Gleneagle Asset Management Limited
Gleneagle Investment Trust (Equity Fund)

January 2022 Review

The Equity Fund gained 1.1% in January in what was one of the worst January performances for equity markets in decades as the concerns over rising interest rates, inflation and Omicron impacts triggered widespread volatility. Globally major indices had reached correction territory being down over 10% from their peaks during the course of the month.

We had flagged in our monthly Investor Note of this looming risk and were able to avoid much of the carnage and in fact at times profiting by being short the major indices during the sharp corrections. We also benefited in the month from the two areas that we believed would be able to withstand any broader market declines – namely oil and lithium.

The oil price continued to appreciate over January and now has breached the US$90/bbl level, spurred by global tensions, limited supply and demand that continues (and will be) stronger for longer. More importantly, with investment in new production at multi-decade lows, the ability of production to meet increasing demand is limited, placing the major oil producers in a strong position to generate excessive profits. Companies like Exxon Mobil released their best profit result in six years and we are expecting the same from the local oil producers Woodside and Santos – both of which we hold in the Fund.

Like January 2021, retail investors piled into the lithium sector again in January 2022 and we took advantage of the expected continuation in the appeal of the sector – at least to short-term traders. Aware of how quickly things reversed in 2021 where the whole sector peaked by early February we took profits on all our lithium position in late January as they diverged away from the trend of the overall market. We currently hold no lithium positions.

Our primary aim this year is to be nimble. There are so many conflicting and diverging signals and developments across the globe it is difficult to maintain high conviction views for any sustainable length of time. As we already noted – energy seems to be the only one where only tailwinds exists and valuations are yet to be reflective of an oil price approaching US$100/bbl. Other resources such as nickel and copper have positive tailwinds for now but are less robust and thus more vulnerable to shorter-term sentiment shifts.

Many technology stocks have been decimated over the past 12 months with the onsite of higher interest rates and a post-Covid hangover where one-time market darlings that became household names are down as much as 80% from their peaks. Stocks like Zoom Video Communications, Peloton, Draft Kings etc reflect how quickly market sentiment can shift and the extent to which stocks can retreat once tailwinds expire. These (and many others) are now approaching levels where short-covering rallies can produce anywhere from 10% to 30% rallies in a single night, so naturally we are on high alert for when signals begin to highlight the increased probability of such a sharp but short-lived rebound.

The hot topic of higher interest rates from central banks across the world, should see a similar outcome for homebuilders. It doesn't take a rocket scientist to foresee that higher interest rates will limit consumer spending power which in turn limits demand and the ability for consumers to build homes in the same size and consistency of recent years. With home builders only down 20% from their peaks, there is potential for additional meaningful declines if expectations continue to rise for higher interest rates.

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Our biggest concern is one that is deeply rooted in historic evidence – central banks being late to respond to market and economic risks, only to play catch-up by condensing all their policy responses into a narrow timeframe (the shape of pin) that ultimately "pricks" the bubble that they themselves created in the first place. Thus sending the economy on a perpetual boom-bust cycle.

Policy makers from the Federal Reserve to the European Central Bank are now talking about rising rates more aggressively to combat inflation – something they refused to believe was sustainable only a matter of months ago. With comments from Federal Reserve chairman Jerome Powell that "rates can be lifted some way before impacting the labour market" is frightening to us. With higher levels of debt that businesses and consumers now carry their sensitivity to interest rates are even greater. Moreover, they have already experienced "tightening" with higher input costs, and the economy is already slowing.

The Atlanta Federal Reserve publishes a GDP-tracker which is a more up-to-date measure of how the economy is currently tracking using current data and unsurprisingly to us, is reflecting just 0.1% GDP growth. Central banks have largely missed a considerable window to raise rates, and now in an attempt to "catch up" to where they should be, they could easily be more aggressive than the economy can handle. Let's not forget that the RBA raised interest rates in February and March 2008 to 7.25% AFTER the stock market plummeted 25% in the prior two months.

It seems policy makers are on a path of re-creating the same mistakes and as was the case in those previous cycles, the warning signs were clear and the opportunity to generate returns from bear markets just as great as the opportunity was during the bull market. For now, we are on high alert for further evidence but are already extremely cautious, which is a positive for the Fund given the already extremely volatile year that is 2022.

Until next month,

Gregory Tolpigin Portfolio Manager
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