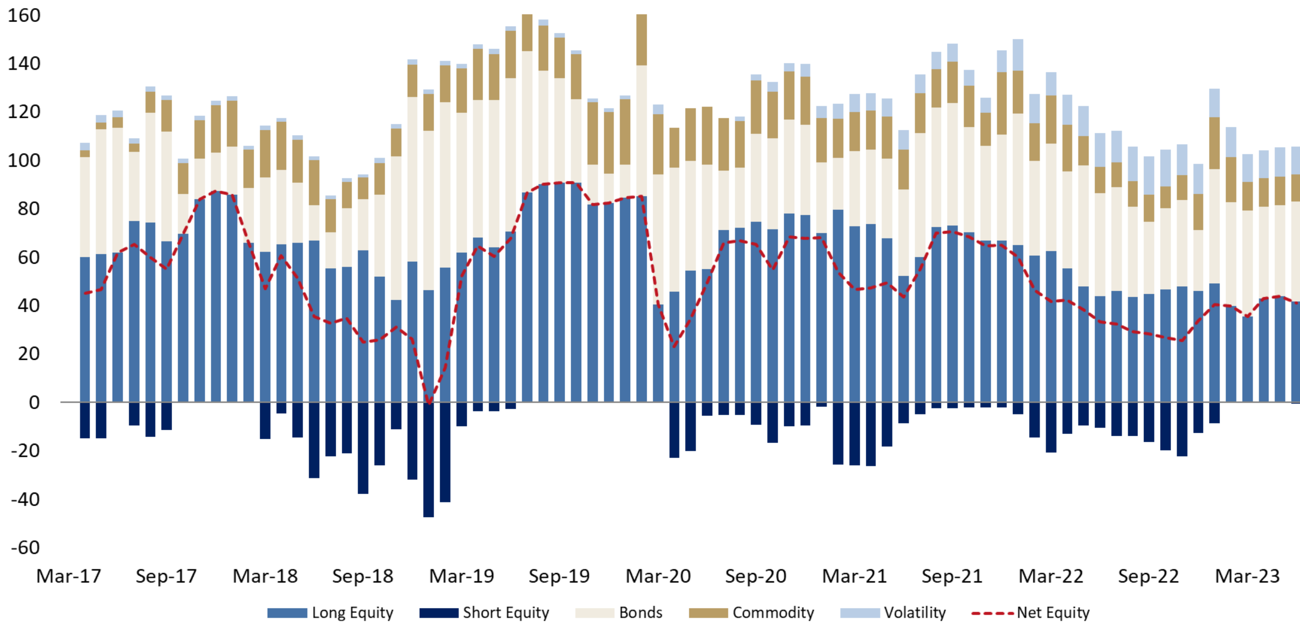
Asset Allocation

	Long	Short	Net	
Core Equities	39.1%		39.1%	↑
US Equities		-0.6%	-0.6%	↓
Energy Equities	2.5%		2.5%	↑
Equities	**41.6%**	**-0.6%**	**41.0%**	↓
US Govt 2 yr. Bond	9.9%		9.9%	↓
US Govt TIPS	14.2%		14.2%	↓
Nowegian Govt Bond	2.5%		2.5%	-
Corporate Bonds	14.7%		14.7%	↑
Bonds (Duration 2.5)	**41.3%**		**41.3%**	↑
Gold Bullion Derivatives	11.2%		11.2%	↓
Commodities	**11.2%**		**11.2%**	
Volatility and CTA	11.7%		11.7%	↓
Total All Assets	**105.8%**	**-0.6%**	**105.1%**	
Cash and Equivalents			**-5.1%**	

Currency Allocation

USD	86.6%
EUR	3.6%
GBP	3.1%
NOK	2.5%
SEK	2.1%
CHF	2.0%
Total	**100.0%**

Evolution of Asset Allocation for Somerston Multi Asset Fund



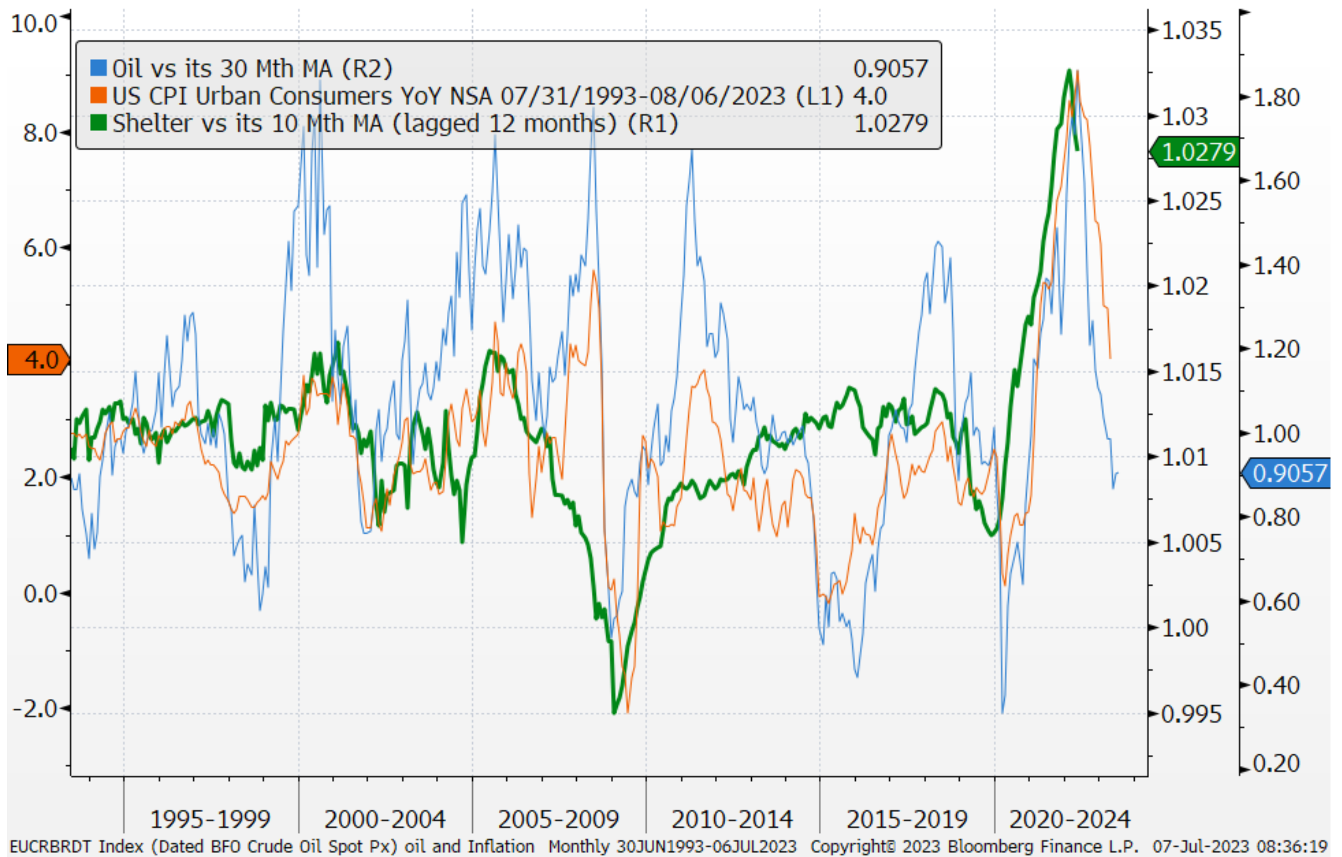
Performance

- The Fund employed a generally low equity allocation throughout the quarter.
- Core Equity contributed 1.2% in the quarter. Adobe, Intuitive Surgical and Amazon were the major contributors, while Thermo Fisher, Estee Lauder and Mettler Toledo were the major detractors.
- Macro equity strategy added 0.8% during the quarter. Mainly driven by exposure to growth factors.
- Bonds detracted 1% as yields across the curve rose.
- Precious metals and Commodities detracted -0.4%.

Commentary

There are many data points supporting the 'recovery' theme. For instance, in certain industries, inventories appear to have been worked through and new orders are slowly starting to pick up; despite the highest mortgage rates in twenty years and mortgage applications similarly at twenty-year lows, in aggregate, US housing starts are recovering, and homebuilders are becoming more optimistic. These economic data points are confirmed by real time financial market indicators: Implied volatility has collapsed to a three and a half year low, credit spreads are behaving well, cyclical sectors such as semi-conductors, autos and homebuilders are significantly outperforming defensive sectors such as healthcare and utilities and high beta stocks are outperforming low beta stocks. It does seem that the market is climbing that 'proverbial wall of worry'.

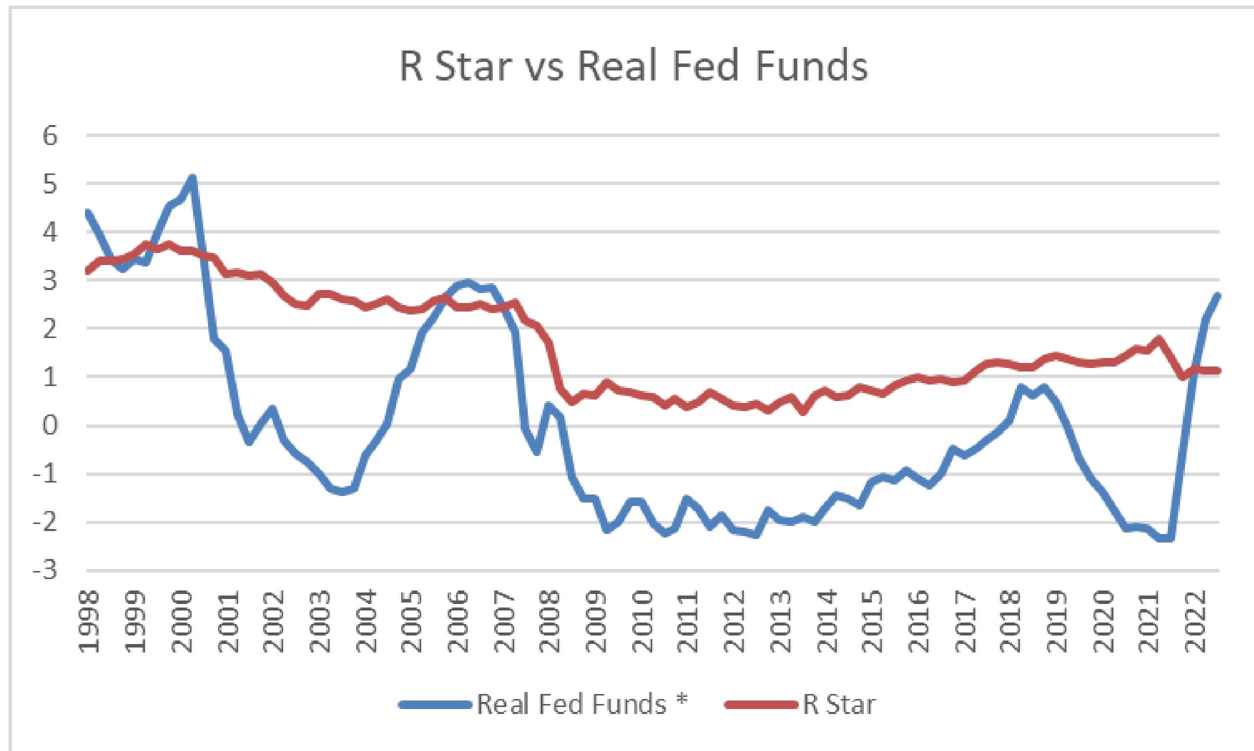
Furthermore, as we have written about previously, with energy prices substantially lower, US inflation is coming down nicely, and once lower rents feed into official shelter inflation, overall US CPI inflation may perhaps even undershoot the 2% target.



The prospect of economic recovery, controlled inflation and nearing the end of the interest rate cycle, is certainly a convincing tailwind for risk assets.

Yet, the cycle is very desynchronised and there are many areas, such as commercial real estate and UK housing, that are really struggling under higher cap rates and mortgage rates.

We have little doubt that interest rate policy is very restrictive. The New York Federal Reserve publish their measure of the equilibrium rate of real interest – termed R-Star. This is presently, estimated to be about 1% (red line in chart below). The blue line is present interest policy deflated by inflation expectations.



This chart analysis corroborates the highly inverted yield curve and the view that, despite what Central Bankers tell us, interest rates are above the equilibrium level. However, with employment still reasonable, despite the lagging nature of employment conditions, Central Banks continue to have a tightening bias it seems.

With so many diametrically opposed signals, it is presently very difficult to have a high degree of confidence on the near-term macro landscape. However, periods of fast bank lending or large monetized fiscal deficits (and thus rapid money supply growth) tend to create inflationary environments. Similarly, periods of technological stagnation, societal dysfunction, the need for resiliency over efficiency, war, and scarce natural resources tend to all contribute to the experience of inflation. We have many of the ingredients for structurally higher inflation and the extent to which technology can overcome these trends remains to be seen.

Interest rates can go to the moon, but they will not address, the dysfunctional benefit system, burgeoning fiscal debt, aging population, need for resiliency, the move to green energy, or war. Ironically high interest rates may actually contribute to these issues. While Central Bankers may be crediting the moderation of inflation to their interest rate policy, I doubt they deserve much praise. In the same way that you cannot cure heart disease with a flu vaccine, inflation caused by fiscal stimulus, war and resiliency initiatives cannot be cured by interest rate policy.

Accordingly, we are investing based on attractive valuations and diversification. And there are plenty of opportunities.

Our Core Equity strategy forms the mainstay of our equity allocation within the Multi Asset Fund. The strategy is focussed on investing in quality business that can compound growth overtime. During the quarter we took advantage of weakness in Adobe to add to our position.   Subsequently, Nvidia had their annual event and

mentioned their strong partnership with Adobe. This spurred, speculation that Adobe would be an 'AI winner' which was supported by Adobe showcasing their beta AI solution during their open day.

The 'Picks and Shovels' providers to the life science industry, have been under pressure as COVID related revenues dissipate. We have taken the opportunity to add to Thermo Fisher, Danaher and Mettler Toledo.

Conversely, we felt the valuations of Intuitive Surgical and Pepsi had become rather full, and we top sliced these holdings.

Weakness across the resource sectors is a symptom of the economic slowdown, however, underperformance of resource equities has allowed their valuations to become more attractive. The mass ESG movement has deprived this sector of capital for many years and, shareholders have coerced management teams to distribute cash rather than invest, accordingly, 'investment' in future capacity has been inadequate, especially if we are to move to a more electrified world.

Inflation linked bonds look well priced in the US. Inflation expectations presently sit at 2.25% for both 10 and 30 years and on the ten-year issue you earn a real yield of 1.5%. There are not many investments that offer such direct inflation protection and a coupon of 1.5% on top, let alone a government issue.

A combination of quality stocks that have pricing power, resource equities and inflation linked bonds seems a fair portfolio in the circumstances. We are maintaining exposure to long volatility strategies given the wide range of potential outcomes. Lastly, we presently maintain our exposure to gold bullion, but it has substantially outperformed other commodities and precious metal stocks and is therefore primed for further diversification.

Nick Wakefield

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