SOMERSTON ASSET MANAGEMENT

# SOMERSTON RAINY DAY FUND

## INVESTMENT LETTER AS AT 30 JUNE 2025

**Portfolio Objectives:** The fund seeks to provide readily realisable, positive returns, during most forms of financial market adversity, while maintaining good value in benign environments.

**Strategy:** We use a fundamental Multi Asset Strategy to identify attractive investment opportunities that are likely to benefit from adversity. We have a 5-year investment horizon.

**Performance:** The Somerston Rainy Day Fund (US Class) rose by +0.2% in the month and rose by +3.1% over the last three months.

**Performance (%) (US Class)**

| | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | Year |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **2024** | | | | | | -1.1 | 2.2 | 0.5 | 1.6 | 0.8 | -1.0 | -1.2 | **1.7** |
| **2025** | 2.7 | 0.6 | 3.9 | 2.7 | 0.2 | 0.2 | | | | | | | **10.7** |

*Total return since inception 12.6%*

**Top Ten Holdings**

| Name | | % Fund |
|---|---|---|
| Kilo Gold Bars (32.15 oz) | Bullion | 25.0% |
| EDC 5.075 05 07 2025 | Bonds | 9.0% |
| US I/L 0 1/8 15 Apr 2027 | Inflation Linked Bond | 7.5% |
| US I/L 2 1/8 15 Jan 2035 | Inflation Linked Bond | 5.8% |
| Bitcoin | Bitcoin | 5.5% |
| S I/L 01 06 2030 | Inflation Linked Bond | 4.6% |
| One River Dynamic Convexity | Long Volatility | 3.8% |
| US I/L 0 1/8 15 Apr 2029 | Inflation Linked Bond | 3.7% |
| US T-Bill 12 Jun 2025 | US Treasury | 3.0% |
| US 10YR Note (CBT) | Bonds | 2.5% |
| **Total for Top Ten** | | **70.4%** |

**Allocation**

| Name | % Long | % Short | Net % |
|---|---|---|---|
| Gold Bullion | 28.8% | | 28.8% |
| Gold Royalty | 4.6% | | 4.6% |
| Silver Bullion | 1.6% | | 1.6% |
| **Gold and Precious Metals** | 34.9% | | 34.9% |
| Equity Long Short | 6.0% | -5.3% | 0.7% |
| Volatility and CTA | 15.4% | | 15.4% |
| Inflation Linked Bonds | 21.6% | | 21.6% |
| High Yield Bond | | -2.6% | -2.6% |
| US Treasury Bills | 7.3% | | 7.3% |
| US Govt 10 yr. Bond | 2.5% | | 2.5% |
| Bitcoin | 5.5% | | 5.5% |
| Carbon | 3.0% | | 3.0% |
| Cash and Cash Equivalents | 11.6% | | 11.6% |
| **Total All Assets** | **107.9%** | **-7.9%** | **100.0%** |

**Currency Allocation**

| | |
|---|---|
| USD | 95.6% |
| JPY | 4.8% |
| SEK | 4.7% |
| GBP | -5.0% |
| **Total** | **100.0%** |

Performance calculations for the month are based on estimates and will be subject to change.

## Performance

The Somerston Rainy Day Fund (US Class) delivered a robust return of +3.1% for the second quarter and +10.7% year to date. This performance underscores the Fund's ability to capitalise on adversity while maintaining resilience in more benign environments.

## Commentary

The second quarter of 2025 was punctuated by sharp volatility, ignited by the "Liberation Day" tariff announcements on 2nd April. The U.S. administration's imposition of tariffs, reaching levels unseen since the 1930s, triggered a swift market correction, with the S&P 500 tumbling 21.4% from early February to its trough on 8th April, evoking memories of the 2020 COVID-19 crash. The CBOE Volatility Index (VIX) spiked to 50 on 8th April, while the MOVE index, measuring Treasury volatility, surged from 106 to 140, highlighting widespread market stress.

Blindsided by the magnitude of the proposed tariffs, investors sought safe-haven assets. Traditionally this would have caused the US Dollar and US Treasuries to appreciate, however concerns that the policies would slow foreign buying of US Treasuries caused these assets to decline. Instead, investors preferred gold as a safe haven causing a 14.8% trough to peak return. Gold's performance has been compounded by persistent fiscal deficits, geopolitical fragmentation, and a notable shift of physical gold from London to the U.S. amid heightened COMEX futures demand. Our significant allocation to gold and precious metals, including gold royalty companies and silver, has been the foundation of our performance, delivering strong returns amid the turbulence.

A reprieve emerged mid-quarter with a 90-day tariff pause and carve-outs for sectors like mobile phones and laptops, alongside a U.S.-China agreement on 12th May to reduce tariffs from 145% to 30% and 125% to 10%, respectively. This sparked a risk-on rally, with the S&P 500 recovering its April losses by May's end, and credit spreads tightening to pre-Liberation Day levels. However, this optimism masks an underlying fragility. The tariff reprieve, set to expire on 9th July, looms as a potential catalyst for renewed volatility. The U.S. administration's threat of a 50% tariff on the EU, alongside sector-specific tariffs targeting semiconductors and pharmaceuticals, has soured negotiations. Reports of doubled steel and aluminium tariffs have further strained relations, with trading partners like China and the EU showing little willingness to concede, raising the spectre of another tariff shock.

The sense of unease is compounded by weakening economic signals. Retail sales declined 0.9% month-on-month in May, following a 0.1% drop from March to April, reflecting a potential demand vacuum post-tariff front-running in Q1. Initial jobless claims climbed to a four-week average of 245,000 by June, which while is historically robust, is trending higher. Our real-time leading growth indicator, is improving but continues to signal downside risks, reinforcing concerns of a broader economic slowdown.

The Federal Reserve's stance adds further complexity. Despite deteriorating macro data, consumer price inflation at 2.4% remains elevated and above the Federal Reserve's 2% target. In May, the Fed maintained a hawkish outlook, projecting higher inflation through 2027 and no rate cuts until at least September reflecting concern over tariff-driven price pressures and potential oil price spikes from Middle East tensions. July will be pivotal. A failure to maintain tariff relief, combined with weakening data, could tip the U.S. economy towards recession, and would cause the Federal Reserve to trigger a rate cutting cycle.

The table below amply illustrates the growth of debt is not isolated to America. Debt to GDP ratios are above 100% for the majority of the G10 Economies – a level that is considered difficult to recover from. As we have once again witnessed in the UK, such high levels of indebtedness remove almost all fiscal options. In the UK this has forced the Labour government to employ very un-labour like policies causing a revolt amongst the core party ranks. Historically, similar high levels debt to GDP in emerging economies consistently led to some form of default and the laws of maths apply equally to developed economies. In this regard, with a long-term view, we consider the risk of fiat currency debasement to be highly likely. Our holdings of precious metals and Bitcoin are sensitive to hedging this scenario.

The debt problem is widespread amongst developed economies

SOMERSTON ASSET MANAGEMENT

| DEBT to GDP | 2004 | | 2014 | | 2024 | |
|---|---|---|---|---|---|---|
| Belgium | 94.0 | | 106.8 | 13.6% | 108.0 | 1.1% |
| Canada | 71.6 | | 85.6 | 19.6% | 104.7 | 22.3% |
| France | 65.9 | | 94.9 | 44.0% | 112.2 | 18.2% |
| Germany | 65.8 | | 74.5 | 13.2% | 62.5 | -16.1% |
| Italy | 103.7 | | 131.8 | 27.1% | 137.0 | 3.9% |
| Japan | 176.2 | | 236.0 | 33.9% | 254.6 | 7.9% |
| Netherlands | 51.8 | | 67.9 | 31.1% | 46.7 | -31.2% |
| Sweden | 50.8 | | 44.9 | -11.6% | 31.8 | -29.2% |
| Switzerland | 54.6 | | 45.6 | -16.5% | 38.3 | -16.0% |
| United Kindom | 39.8 | | 86.2 | 116.6% | 101.8 | 18.1% |
| United States | 62.1 | | 103.4 | 66.5% | 124.0 | 19.9% |

03/07/2025 Somerston Asset Management 13

Our portfolio remains well-positioned to weather this uncertainty:

1. Geopolitical fragmentation and supply chain rewiring continue to bolster the appeal of gold and precious metals as an uncorrelated asset class. Foreign demand for US Debt following Moody's downgrade further support the investment case for Gold.
2. When the valuation of cyclical equities overwhelms that of defensive equities, we favour a relative trade of long defensives and short cyclicals which also has a negative relationship with the market.
3. Our volatility strategies are poised to deliver outsized returns if markets suddenly and substantially falter.
4. Inflation-linked bonds hedge inflation driven yield increases.
5. The Fund's diversified approach, including exposure to Bitcoin and carbon, provides additional resilience.

With equity valuations, credit spreads and implied volatility once again close to extremes, the tinder for a severe market correction is stacked high. Whether we get the spark that causes financial markets to heat up remains to be seen.

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