Fixed Income Fund

2021 Annual Review

SharePrices
1300 123 345
members@shareprices.com.au

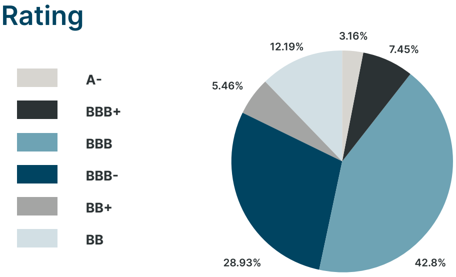
Fund Overview

The Fixed Income fund's point of difference is the variety of return sources it uses to deliver its investment objective. It seeks to protect investors against inflation risk by using specialised techniques, which enable the hedging of inflation. The fund also utilises the skill set of the manager, Fortlake Asset Management, to run overlay, arbitrage and offer short-term credit strategies.

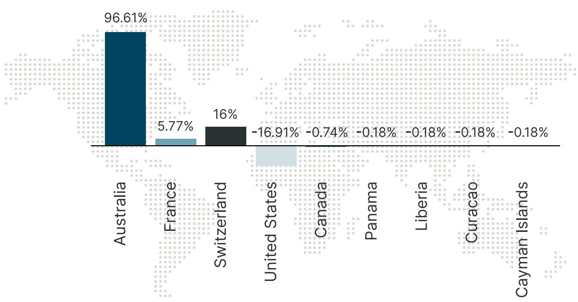
5% p.a	**0.41%**	**100%**	**Diversified**	**BBB**	**224 - 298**
Targeted Distribution of Income to Investors*	Income Distribution Each Month Since Inception^	Positive Months Since Fund Inception	Portfolio of Investment Grade Bonds	Average Credit Rating	Number of Exposures

Gleneagle Investment Trust | Retail Offer	
Name of Class	Fixed Income Fund
Asset Class	Short Term Fixed Income
Target Returns	Targets a return for investors to receive a consistent distribution of income of 5% p.a*
Investment Manager	Fortlake Asset Management
Responsible Entity	Gleneagle Asset Management Limited
Administrator	Apex Fund Services Pty Ltd
Custodian	J.P.Morgan & Gleneagle Securities (Aust) Pty Ltd
Withdrawals	Monthly applications & withdrawal requests
Distributions	Monthly
Reinvestment	Monthly distribution can be reinvested
Unit Pricing	Monthly
Minimum Investment	$50,000 (no maximum)
Establishment Fee	Nil
Contribution Fee	Nil
Withdrawal Fee	Nil
Termination Fee	Nil
Management Fee and Costs	2.2%
Manager Performance Fee	Nil
Buy / Sell Spread	0.00% / 0.15%
Investments	Bank Deposits & Term Deposits High-Grade & Investment-Grade Bonds Asset Backed Securities
Risk	Refer to PDS
Reporting	Confirmation statement upon account opening, transaction statements, annual distribution, holding and tax statements, online account statements.

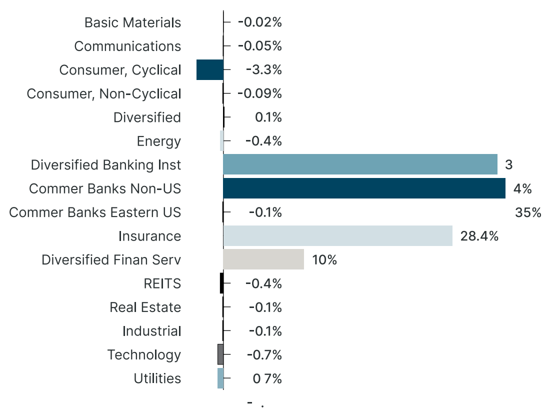
Credit Rating



Market Exposure by Country



Market Exposure by Sector



*^Past performance is not indicative of future performance. *Targeted return provides an indication of what the fund aims to achieve. There is no guarantee this target return will be achieved. Fund inception is 18th May 2021.*

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Author: Dr Christian Baylis

One Year On

We set out on a path to attract investors that shared a different and refreshed vision of the asset class, with the expectation of a very slow uptake at the outset due to the unique approach, followed by a more loyal long-term following. We were mindful that such an approach would warrant paying the price up-front to develop something necessary and different, therefore seeking to hockey stick our business case in the outer years. Pleasingly that was not the case, with our movement into core markets now 3-4 years ahead of schedule. Contracted FUM has now surpassed $1b in our first year. A great start and worthy milestone to reflect upon for all those instrumental in the formation of the business.

Philosophically Speaking

A philosophical perspective is an important part of any investment process, so unsurprisingly, we are often asked to articulate our views on this particular topic. However, I thought it would be worthwhile delving into this a little more deeply as its relevance and its true effect on actual outcomes depends on a variety of factors. In many ways and across many institutions, the investment philosophy is a constructed process that lacks authenticity. Often left to the marketing department to formulate, its essence and true meaning tend to have little buy-in from the investment personnel. What you tend to see is that philosophies are very idealistic, overarching, long term in their ideal but in many instances get eroded by the day-to-day friction of team dynamics, personality, bureaucracy, or hidden ulterior beliefs. Take, for example, an institution that has not changed its philosophy for 20-30 years. Can we truly believe everyone that goes in and out of that turnstile was a true convert to the philosophy that was thrust upon them… The cornerstone of the business should, in fact, be an authentic philosophy and one that you believe in, perhaps obsessively. In turn, this attracts people who see the merit in that way of thinking and hopefully want to come along for the ride. Importantly, this doesn't come at the exclusion of diversity of thought and more constructive approaches. From our perspective, this should be a view of the world and set upon a vantage point that enables the conduct of a true and authentic investment process, based on a genuine belief system that is grounded in merit and tortured under the weight of fact-sensitive analysis.

Informal conversations and unscripted ideas about true beliefs are very telling in the context of how asset managers act on a day-to-day basis. I don't know an asset manager that looks at their Due Diligence Questionnaire (DDQ) daily and benchmarks their every action against the stated philosophy on page one. Therefore, what you truly believe and what drives your short-term cognitive reality is very much where your philosophy should come from. This will ultimately become an ex-post philosophy if constructed authentically. By implication, it requires a lived experience as part of its creation, and that cross-section of experience can be very significant if acquired over tumultuous periods. Identification of this philosophical construct formulates the core of the belief system. This is further solidified through the day-to-day, embedding the belief system into the firm DNA, and in turn it should be representative in the results.

You see, asset managers obtain the investing constituency they deserve. A good place to start is setting up that relationship with realistic communication and outlining the limitations of what we can do. Suppose we were to focus our communication on short term results, eternal optimism and knowing everything with utmost confidence. We will attract those exact same investors focused on those very same factors. This leaves us indulging the human desire for more assured outcomes – a false narrative indeed. In practice, this communication extends beyond the range of possible outcomes, acknowledging that we will face outcomes that may enter unknown territory from time to time. It is far more important to focus our strategic processes north and south of the central estimate, not east and west along the "jackpot line". Investment decisions based on tempestuous desire shouldn't find a home if the starting point acknowledges the treachery of overconfidence, moreover, the inevitable sequence of missteps that will follow. Analogous is the pandemic, for which we remain acutely focused on "crystal-ball-itis", with it spreading rapidly along a hyperbolic curve and clustering around the central banking community at present. Within the realm of investment communication, we present informed guidance to our investing constituency. Still, as with all asset managers, we encourage you to treat such opinions and guidance with due caution and a healthy level of inquisition. We can deepen the understanding by identifying and establishing that some things can only ever be partially explained. The plausible range of actual outcomes will be time-dependent and subject to various unknowns; you should know this and invest on that basis. A deluded investor class will leave at precisely the wrong time. They will leave disappointed and disrupt the ecosystem of those who accept a world of opportunity swamped by the possibility and plausibility of alternative outcomes. By focusing our investor class on the key points of uncertainty and return, or better still, the "unreal" return, we hope that you as investors have all that you require to make an educated decision.

A Fruitless Game of Ruling Out

As we look back at 2020-2021, communication was the key policy weapon in a world where the interest rate ammunition was fully depleted. In hindsight, communication became the central tool as many of the lived experiences on other policy options were largely ineffective. A key plank of those alternative policies was centred around forward guidance of the interest rate path. We now know this as a policy option has questionable benefits and poses significant credibility risks. On balance, a policy with net negative benefits.

Firstly, using communication as a policy tool deliberately takes the emphasis away from the macro signals we use to analyse the economy's health, emphasising the discretionary power that central bankers have. The objective here is to desensitise markets from the macro signals they typically rely upon. Encouraging behavioural change based on communication rather than the price of money is a novel idea and not commonly seen over a supa secular time horizon. In practice, this means convincing markets that the reaction function has changed and that, for now, it is somewhat looser than it once was. In more pointed terms, you reduce uncertainty about the direction of interest rates to achieve your policy objectives. For example, by reducing uncertainty around which way you may move interest rates over a set time frame, the question of variance becomes less important than the question of timing. At present markets are very much focused on timing and less so on direction. Central banks have navigated the current state of play through communication. A curious case was when Governor Lowe recently commented that interest rate hikes could plausibly increase in 2024 but made no mention that they could plausibly increase in 2022 despite the current high probability in market pricing for a 2022 increase. We know this is an asymmetry of communication, as the plausible outcomes of raising in 2022 and 2024 are almost equal in practice.

The real-world implication is that consumers may make many decisions based on the communication, irrespective of what the macro data may inform. The most obvious is purchasing decisions contingent on the cost of money, such as a house purchase. Knowing this, one must wonder why central bankers have moved into the world of 'rule-in, rule-out' without considering the implications for risk markets and consumers when making these statements. In recent history, we have seen central banks 'rule out' negative interest rates. This puts 'at the margin' upward pressure on the currency, which reduces inflation due to currency effects, moving it away from the central banks' objective of 2-3 percent. Ruling-out negative interest rates or an increase in 2022 might sound logical and indeed justified based on the empirical understanding of the real-world implications to date. But, whilst the evidence is unsettled on these particular topics, the world is a highly uncertain, so keeping risk-based premia in markets only serves to help the central bank achieve its policy objectives.

Simply put, it increases the 'chance' that the central bank does not have to take such extraordinary steps as it enables risk premia via currency or interest rates to do some of the heavy lifting despite the underlying intention of the central bank. We are seeing a belated reckoning on this point with some central banks, such as the Bank of England, abandoning forward guidance which is now being heavily critiqued as a policy tool. Moreover, the Federal Reserve has made pointed comments on the topic, and the RBA has in effect abandoned its forward guidance policy mid-stream with the disbandment of the 3-year target yield strategy.

The disparity between central bank guidance and market pricing can be used as a barometer on the perceived credibility of the central banks' future actions. Markets are attuned to every word the central banker speaks; don't throw it away when you need it the most, especially when it helps deliver the outcomes you need. Ruling out an action, coupled with potentially undelivered statements of overconfidence, can slowly erode the future potency of the communication tool. Central banks are walking a fine line here and risk being forced into a more limited suite of tools for future crises. It is clear they are losing the war.

Wishful Thinking

A confusing narrative around inflation continues to pop up despite clear evidence that lockdowns worsen supply chain issues definitively. On the other hand, the demand side is becoming immune to lockdowns as savers fatigue sets in, i.e., people want to spend but, in many cases, can't due to structural limitations imposed due to the pandemic. Furthermore, people want to spend the bounty received from the transfer system, and with inflation running at over 6 per cent in much of the developed world, they will lose it pretty quickly in real terms if they don't. It has also been argued that monetary policy is the incorrect tool to address temporary price shocks because price pressures are transitory. This is a confused logic as shocks, by definition, are always temporary and fade over the passage of time. Central banks are meant to respond to shocks, that is the remit that comes with delivering price stability. Macroeconomic models for inflation typically have controls in them which allow for shocks, and in all cases, monetary policy reacts to those shocks as a control. Ignoring a shock because of temporary gut feel is not a policy prescription; hope is no strategy when it comes to inflation. If there was no reaction function in those models, forecasted CPI becomes unmoored and breaks away from the targeting regime. Moreover, inflation expectations become unmoored, CPI volatility ensues, and we find ourselves in an inflation rodeo of sorts. When central banks don't respond to inflation shocks, we have very good evidence and clarity of what follows. A litany of historical precedents should serve as a strong warning to begin risk mitigation against such an outcome.

From a positioning perspective, this is the gift that keeps on giving for those willing to step in on the short side of rates or inflation markets. In our view, central banks are confusing transitory and 'cumulative' and ignoring the cumulative impact of continued lockdowns on supply chains. The clear anecdotal evidence suggests fundamental shifts in the way front line retailers are stocking inventory, moving from 'just in time' to 'just in case' – this is not in the official data yet. This subtle difference has significant pricing implications for 'at the docks' inflation and serves to put a significant and extraordinary amount of pressure on an already weak supply chain. If anecdotal is not your thing simply look to the Chinese PPI numbers as ground zero for global Producer Price Inflation (PPI), now running at 13.5 per cent and trending above 9 per cent for the last 6 months. These numbers have typically struggled to get above half a percent in more normal times. If you have heard the term 'costpush' – the former stated is the cost, and the retailers are clearly now doing their bit on the push – the push will take time. The more sophisticated and significant inflation models work off a mark-up over cost – such as the widely used mark-up model. If China was ground zero for the decade of disinflation we have seen, the counterfactual will apply in theory. To make matters more uncertain, many are now taking drastic steps to sand-bag future supply chain issues by onshoring much of the supply chain. This will move supply from low-cost scale producers such as China to subscale incubation zones, meaning that parts of the world are now starting to pay something akin to a supply chain insurance premium. This cost is still to be quantified, but safe to say, it only adds to the upside risks.

At a point, transitory morphs into cumulative the more you lockdown and structural inflation becomes an issue. This permitted unmooring of the inflation anchor comes with consequence; it is not a transitory phenomenon. Think of this like a layer cake, every time we slow down the supply side without slowing demand, it puts additional months of imbalance into the price-setting function and layers on price. The continual wrenching of the supply side handbrake enables demand to gain an unassailable lead and entrench an imbalance where there is no window for that layer of price to transitorily ebb back to where it was. This is allowing demand to run laps around supply in ever greater quantities. Worse still, this is now moving structurally into expectations, and that is where the upside danger is. The inflation coil is now very tightly wound up, and to those waiting for the transitory bus, it may be a long wait.

On wishful thinking, as we consider the year ahead of 2022, there are some key themes to call out. Keep an eye on diffusion indexes of price changes. These are often useful indicators of turning points in the CPI data. We are now seeing a larger number of categories "diffusing" and exceeding inflation targets on longer time horizons. More categories in relevant baskets of goods are sitting above the 3 per cent level. In addition, liquidity will reshape in 2022 as central bank security holdings decrease. This will lead to a reduction in bank reserves and, therefore, liquidity. Finally, the absence of a price insensitive buyer will drastically change backstop liquidity and with that, risk markets. For the first time in 15 years, there will be no G7 central banks supporting risk. Yes, the stock of bonds on central bank balance sheets will still be significant, but this at the aggregate level will be falling as a percentage of GDP, assuming GDP grows. When risk and inflation intersect, central banks do not have a remit to support markets; generally speaking, they can only do so under the guise of inflation targeting and full employment. Liquidity, and risk, have been in an indirect and cosy relationship due to central banks undershooting their respective inflation targets. Risk has largely benefited from this slip stream by getting pulled into the vortex of the inflationary battle. Our wishful thought for 2022 is that this paradigm will end.

We wish all our investors and keen supporters the best of luck for 2022.