Q4 General Update

JANUARY 2022

We build and maintain portfolios for clients which address their specific needs

Baggot is a Central bank regulated investment manager. We specialize in designing and monitoring investment strategies that are built using global investment products and assets. Where almost all financial advisors and brokers would simply refer your business to a large external manager, in return for a commission, we use in-house expertise to actively manage your assets.

We offer Investment strategies across various risk profiles. In many cases, we build portfolios in-line with our client's specific needs (CGT focus, Income focus, etc.).

As a principle at Baggot, we do not charge upfront fees or expose our clients to lock-up periods. You can add or withdraw funds at any time and switch between strategies at no extra cost.

If you would like a review of your current investment strategy or to discuss future investment opportunities please contact us.

Call 01-699 1590

Peter Brown
Managing Director

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Before getting into product returns it should be noted that our product return numbers include all charges, which is not the case for our peers

01.

Baggot returns summary

BMA, our flagship risk profile 4 (medium risk) multi-asset product posted a gain of 2.5% in Q4 and ended the year with a 12.6% total return in 2021. The benchmark Irish Life MAPS 4 posted a 5.2% return in Q4 and a 14.3% for the year. Over the last 24 months with our numbers including all charges and costs and their numbers not including all charges and costs BMA has outperformed MAPS 4 by 6.3%.

BMS, our quantitative, systematic absolute return strategy (medium risk) gained 3.2% in Q4 and ended the year with a 7.8% return. BMS outperformed the benchmark (IQ Hedge Multi-Strategy Tracker) by 1.25% in Q4. BMS gained 7.8% in 2021, outperforming the benchmark by 3.92% for the year. BMS has consistently outperformed the benchmark over the last couple years.

BME, our higher risk profile equity basket (Risk profile 6) lost 1.5% in Q4, with YTD returns coming in at 17.8%. The benchmark MSCI World index posted a 2.6% return in Q4 and 19.9% returns for the year. The benchmark has large exposure to big cap growth/tech stocks while BME favours a more Value driven approach currently. Big cap growth/tech stocks did well to finish the year but we are deeply concerned with valuations in the space, particularly as central bank policies are looking much more hawkish. BME has started off the year well, up 4.1% in 2022, as of today January 12. Not so for big cap growth/tech stocks, which are currently down nearly 3% to kick off the year.

Before I move on, I'd just like to mention that our low-medium risk multi-asset product built mainly for corporates returned 12.6% in 2021 including all charges and costs. A 3.05% outperformance of the benchmark Irish Life MAPS 3 Fund.

02.

Market returns summary

Return numbers noted below are all based in Euro denominated terms. Data taken from unhedged (currency) European UCITs ETFs, which include costs as well as dividend payments.

For perspective when comparing returns, the EURUSD lost 6.9% in value in 2021, not including "carry" which is the difference in yield between the Euro and US Dollar. In total you are looking at a roughly 8.6% loss in value in 2021. We highlight EURUSD and none of the other currencies because the US Dollar is the reserve currency of the world.

Q4/ Asset Class Returns

S&P 500
13.4% / 39.1%

NASDAQ 100
13.6% / 37.5%

Euro Stoxx
6.5% / 23.9%

German DAX
4.0% / 15.0%

Stoxx Europe 600
7.6% / 25.3%

FTSE 100
7.2% / 26.6%

MSCI EM Asia
0% / 1.5%

Vanguard FTSE EM
-1.2% / 7.6%

MSCI China
-4% / -15.6%

MSCI Japan
-1.6% / 9.6%

MSCI Word
10.2% / 32.1%

MSCI Latin America
-1.1% / -1.9%

MSCI India
1.8% / 35.7%

MSCI Asia Pacific ex-Japan
1% / 3.8%

Q4/YTD Bond returns (Euro denominated returns):

Europe Investment Grade Corporate Ultrashort dated
-0.26% / -0.24%

German 10+ Year Bond ETF
2.09% / -4.85%

US 10+ Treasury Bond ETF
5.37% /3.21%

Europe Aggregate Bond ETF
-0.63% / -3.07%

EM Bond ETF
2.36% / 6.17%

Barclays Global Aggregate Bond ETF
1.47% / 2.80%

US Inflation Protected Bonds
4.37% / 14.29%

Europe Inflation Linked Bonds
1.65% / 6.23%

Q4/YTD Precious metals (Euro denominated returns):

Gold
4.8% / 4.1%

Silver
6.4% /-5.7%

03. Equities

Generally speaking we saw decent returns for global equities in Q4. The biggest laggard regions were the MSCI China with a – 4% return and the MSCI Japan with a – 1.6% return in Q4. US Equity indices posted the strongest returns. The Nasdaq 100 gained 13.6% and the S&P 500 gained 13.4% in Q4 followed by the MSCI World with a 10.2% gain.

On the year, the S&P 500 posted the strongest return with a 39.1% gain followed by the Nasdaq 100 with a 37.5% return and the MSCI India was not far off the lead for the year with a 35.7% gain. The MSCI China was the big laggard on the year with a – 15.6% return. It continues to amaze me that we have such a huge difference in returns amongst EM countries!

It should be noted that much of the US outperformance was due to US Dollar strength during the quarter and for the year.

04. Bonds

US 10+ Year Treasury Bonds performed best in Q4, posting a 5.37% return, followed by US Inflation Protected Bonds which generated a 4.37%, return during the Quarter. Laggards in Q4 were European Aggregate Bonds Europe with a - 0.63% return and Europe Investment Grade Corporate Ultrashort dated Bonds with a – 0.26% return.

On the year US Inflation Protected Bonds performed best with a whopping 14.29% return, followed by European Inflation Protected Bonds which posted a 6.23% return for the same period. Again, it should be noted that much of the US outperformance was due to US Dollar strength during the quarter and for the year.

05. Precious Metals

Silver was up 6.4% in Q4 while Gold gained 4.8% for the same period. On the year Gold returned 4.1% while Silver had a - 5.7% return for the year. For perspective and given the fact that both assets are stores of value, it's probably worth considering that the Euro lost about 2% on the Qtr and about 8.6% on the year (that number includes the loss in value of the Euro vs the Dollar for the year and the loss in yield due to negative yields in Europe).

06.

Outlook for 2022

Central banks are way behind the curve on the inflation front. Reported inflation is running in the 6-7% range. Anyone who lives in the real world knows that's a low ball figure. When you go to the grocery store, what do you think? Are your costs 6-7% higher in the last year, how about petrol? Ask anyone who works in construction.

The truth is we probably are experiencing double-digit inflation, yet central banks continue to expand their balance sheets and interest rates are woefully behind the rate of inflation. Up until late last year central banks told us inflation was 'Transitory'. More recently they've backed away from using that term as we continue to see some of the hottest inflation prints we've seen in decades. I won't spend a whole lot of time on why because 'why' doesn't really matter. What matters is that central bank policies will have to change in response and that means the investing template will have to change in order to be successful. I'll try and keep the 'why' aspect brief.

Covid brought about the biggest global demand destruction in at least 100 years. Central banks and governments stepped in to fill the gap by cutting interest rates and implementing fiscal stimulus policies. They over-filled the gap. When you print that much money and let it out into general money supply it creates a situation where you have too much money (infinitely printable money) chasing too few goods. Central banks have no control over many of the drivers of inflation, such as supply bottle necks, under-supplied commodity markets as a result of no capex,.All the capex has gone into Tech which is now oversupplied!

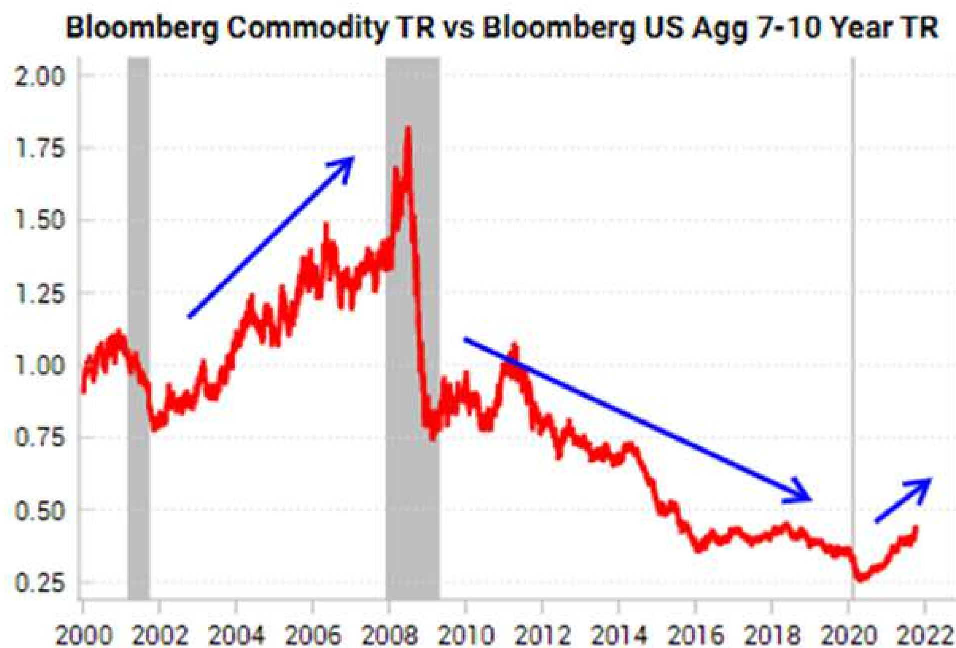
ESG policies – I said this last month, but I'll re-iterate; this is not a political statement. I'm simply pointing to cause and effect. These environmental policies are creating a tightness of supply of the commodities that are the lifeblood of the global economy and the 'green' infrastructure is not yet even remotely close to being large enough to replace the old 'dirty' energy. They are making the cost of getting fossil fuels out of the ground much more expensive and also making it very difficult to get permits. These policies ensure that there will be a shortage of supply in the coming years which will drive energy costs higher, which is inflationary.

Governments have seen that being reliant on other countries (lower cost producers) to supply key drugs, materials, semiconductors, etc…'just in time delivery', may not be the best idea during crisis periods and also fuels inflation. This has caused a lot of governments (especially the US) to shift policies away from offshoring and back toward onshoring…That's also inflationary!

Another consequence of overfilling the demand gap has been asset price inflation. The global financial crisis (GFC) in 2008 put a lot of retirement plans on hold. Their pensions took a massive hit and a lot of people put off retiring. The opposite has happened in the last 2 years and there are a lot of people looking at fat retirement accounts who've decided not to re-enter the workforce. This is inflationary. It will cost more money to fill that job.
If I thought about it, I could probably go on. A lot of these influences are things the central banks don't have control of and we think they have dramatically changed the investing template for the future.

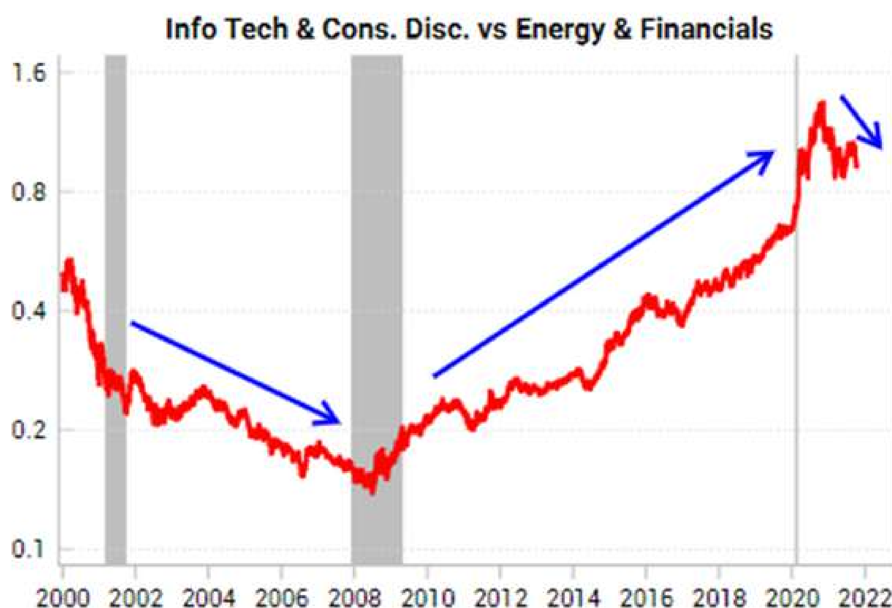
This is an excerpt from Variant Perception, a leading Investment Research firm;

Market leaders tend to rotate after a recession and enjoy a multi-year period of outperformance. The GFC ushered in a decade of real asset underperformance vs financial assets (proxied by commodities vs bonds), which has reversed after the lockdown recessions.



Source: Bloomberg, Macrobond, Variant Perception

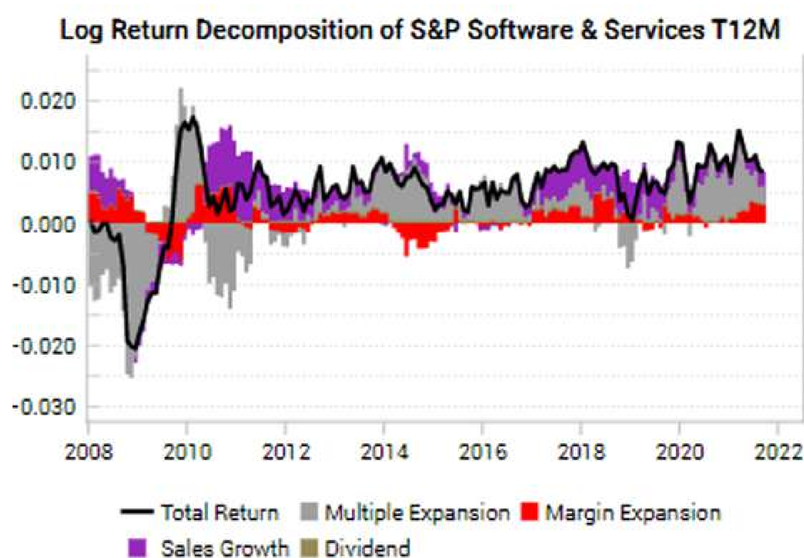
Similarly, info tech and consumer discretionary heavily outperformed vs energy and banks during the QE/financial repression of the last decade, which has also started to reverse.

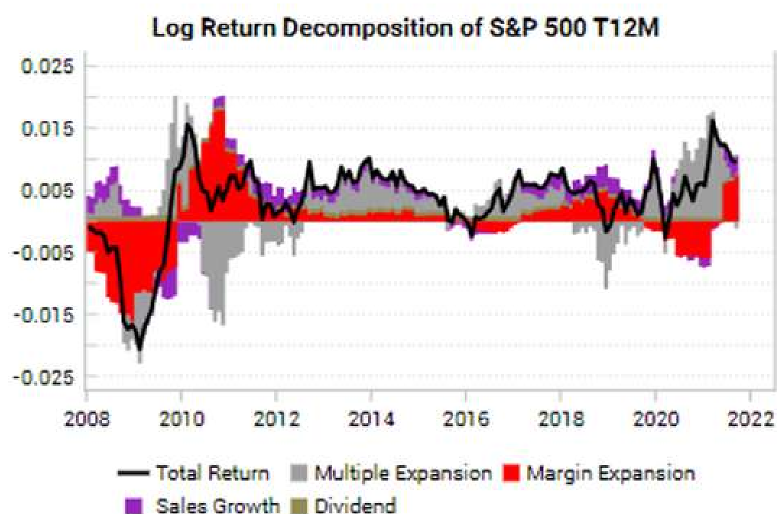


Source: Bloomberg, Macrobond, Variant Perception

The shocks associated with recessions often result in large shifts in the policy environment, causing shifting market leadership as business models shift and adapt. The pandemic brought with it aggressive and coordinated monetary and fiscal policy stimulus, which was last seen in World War II. This suggests the current change of market leadership towards inflation assets has legs.

One long-standing market leadership trend that has not reversed after the pandemic is US equity outperformance vs the rest of the world. US outperformance over the past decade has been linked to the upward re-rating of tech valuations. The decomposition of log returns for the S&P and for the software sector shows the remarkable and continued contribution of multiple expansion as a key driver of returns since 2012 (grey area in charts).





Source: Bloomberg, Macrobond, Variant Perception

Investors should beware of the implicit duration exposure of equity portfolios to rising yields, which is likely to bring about the end of secular multiple expansion that has driven tech outperformance for the past decade.

We think the stage is set for a shift in favour of real assets over financial assets, which is another way of saying to go for Value over Growth. Time to favour Industrials, Materials, Energy, Financials and Commodities. Also keep in mind that in an era of low rates and no inflation companies borrowed money cheaply to buy back stock, synthetically driving earnings per share higher. The consequence of this is to leave too much debt on the balance sheet once interest rates rise. So we think if you look for companies that have done the opposite, companies that have low debt levels and good free cash flows, those companies can return that cash to shareholders via increasing dividends. For a long time companies haven't been rewarded for paying dividends, they've been rewarded for issuing debt to buy back stock. We think the future will favour those who return capital to shareholders via increasing dividends.

07.

Bonds

Our Bond exposure hasn't changed. Where we require bond exposure (due to risk constraints) we continue to keep exposure in Inflation protected bonds and Ultra-short dated European investment grade bonds - which carry the lowest risk profile possible. If we had a choice we wouldn't hold any Bonds whatsoever, but in multi-asset portfolios, when you own higher risk profile assets such as Equities and Commodities, you must offset that risk with something that has a very low risk profile. The gap between inflation and interest rates is very wide, this creates a lot of risk for longer duration bond investors.

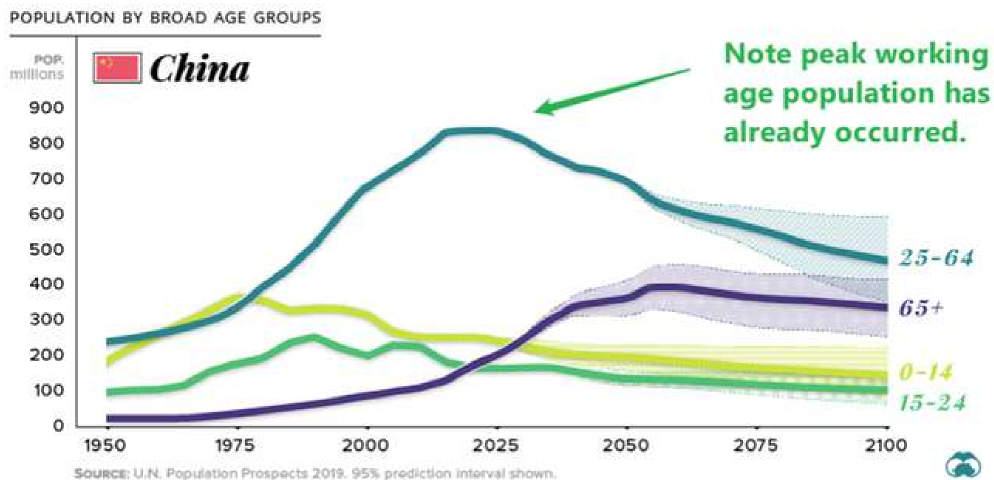
08.

Equities

Again we favour Industrials, Materials, Energy and Financials. We favour Value focused Equities over Growth. In the west we think you must avoid the big US indices because so much of the risk exposure in those indices is in areas that to us, looks like a fly in search of a windshield.

Our only real growth play is in India which we continue to see as an outperformer amongst emerging markets. Everyone talks about China when they talk about EM, but let me ask you, would you rather buy China with poor demographics from 3 decades of their one-child-one-family policy and the suspect welcoming of foreign capital? Or a country eager for Foreign Direct Investment that has one of the best demographic profiles on earth (low dependency on the tax payer)? There just aren't many large markets with business-friendly leaders and good demographics to invest in.

Demographic picture of China, courtesy of the UN



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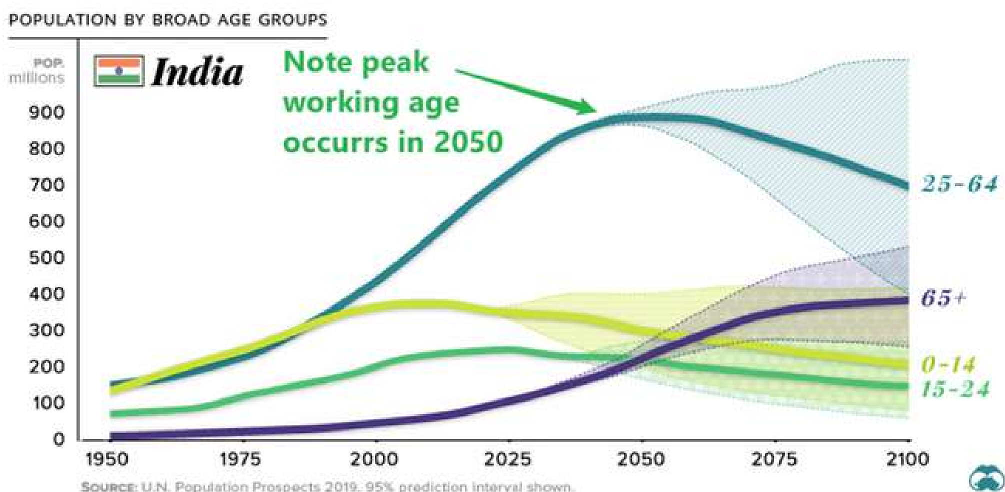


It has been an easy investment to justify in the past year because Indian indices are currently acting relatively well compared to other Emerging Markets.

On top of that we've managed to find an investment run by one of the greatest investors on the planet at a 30% discount to the Net Asset Value (NAV) of their holdings. To top it all off, this company has been buying back stock! Not long ago (before covid) this asset traded at a 5-10% premium to NAV. India at no discount, in our opinion is one of the best long-term investments you can make right now…now add in the kicker of a 30% discount to NAV, a top class manager of those assets, plus buybacks and you have what we believe are the makings of a rare opportunity.

09.

Commodities

Carbon Credits have gained roughly 75% since we first added it to our portfolios in April 2021. That's a big gain obviously, but we still think it is very early days in the grand scheme of things. It's important to remember though that this is a volatile asset that can make large moves in both directions in the shorter term. You have to keep your eye on the longer term potential, otherwise it will give you heartburn! The only thing you can really know is that when things get really speculative and seem to go vertical in a short space of time, the pullback will inevitably come, and it will likely be larger than normal.

From October 19 to December 8 last year, a period of about 7 weeks, it rallied 43%... then over an 8-day period from December 8 – 17 it dropped 15% before recovering. It's very important to understand that higher volatility assets may not be volatile all the time, but that doesn't mean that they won't be volatile at some point.

Carbon Credits have a very low correlation to all other asset classes which make it a very appealing piece of the portfolio puzzle, particularly at this stage of the global equity rally. Not to mention that it might be the most ESG friendly asset you could own or that it has full government backing in Europe, the US, the UK and many parts of Asia. The ESG theme is important. If we are to meet emissions targets for 2030 and 2035, then this market will have to go dramatically higher over the next decade. I've seen estimates firmly rooted in reality that put a $10 Trillion market cap on it by 2035. We think it will be a mainstream investment in five years' time, if not sooner. That said, it will not go there in a straight line.

Where appropriate to investor risk profiles, we originally invested in Uranium in Q4 2020 when it was called Uranium Participation Corp. That was before Sprott took over last summer and turned it into an Investment Trust. Since our original investment in Q4 2020 it is up nearly 115%. Client accounts will show a return (currently) of about 41% since investment but that only includes the period since the corporate action, when the name changed from Uranium Participation Corp to the Sprott Physical Uranium Trust. We still think it is very early days in the Uranium bull market.

I wrote this in the last Quarterly report but I think it is an incredible fact that gives important perspective; Did you know that one single pellet of Uranium, around the size of your fingertip contains the same amount of energy as approximately one ton of coal, 149 gallons of oil, or 17,000 cubic feet of natural gas?

Nuclear is the only scaleable zero emissions bridge to a carbon free world. Because of Fukushima it went through a long period of underinvestment. Consequently there's nowhere near enough supply, relative to demand and nuclear power generation continues to grow. We believe the price of Uranium needs to rise significantly over the next year just to be economical for miners to extract.

The spike in prices of Natural Gas, Coal and to a lesser degree Oil have created a renewed sense of urgency for power companies to move toward nuclear.... but the power companies have been caught flat-footed as the Sprott investment trust is taking a lot of uranium supply offline. Sprott is now consistently buying 100-300K pounds per day. Assume 100K/day which is something like $4 million USD (400K shares), which is doable in the current non-bubble light volume regime (for Spot Uranium Prices). That's roughly 25 million pounds of uranium taken offline in a year! That's an insane amount of supply going offline! The potential upside is staggering. While all this is going on the world's largest uranium producer Kazatomprom took notice;

"Kazatomprom has announced it is to participate in a physical uranium fund, ANU Energy OEIC Limited, established on the Astana International Financial Centre (AIFC). The fund will hold physical uranium as a long-term investment, with its initial USD50 million of purchases financed by its founders and plans to raise USD500 million for additional uranium purchases in a second development stage."

Full article here;
https://www.world-nuclear-news.org/Articles/Kazatomprom-announces-physical-uranium-fund

This is just going to add to supply tightness in the coming years.
I also highlighted this last Quarter but if you haven't read it I'd encourage you to do so...I thought Harris Kupperman made some very important points about the subject here in September;
https://adventuresincapitalism.com/2021/09/02/the-new-gbtc/

The tricky part is that there aren't many ways to play the Uranium theme as a pure play. Sure you can buy equity in a Uranium producer, but it's a company not a uranium pure play. A lot more factors can go against an investor in a publicly listed uranium miner, even if the price of uranium goes up. This is why we like to hold the Sprott Physical Uranium Trust. All it does is hold physical uranium.

The downside though is that investment trusts have a fixed amount of shares available on the market. They aren't like ETFs where float size can increase or decrease in line with demand, or lack thereof. Consequently they sometimes trade at a premium to NAV and sometimes they trade at a discount to NAV. We cannot and will not put new money to work at a huge premium to NAV. The image below shows the historical premium/discount of the market price verses the NAV (Net Asset Value of Uranium holdings). The red oval shows the highest premium it has ever traded at….a 28.53% premium on Sep 13, 2021. Currently it trades at NAV (green oval).

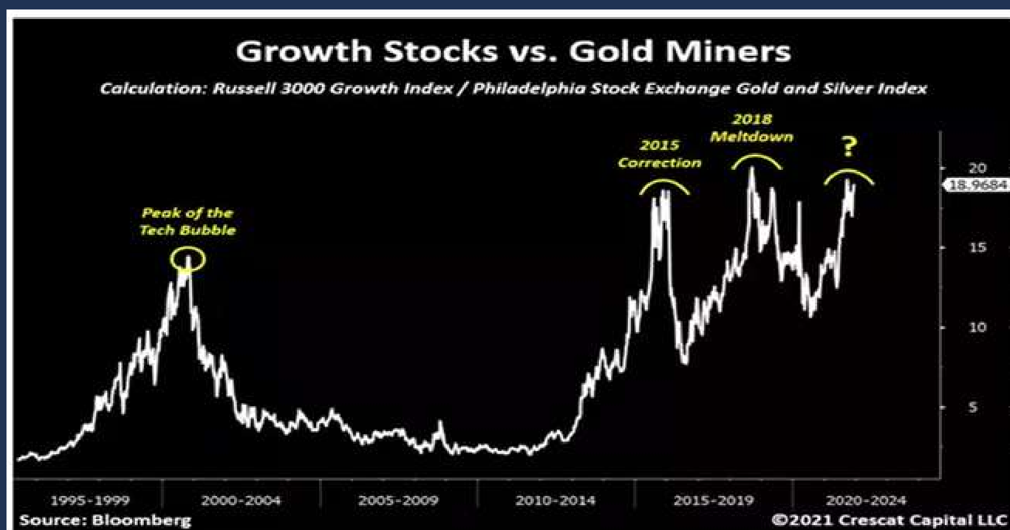
https://www.sprott.com/investment-strategies/physical-commodity-funds/uranium/#

It is a volatile asset but where appropriate to the risk profile of the client and given that it is currently rationally priced, we think now is a good time to put new money to work in the space.

Precious Metals had disappointing returns in 2021 but they are another very important asset for us. Firstly because they are not correlated to other asset classes. I've spoken at length in the past about how important correlation diversity is at the portfolio level. I'm sure your eyes are glazing over with excitement at the term.... but it really is the most important factor in investing.

Think about it, the 5 biggest stocks in the world are Apple, Microsoft, Google, Amazon, and Facebook. These stocks are all very highly correlated. This means they are all the same trade. They will all rise and fall in tandem. If you own all five of them as an equal weighted basket, you have zero diversification.

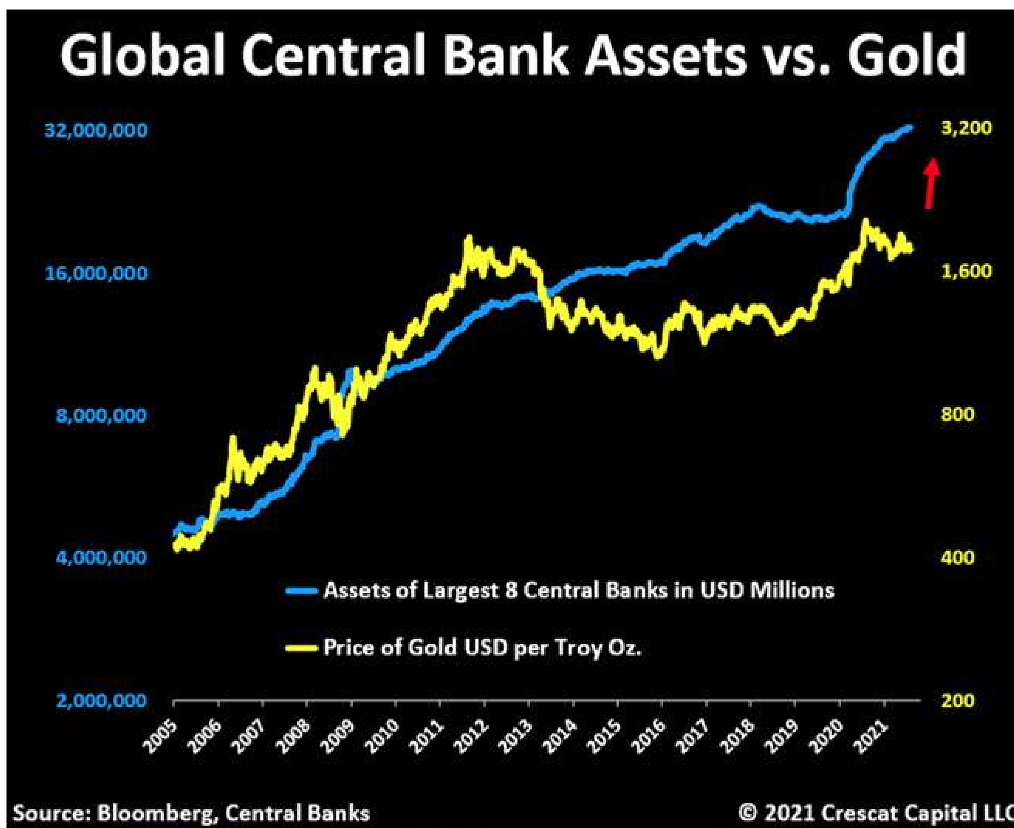
Our focus on correlation diversity is what allowed us to outperform so dramatically in 2020 when it really mattered. If you have strong correlation diversity when something goes wrong, that you can't see coming, your whole portfolio doesn't blow up at the same time. This is one of the most important reasons why we like Gold and Silver. They've been important safe havens for at least 6000 years, they tend to do well when you absolutely need them to....as was evidenced not just in 2020 but also in 2018, 2015 and during the Tech Wreck in 2000.



https://www.crescat.net/december-research-letter-pipe-dreams-and-ponzi-schemes/

They are the ultimate tangible assets and they are valued in infinitely printable money…Money that yields far less than the rate of inflation. Gold and Silver not only provide cheap portfolio insurance against central bank policy mistakes which we find comforting considering that US Money supply has surged $609 Billion in Q4 (seven times the historic avg) alone.

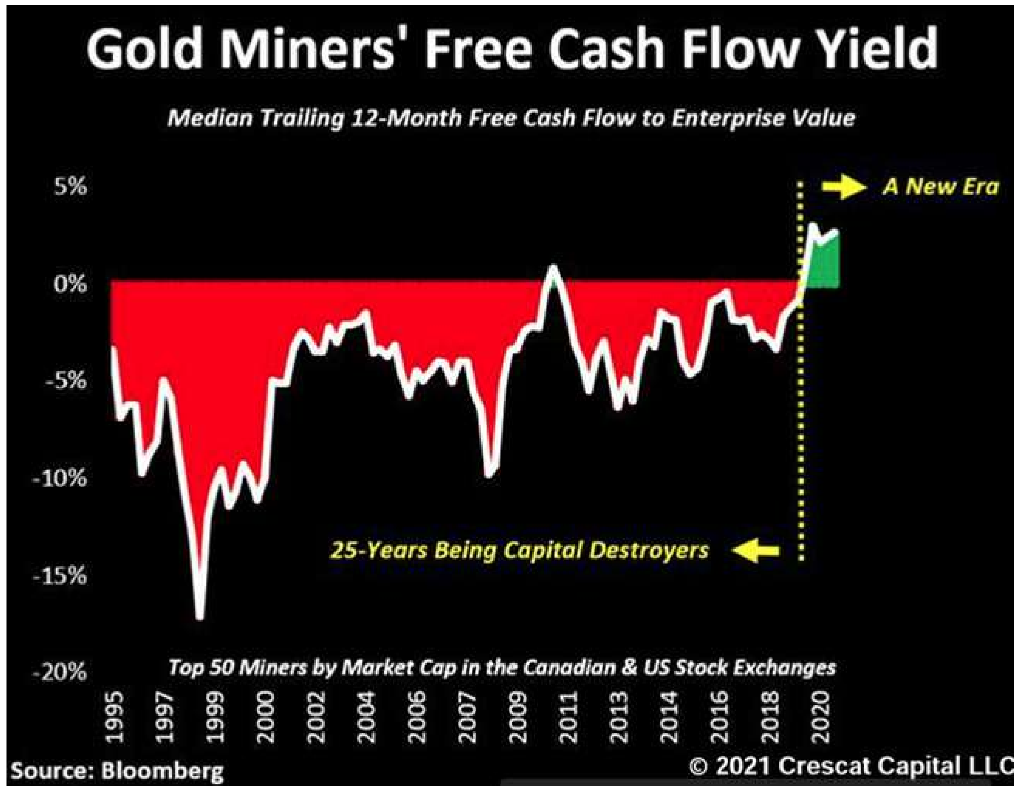
This is not a US only issue. For the record China's money supply expanded $840 Billion in Q4. Nearly $1.5 Trillion from just the US & China in Q4 alone. Inflation data in the US, Japan, Germany, Italy, etc is growing at the fastest pace in decades, yet central banks currently plan to expand the monetary base for at least another 3 months while keeping short rates at zero.



https://www.crescat.net/

Fiscal spending continues to be very aggressive while governments continue to run deficits as far as the eye can see. All reasons to hold precious metals. We see them as important components in our multi-asset portfolios.

As for precious metals mining companies, they trade at extraordinarily cheap valuations, have excellent fundamentals and great balance sheets. “Free cash flow has been positive for the last 7 quarters for the top 50 gold miners.”- Tavi Costa



https://www.crescat.net/

Not all assets suit all investors, but where appropriate we have a selective focus in industrial metals, particularly Copper. Goldman recently called it the new oil as the trend toward EVs continues. There’s just not enough supply relative to demand. We also see the potential for dramatically higher oil prices in the coming years but in the Energy space we prefer Uranium at this time due to the attractiveness of the price and the fact that it has political tailwinds.

9.

Conclusion

To conclude we're very happy with the way our portfolios are constructed. We've tried as best we can to align portfolios for an inflationary environment and will continue to have that stance until the data tells us otherwise. We continue to see a lot of risk in pockets, but we also see some very attractive opportunity sets.

We're trying our best to take advantage of the opportunities while avoiding some of the riskier hotspots in the world, of which there is no shortage, and gives us reason for concern. It is not time for complacency. In January of 1966 the Dow Jones Industrial Average hit a level of 990. It would continue trading in a range of roughly 600 to 1,000 over the following 17 years. This was a period of high inflation. During that period those who built portfolios for inflation did very well. Those who did not, suffered.

Please do let us know if you wish to discuss your portfolio at any time.
We appreciate your faith and trust in us. We're human but we do not take the responsibility lightly.

Kind regards,
David Flynn
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