Gleneagle Asset Management Limited
Gleneagle Investment Trust (Equity Fund)

February 2022 Review

The Equity Fund gained 1.9% in February as we benefited from having a concentrated portfolio focused largely on resources and commodities, while being actively cautious on the broader indices given that the investing environment has changed significantly since last year.

Most recently this environment has taken an even more decisive change with the Russian invasion of Ukraine that has sent commodities soaring and equity indices tumbling. Russia accounts for a significant supply of a wide range of commodities and their supply disruptions to the West have the potential to create some very painful effects to businesses and consumers.

Much of the headlines have centred on the supply of oil and gas and the subsequent spike in prices, but lesser known commodities like neon gas are of particular concern. Russia/Ukraine supplies almost 90% of the world's neon gas which is a crucial input into the manufacture of semiconductor chips. Any decision to limit its supply to the West will have disastrous effects on the manufacturing of almost all tech products, not to mention the impact of 40% of global wheat production or 40% of the world's palladium being cut from the Western consumers.

There are so many potential outcomes to this conflict that it is impossible to determine what the end result will be. We do however have a strong belief that Western economies have the potential to suffer just as much as the Russian economy if there is a direct "mirroring" by Russia of Western sanctions and China continues to openly trade with Russia.

As a result, our strategies remain unchanged. Our focus remains on trading actively given the high levels of uncertainty and that news headlines have the ability to change the market's trajectory in an instant. We remain very cautious towards indices but positive on a range of commodities. Most recently oil, copper, lithium, nickel and rare earths had dominated our attention but in the past month we have dropped our lithium interests in exchange for gold.

Not only has the surge in inflation and the breakout of war triggered an increase in demand, but the Russian Central Bank has also been cut off from its foreign currency holdings (SWIFT payments network). This is a new risk for central banks and the only way to circumvent this "risk" is to increase the holding of gold. As a result, we believe that gold has now finally embarked on a long-term trend higher into fresh record territory that could see levels into the mid-$2000/ounce range this year.

One primary rule we always abide by where possible is buying at the source first. This means that with our bullish view on gold, our first and primary position is to directly own gold. This is crucial in ensuring that one profits from having the right idea. There is no guarantee that gold stocks will follow the gold price higher if there is a stock market crash for example, or if the gold producer purchased has some production issue. Let's not forget that the greatest cost to producers is oil and that itself is also soaring. Margins quickly become the issue for gold producers, not solely the improving price of gold. It is possible for gold companies to make less money with a higher gold price! As a result, the fund's largest exposure to gold is gold itself followed by an array of US and Australian gold producers (not explorers).

In our last monthly note we highlighted the risks of the Federal Reserve raising rates too hard, too fast and for too long. Even with the outbreak of war in Ukraine, the Federal Reserve is tipped to rise rates in March and then another six times this year. With consumers carrying significantly more debt this cycle, coupled with rapidly rising costs, the global economy is likely to experience a sharp slowdown if not recession. NZ has already raised interest rates four times and consumer confidence is at a record low.

Unfortunately, this high level of sensitivity to interest rates due to high debt levels will result in central banks having little capacity to raise rates without "killing" the economy. The next phase of our economic reality will be a de-leveraging cycle where consumers will use excess savings to reduce debt, translating to lower levels of economic growth and consumer spending. This can take many years to play out and will result in investors needing to focus on areas where consumer spending habits are changing (the electrification of transport) rather than spending more in traditional areas (property, travel, technology). Even personally, our household is in a phase of reducing "expenses" with the number of streaming services being reduced from 4 to 1 – after all, who has time to watch Netflix, Stan, Disney, Foxtel etc all at the same time? Overkill and totally unnecessary. We suspect we are not the only household focusing on unnecessary luxuries in a new world of rising costs, pandemics and higher interest rates.

As equity markets fall and fear grips markets, we remain cautious and in a position to benefit from either a quick resolution to the Ukrainian conflict or a prolonged trade war. We understand the risks of both outcomes and look to position the fund as best as possible to benefit from whatever global markets and Governments decide to do.

Until next month,

Gregory Tolpigin Portfolio Manager
Gleneagle Securities (Aus) Pty Ltd