

A nighttime photograph of a cityscape, likely London, featuring a prominent cable-stayed bridge and modern buildings. A large, full moon is visible in the dark sky. The scene is reflected in a body of water in the foreground. The entire image has a blue color overlay.

BAGGOT
Investment
Partners

Q4 General Update
JANUARY 2023

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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01.

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

Baggot returns summary

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

BEI, (Baggot Equity Income) our global equity income focused portfolio (medium-high risk profile) **outperformed** the benchmark Setanta Equity Dividend Fund by 7.75% in 2022. The benchmark lost – 2.53% on the year while BEI has gained 5.22% for the same period. It has been a good start to the New Year. As of today BEI has gained 5.2% YTD.

BME, (Baggot Multi Equity) our higher risk profile equity portfolio **outperformed** the benchmark MSCI World Index by 14% in 2022. The benchmark MSCI World index posted a loss of – 12.95% during the period, while BME has posted a gain of 1.05% for the same period. It has been a good start to the New Year. As of today BME has gained 2.9% YTD.

BMA 4, (Baggot Multi Asset) our medium risk multi-asset portfolio outperformed the benchmark Irish Life MAPS 4 by 2.5% in 2022. The benchmark Irish Life MAPS 4 lost – 10.4% in 2022 while BMA 4 lost – 7.9% for the same period. It has been a good start to the New Year. As of today, BMA 4 has gained 4.55% YTD.

BMA 5, our multi-asset portfolio with a medium-high risk profile has outperformed the benchmark Irish Life MAPS 5 by 3.7% in 2022. The benchmark Irish Life MAPS 5 lost – 13.1% in 2022. BMA 5 posted a – 9.4% return for the same period. BMA 5 has started the year well. As of today it has gained 5.8% YTD.

BMA 6, our multi-asset portfolio with a high risk profile has **outperformed** the benchmark Irish Life MAPS 6 by 11.4% in 2022. The benchmark Irish Life MAPS 6 lost – 13.8% in 2022. BMA 6 posted a – 2.4% return for the same period. BMA 6 has started the year well. As of today it has gained 4.9% YTD.

Before I move on, I'd just mention that the five portfolios mentioned would be our more popular, but we do have other investment portfolios that have been tailored more to the specific needs of some clients which have all posted very competitive returns over the years. For any further information contact pbrown@baggot.ie.

02.

Market Returns Summary

Q4/YTD Asset Class Returns

Asset class 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 gained 9.2% in value in Q4, to finish the year down – 5.5%.

Equity Returns (Euro denominated returns)

Of the major equity indices, the big losers in 2022 were the Nasdaq 100 with a loss of – 28.5%, followed by the MSCI China A Shares which lost – 21.7% and the MSCI EM Asia, down – 15.5%.

The only winner on the list in 2022 was the MSCI Latin America with a 15.9% gain. The FTSE 100 did relatively well compared to the rest of the pack with a loss of – 1.0%. The MSCI India posted a loss of – 2.9% which was also a relatively good return in compared to the others.

Q4/YTD

S&P 500

-1.8% / -13.3%

NASDAQ 100

-8.8% / -28.5%

Euro Stoxx

14.6% / -9.2%

German DAX

14.8% / -12.9%

Stoxx Europe 600

9.9% / -10.6%

FTSE 100

8.1% / -1.0%

MSCI EM Asia

1.3% / -15.1%

Vanguard FTSE EM

-1.0% / -12.4%

MSCI China A Shares

-4.9% / -21.7%

MSCI Japan

3.4% / -11.9%

MSCI World

0.4% / -12.95%

MSCI Latin America

-3.0% / 15.9%

MSCI India

-7.1% / -2.9%

MSCI Asia Pacific ex-Japan

2.7% / -12.6%

Bond Returns (Euro denominated returns)

In Bond land, German 10 Year Bunds had the worst performance in 2022 by far, losing – 32.7%. US 10 Year Treasuries did not fare much better losing – 24.9%. European Aggregate Bonds had a poor showing as well for the year, posting a loss of – 17.3%.

There were no winners in Bond land this last year. Europe Investment Grade Ultrashort dated Bonds had the best showing with a loss of – 0.4%. It gets pretty ugly after that with US Inflation Protected Bonds posting the next best returns among the major Bond proxies with a loss of – 6.9%.

Q4/YTD

Europe Investment
Grade Ultrashort
dated Bond ETF

0.6% / -0.4%

German 10+ Year
Bond ETF

-5.1% / -32.7%

US 10+
Treasury Bond
ETF

-9.1% / -24.9%

Europe Aggregate
Bond ETF

-1.3% / -17.3%

EM Bond ETF

-1.0% / -13.3%

Global
Aggregate
Bond ETF

-4.5% / -10.7%

US Inflation
Protected Bonds

-6.7% / -6.9%

Europe Inflation
Linked Bonds

1.3% / -9.8%

Precious Metals (Euro denominated returns)

Precious metals continued to demonstrate their importance as a safe haven. Silver did best with a gain of 9.5% in 2022, while Gold came in with a respectable gain of 5.8% in 2022.

Gold

-0.3% / 5.8%

Silver

15.6% / 9.5%



03.

Bonds

Developed Market Bonds had their worst year ever, in 2022. Bonds are traditionally considered safe haven investments. Why? Corporate Bonds are higher up the rights chain, meaning bondholders have the first claim on any assets in a bankruptcy situation or re-structuring. As for Government bonds, investors have always seen them as a place where you can get a risk-free return. You get your money back plus the yield.

We've spoken of the dangers of this attitude many times over the last 5 years, at times, contradicting our peers for refusing to pay governments to lend to them, which is what happened when government Bond yields were trading at negative yields. It is only when you buy ultra-short duration government bonds that you can pretty much bank on getting all of your money back plus the yield. In an inflationary environment where central banks are raising interest rates, ultra-short duration bonds do best because the investor is only lending the money out at a set interest rate for a very short period of time. So if the central bank hikes interest rates, then every time your bond comes to the end of its lifespan, which will be in days not months or years, the investor can reinvest those funds at a higher interest rate. This allows ultra-short duration government bond investors to benefit from rising interest rates. On the flipside though, if you buy a 10 year government bond paying a 1% yield, you're stuck getting 1% for the duration of that bond's life. If interest rates go up to 5%, nobody will want to own that 10 year government bond paying a 1% yield.

Because interest rates pretty much went down consistently for the last 40 years people were always keen to buy long duration bonds. They knew that if interest rates continued down, then in the future, long duration bonds would pay an even lower yield. 40 years is a long time! Long enough for the entire industry to forget what an inflationary environment can be like and what the ramifications of that can be to investment portfolios. 40 years is almost the length of an average person's entire working life. Investors got used to disinflationary and at times, even deflationary conditions, the industry built investment products suited to that environment. When, as now, you get a major regime shift to an inflationary environment, things start blowing up in financial markets. The end result, is that the assets which benefitted most from the former disinflationary/deflationary regime suffered the most last year.

Shortly we will take a look at some of the carnage but before we do I want to break down the risk categories for you, so that you can have an understanding of how badly things went wrong for investors in bonds last year.

The image below shows the scale of ESMA (European Securities and Markets Authority) risk ratings. The one-to-seven scale is an easy way of comparing investment products and assessing their level of risk. Lowest risk to the left and highest risk to the right.



ESMA risk ratings use the previous five years of historical performance data to assess how volatile, and therefore, how risky a given investment product may be.

This next image shows the risk ratings and their corresponding volatility ranges.

Risk Rating	Volatility Ranges	
	Equal to or above	Less than
1	0%	0.5%
2	0.5%	2%
3	2%	5%
4	5%	10%
5	10%	15%
6	15%	25%
7	25%+	

So in a negative year, an investment with a risk rating of one will be expected to lose no more than 0.5% while an investment product with a risk profile of six could be expected to lose 25%.

















Lower risk investment products have typically owned a lot more bonds than riskier assets such as equities, commodities or property. An investment product with a risk category of one will be made up entirely of developed market, ultra-short term (think less than one year in duration) investment grade bonds. Investment products with a risk category of two will be made up primarily of short-medium term (think 1 – 3 years in duration) bonds.

OK so now onto the carnage. You can see from the image above that an investment product with a risk profile of two would be expected to lose no more than 2%. Before factoring in all charges and costs, the largest most popular Irish investment product with a risk category of two, lost – 9% in 2022. That is 4.5X the expected worst-case scenario, and it is not like you were ever going to be compensated for the risk because yields were so low. That is a severe breach of the risk category!

Unfortunately, that is what happens when German government bonds (which are considered some of the safest assets in the world) lose 1/3rd of their value. By the way, none of our investment products at Baggot breached their risk category in 2022.





Many investment advisors and brokers will make excuses and say it was a once in a lifetime event, that there was nothing they could do about it, but frankly that is not true. In our January 2020 update which was published before markets became aware of Covid, we wrote this (in bold print below);

In 2019 we saw a record number of negative yielding debt globally. At one point there was \$17 Trillion in total global negative yielding debt. Take Germany for instance;

Name	Yield
 Germany 3M	-0.587
 Germany 6M	-0.588
 Germany 9M	-0.644
 Germany 1Y	-0.581
 Germany 2Y	-0.599
 Germany 3Y	-0.599
 Germany 4Y	-0.586
 Germany 5Y	-0.522
 Germany 6Y	-0.466
 Germany 7Y	-0.412
 Germany 8Y	-0.364
 Germany 9Y	-0.297
 Germany 10Y	-0.221
 Germany 15Y	-0.096
 Germany 20Y	0.066
 Germany 25Y	0.188
 Germany 30Y	0.290

You pay the German Government to lend them money all the way out to 15 years in bond duration. This means that the only way you can profit from these bonds is through capital appreciation. These bonds are guaranteed to cost the holder a significant amount of purchasing power for the duration of the bond.

The US carries the highest yield in Developed Markets, yields are paltry and do not sufficiently compensate the holder for the risk of inflation;

Name	Yield
 U.S. 1M	1.542
 U.S. 3M	1.561
 U.S. 6M	1.573
 U.S. 1Y	1.552
 U.S. 2Y	1.561
 U.S. 3Y	1.570
 U.S. 5Y	1.616
 U.S. 7Y	1.733
 U.S. 10Y	1.815
 U.S. 30Y	2.281

The lack of yield from high quality Developed Market bonds is a major problem for investors in the middle to lower risk profiles. If you are a Risk Profile of 3, you are expecting portfolio volatility to range between 2 and 5%. That means you have to hold a majority portion of your assets in Bonds, but the safest, least volatile bonds in Developed Markets virtually guarantee low or no returns. Even on a Risk Profile of 4, accepting 5 – 10% portfolio volatility, you have to hold a significant portion of your assets in Bonds.

Many investment products in the lower to middle risk profiles in the market have had exposure to long duration Developed Market Bonds in 2019 and profited from capital gains on the Bonds. We at Baggot refuse to take long duration Developed Market Bond exposure in our European fund portfolios and Discretionary products. We find it perverse to expect to generate a return on government bonds when you are actually paying the borrower to lend to them.

-End of excerpt from our Jan 2020 update

We did really well in 2022 where Bond exposure was concerned. Where we must have bond exposure, we kept pretty much all of our holdings in ultra-short dated European investment grade bonds which were only down - 0.4% on the year.

We continue to be sceptical about whether medium-long duration Bonds are investible yet. We would much prefer to own longer duration bonds to the ultra-short dated ones because yields are better in longer duration but as I have said throughout the last couple years, we think that is about as wise as trying to pick up a nickel in front of a steam roller. The gap between inflation and interest rates is still very wide. US inflation is still running at 7.1% with interest rates at 4.5% and in Europe, inflation is running at 8.6% with interest rates at 2.5%. The gap between inflation and yields is just too wide to change our stance.

There is still a lot of risk for longer duration bond investors. Ideally you'd like to see 3% inflation and 5% yields. That is a 2% positive real rate (the difference between inflation and interest rates). Currently even in the US you are looking at - 2.6% negative real rates and in Europe - 6.1% negative real rates. We continue to be uncomfortable with risk vs potential reward in medium-long duration bonds, particularly where European bond markets are concerned.

04. Equities

In our last few general updates I have suggested that the inflationary impact of the war would likely hit corporate profit margins and that we see a very high likelihood of lower growth and higher inflation (Stagflation) going forward. We continue to have strong conviction in that outlook. That template has served us well in the last year as is evidenced by the fact that **both of our diversified Equity products produced positive returns in 2022.**

I posted this bit in both of our last two general updates, but it is still very relevant. Look at sector performance during periods of stagflation. We've highlighted real returns (return after taking account of inflation).

Start	End	Materials	Discretionary	Industrials	Energy	Health Care	Financials	Staples	Info. Tech.	Telecom	Utilities
Q4/1973	Q3/1975	18.9%	-7.9%	-13.6%	-4.0%	-11.0%	-21.0%	-10.0%	-24.3%	-2.6%	-11.1%
Q2/1979	Q2/1981	26.6%	17.0%	33.2%	54.2%	29.3%	37.4%	20.4%	-7.9%	-5.8%	-4.4%
Q1/1982	Q1/1983	48.5%	70.5%	55.2%	17.8%	43.0%	41.2%	45.8%	79.3%	15.9%	16.8%
Average Nominal Return		31.4%	26.5%	25.0%	22.7%	20.4%	19.2%	18.7%	15.7%	2.5%	0.4%
Average Real Return		17.6%	12.7%	11.1%	8.9%	6.6%	5.4%	4.9%	1.9%	-11.3%	-13.4%

Source: Bloomberg, Incrementum AG

We continue to favour Value focused Equities over Growth. As we have said for the last year, in the West, we think you have to avoid the big US indices because so much of the risk exposure in those indices is in areas that to us look like a fly in search of a windshield. That is not to say that there are not Sectors or Industry Groups that we have a favourable view of in the US, such as Energy and Materials but those Sectors are a very small proportion of the US indices.

As an exercise, let's look at the big components in the US indices, which also happen to be the largest cap stocks in the world and would also be the largest holdings in global indices such as the MSCI World, among others. Data below are total returns, which include dividends.

USD denominated returns / Euro denominated returns

Apple

-26.2% / -20.7%

Microsoft

-27.4% / -21.9%

Google

-39.6% / -34.1%

Amazon

-49.9% / -44.4%

Nvidia

-51.0% / -45.5%

Tesla

-67.8% / -62.3%

Meta

-64.4% / -58.9%

Those companies represent 46% of the Nasdaq 100 index and 20% of the S&P 500 index and the scary thing is that all but one is still pretty expensive on a valuation basis. I don't mind paying a high valuation if the growth rate justifies it. Meaning, there is a big difference between paying 20X earnings for a stock growing at 60% vs paying 20X earnings for a stock growing at 5%. There is a big difference and that is a very important factor in the investment process. Apple trades at 21X earnings. The consensus estimate for future growth is 8.7%. That is still grotesquely overvalued!

We try our best to align good valuations with strong relative performance. From that perspective we continue to favour Latin American Equities. Also commodity-centric equities acted very well in spite of a very strong Dollar for much of the year. If they can perform as well as they did, in a strong Dollar environment, imagine how well they can perform in a weak Dollar environment!

We're currently more focused on Emerging Markets and Natural Resources Equities but within Developed Markets we favour the FTSE 100 and Japan as there continues to be a strong combination of currency debasement (export competitiveness) and relatively cheap valuations.

Valuations below taken from Reuters. I've highlighted relatively cheap areas in green and relatively expensive areas in red;

P/E=Price/Earnings Ratio
P/B=Price/Book Value Ratio

Nikkei 225 (Japan)

P/E of 12.1
P/B of 0.9

Nasdaq 100

P/E of 27.3
P/B of 6.7

S&P 500

P/E of 21.1
P/B of 3.3

FTSE 100

P/E of 13.0%
P/B of 2.0

CAC 40

P/E of 16.5
P/B of 1.6

German DAX

P/E 14.7
P/B of 2.0

FTSE Eurofirst

P/E of 16.4
P/B of 2.3

S&P TSX (Canada)

P/E of 14.7
P/B of 1.7

S&P ASX 300 (Australia)

P/E 15.6
P/B of 1.9

Keep in mind that the FTSE 100 is much more an international index than it is a UK focused index.

Growth stocks have been out of favour since major central banks began to raise interest rates in response to inflation. When the cost of borrowing goes up as dramatically as it has in the last year, it becomes much more expensive to fund growth. Further, when interest rates were zero there really was no competition for Equities. Now that investors can get 4.5% in US T-Bills (one month duration US Treasuries) there is an alternative and that puts pressure on valuations and takes a lot of capital away from the Equity space. Particularly those that represent the highest weightings in the major indices.

Generally speaking we see much more opportunity in Equities in the coming year than was the case last year. That does not mean that we expect that a rising tide will lift all boats. We see potential for some big winners and also some big losers. Generally speaking we think the Dollar has likely peaked. The Dollar is the reserve currency of the world and most of the debt globally, is denominated in Dollars. When the Dollar rises, the cost of servicing Dollar denominated debt goes up for countries/companies outside the US.

So why do we think that (generally speaking) the Dollar has peaked? The US Federal Reserve was the first major central bank to hike interest rates and it hiked aggressively. Now the size of US interest rate hikes is getting smaller and the pace of hikes is likely to slow as the gap between the rate of inflation and interest rates continues to narrow. In the last paragraph of our Bond market thoughts, I spoke about the gap between inflation and interest rates (Real Rates) in Europe and the US. Again, Real interest rates are defined as the difference between the interest rate that you get on cash and the rate of inflation. Real interest rates in the US are -2.6% , meaning that after you get your interest, you lose 2.6% of your purchasing power to inflation. Real interest rates in Europe are -6.1% . Europeans are losing 6.1% of their purchasing power to inflation. This tells us that the ECB is likely to have to raise interest rates much more aggressively going forward than the US Federal Reserve will. It's a similar situation around the world. Major central banks are now aggressively playing catch up with the US Federal Reserve. That is why we believe the Dollar has peaked.

However the US Federal Reserve may have to continue hiking rates for quite some time albeit at a slower pace, particularly if the rate of inflation begins to start rising again. Inflation is still quite high, even in the US and history tells us that once the inflation genie gets out of the bottle, it typically takes many years to get it back under control, sometimes decades.

We still think there will be opportunity to generate positive returns in Equities. When you go from a long term disinflation/deflationary regime to a sustained inflationary regime, investors stop paying crazy prices for growth stocks. To us this looks a lot like the Tech Wreck at the turn of the century. We believe capital will continue to flow out of those former market darlings and into things like emerging markets, value stocks and commodities. And a weaker Dollar should be very supportive of value stocks, emerging markets, and commodities.

05.

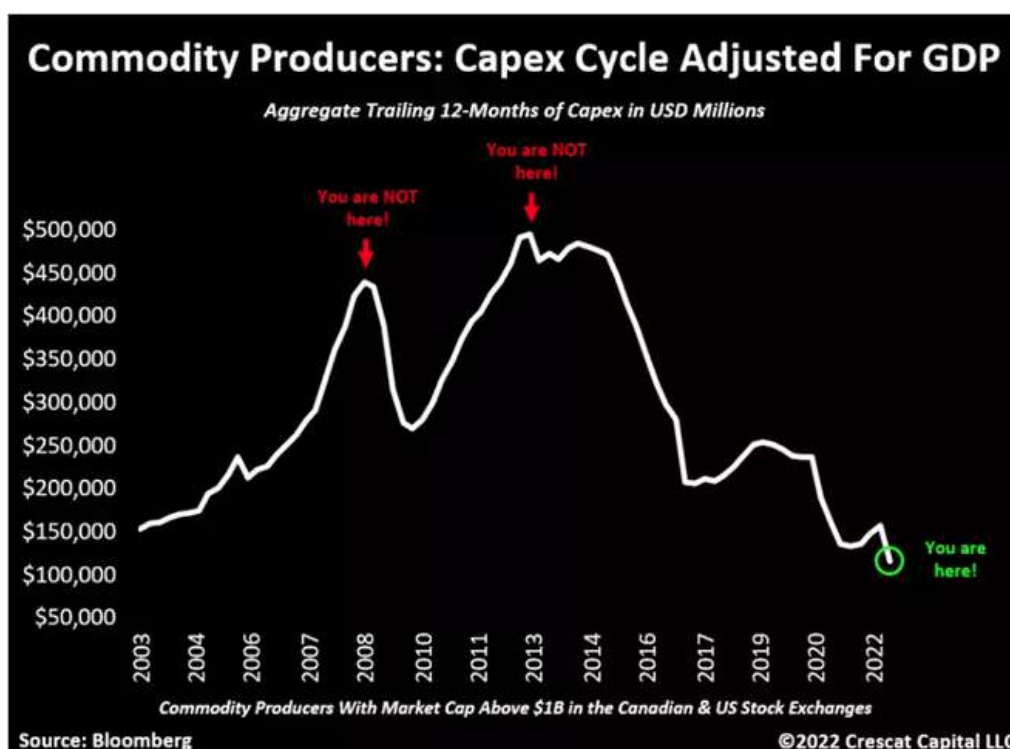
Commodities

Our view on commodities really hasn't changed much since last quarter. The only things we see that have really changed are;

1. China lockdowns have ended. This is very supportive of commodities.
2. The Dollar has likely peaked (generally speaking). This is very supportive of commodities and the companies in that space.

We continue to believe there will be some demand destruction in commodity land brought on by tighter central bank monetary policies, but central bank policies have no impact on the supply side. When you look at the supply side of things across many different commodities, structural supply deficits suggest that we will need to see significantly higher prices in order to bring enough supply to the market to satiate demand.

"At Crescat, we have been highlighting the truly unprecedented structural shortages for natural resources which are best illustrated by looking at aggregate CAPEX spending trends for commodity producers. While many investors are selling commodity stocks because they fear it will be another 2008-style deflationary global financial crisis or 2015-style commodity bust, we show below that it is exactly the opposite setup now." – Tavi Costa of Crescat Capital (A highly respected global macro hedge fund manager)



“Metals of all varieties are critical to inflation protection, economic growth, and energy transition in the real world today. These are the factors that matter in the current macro environment. The companies that control the best new metals’ deposits offer deep value, strong growth, and ultra-high appreciation potential in the stock market now.” – Tavi Costa of Crescat Capital.

Now consider how utterly cheap commodities are relative to equities from a longer term perspective. The chart below shows the S&P GSCI (Goldman Sachs Commodity Index) Total Return Index Divided by the S&P 500 over the last 5 decades. If it is rising it means commodities are outperforming equities. If it is falling it means equities are outperforming commodities. When the graph is closer to the bottom of the chart window, it means commodities are exceptionally cheap vs equities. When the graph is closer to the top of the chart window, it means equities are exceptionally cheap vs commodities.



Not only are we looking at structural supply deficits for most commodities, we are also being given the opportunity to own many of these commodities and commodity companies at ridiculously cheap prices relative to the main equity indices.

You can have commodity companies that supply many of materials needed to fuel the green revolution with low debt levels, decent balance sheets and high free cash flows...things the world actually needs, or you can have the big western equity indices generating negative real free cash flow (free cash flow after taking account of inflation).

S&P 500 Real Earnings Yield

Aggregate Earnings Yield – CPI YoY Change (%)



Source: Bloomberg

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Tech Stocks: Real Free-Cash-Flow Yield

Aggregate Free-Cash-Flow Yield Minus CPI YoY Change



Source: Bloomberg

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06.

Oil

China (responsible for almost half of global commodity consumption) has come out of a long lockdown period which has certainly cut global demand for energy to some degree. Add to that the fact that the Biden Administration has been releasing 1 million barrels per day (bpd) from the Strategic Petroleum Reserve (SPR) which has also been an impediment to higher Crude Oil prices. This cannot go on forever until these reserves are depleted. The SPR is already at dangerously low levels.

We believe the Biden administration timed these SPR releases to drive oil prices lower into mid-term elections to try and buy votes for the Democrats. We don't see how the SPR can continue down this path much longer. We expect that the administration will have to reverse course soon and begin to buy oil to bring the SPR back to more historical levels.

Bring China back to normal consumption post-lockdowns and discount an end to the SPR releases and my belief is that you have more than offset the weaker demand that has been brought about by tightening monetary policies.

We see risk to the upside for Crude Oil and Natural Gas prices. And given that energy is directly and indirectly a huge component of the inflation data, if prices do head higher over the coming months, we would expect central banks to be more aggressive with interest rate hikes. Therefore, we see Energy companies as a hedge to further inflation.

07.

Uranium

Uranium was one of the better performing assets in our portfolios in 2022. Our position gained roughly 12%. The long term investment case hasn't changed. Nuclear is the only scale-able zero emissions bridge to a carbon free world. It is also an easy way to remove energy dependence on countries that do not have our best interests at heart. 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.

There is roughly 185 million pounds consumed per year, plus an additional 50 million pounds is being taken off market by investors, yet there is only 125 million pounds produced per year. That's a 110 million pound supply deficit per year. We see dramatic upside potential over the coming years.

"In our view, physical uranium and uranium miners are well positioned to take share within the energy sector as energy security and decarbonisation increase in importance. With the number of nuclear reactors planned to increase by 35%, governments are signalling the need to embrace the reliable, efficient, clean and safe energy produced by nuclear to meet ambitious decarbonisation goals.

At the same time, a uranium supply deficit remains entrenched, and uranium miners may be the recipients of increased investment, which may bring the market back into balance." – Jacob White of Sprott Asset Management

MEASURING RADIATION EXPOSURE

Radiation stemming from nuclear energy is far less when compared to activities not commonly associated with nuclear activities, such as flying on an airplane or interacting with more traditional energy sources.

MILLIREMS OF RADIATION (MREM)

5,000	Annual U.S. regulatory radiation limit for an adult
500	One transcontinental round trip flight
360	Average person's annual exposure from all sources
20	Living one year outside a coal plant
2	Living one year outside a nuclear power plant

Source: U₃O₈ Corporation.

Images from: <https://sprott.com/investment-strategies/physical-commodity-funds/uranium/>

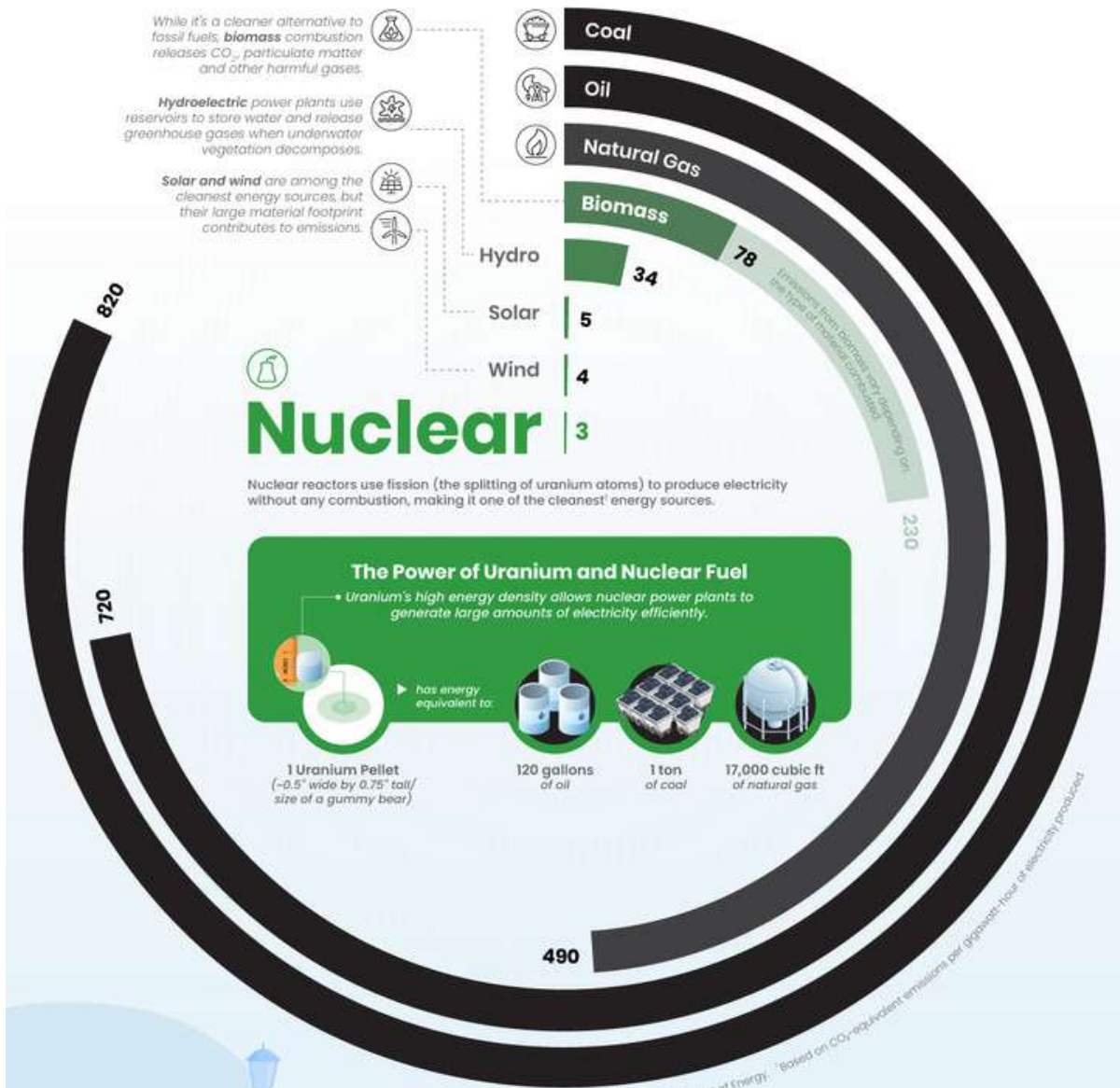
URANIUM

A KEY ELEMENT TO ACHIEVE A NET-ZERO CARBON FUTURE

The world is moving towards net-zero carbon energy. As populations and energy needs rise, energy sources of the future need to be both clean and sustainable.

Which energy source is the cleanest?

CO₂-Equivalent Emissions Per Gigawatt-Hour of Electricity Over the Lifetime of a Power Plant ^{Tonnes}

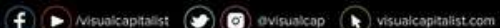


As one of the cleanest and most powerful sources of energy, nuclear power could play a key role in helping countries achieve decarbonization goals in the fight against climate change.

Sprott Physical Uranium Trust

The World's Largest Physical Uranium Fund*
TSX: U.U (\$US) | U.UN (\$CA) sprott.com/uranium

*Based on Morningstar's universe of listed commodity funds. Data as of 8/30/2021. Important information about the Trust, including the investment objectives and strategies, applicable management fees, and expenses, is contained in the Management Information Circular. View the Management Information Circular: sprott.com/media/4122/uranium-management-information-circular.pdf. Please read the document carefully before investing. Investment funds are not guaranteed, their values change frequently and past performance may not be repeated.



7.

Carbon Credits

Carbon Credits lost – 17.4% in euro denominated terms in 2022. Obviously not something to shout about but our position is still up dramatically since we originally invested in early 2021. Also, in our multi-asset products we did pare back exposure in early November so our clients were only down roughly – 7.5% on the position for the year.

From a long-term perspective, we are wildly bullish on Carbon credits! Not that all Carbon credits are the same. We certainly wouldn't advise getting involved in some of the illiquid parts of the market, but we are quite confident that the stuff we invest in for our clients is only going higher over the long run. We do not think that last year's downside had anything to do with the fundamentals of the Carbon credit market. On the risk scale of 1-7, with 1 being the least risky and 7 being the riskiest, Carbon credits are a 6. Except for ultra, short-dated bonds, uranium, precious metals, energy and Latin American equities, 2022 was a bad year for just about everything else that I can think of. We believe Carbon credit markets were softer as a result of a psychological shift in financial markets away from riskier more speculative markets and while you can make a very strong fundamental case for the long term upside potential of Carbon credit markets, there is no doubt that it is a volatile and risky market.

In my opinion, it is always the case that markets, which are in the early stage of their growth cycle (Carbon credits), that present large long term upside potential are very volatile and when global markets become more volatile pretty much across the board, as was the case in 2022, most riskier, more volatile markets will not come out of it unscathed.

The long term investment case grows stronger by the day. Carbon credits are in limited supply. The market is very short of supply this year and it will only become shorter of new supply in the future. Real fundamental demand exceeds supply, and that trend is only going one way as far as we can see.

If there had ever been a time for governments to do an about face and relax the emissions caps, the energy crisis we have seen since Russia invaded the Ukraine provided every excuse, but they did not! Instead they doubled down (Fit for 55) and decided to go for even tighter standards in the future.

Europe is the global leader in the Carbon credit markets and European governments are very supportive. It is plainly obvious to see why, as It is quickly becoming a large source of revenue for European countries. European governments earned roughly €150 Billion last year from the Carbon credit market. They only have to spend half the revenue earned on Green projects, so the rest goes into the tax coffers and we are only in the very early stages of this market. It is an important and growing source of revenue for finance ministers of European nations, particularly at a time when other sources of tax revenue could come under pressure as a result of recession.

Infographic – Fit for 55: reform of the EU emissions trading system:

“The EU emissions trading system (EU ETS) is the EU’s key tool for reducing greenhouse gas emissions. The reform of the system is a part of the ‘Fit for 55’ package – a set of proposals to revise and update EU climate, energy and transport legislation, which will contribute to the EU’s climate goals of reducing net greenhouse gas emissions by at least 55% by 2030 and reaching climate neutrality by 2050.

In December 2022, the Council and the European Parliament reached a provisional political agreement on ETS reform.”

Reform of the EU emissions trading system explained

The EU's emissions trading system (EU ETS) is one of the world's largest carbon markets and the EU's key tool for reducing greenhouse gas emissions.



The system puts a price on carbon. Every year, entities covered by the ETS have to buy "allowances" corresponding to their greenhouse gas emissions.



Every year, a cap is set on how many allowances are put on the market for that year and each year; that cap then decreases with every passing year. This creates financial incentives for companies to cut emissions.

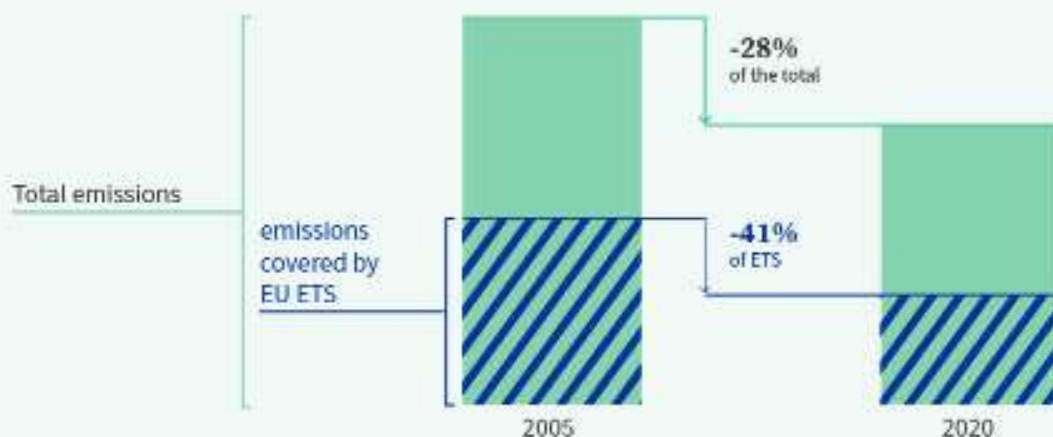


However, certain sectors that are exposed to 'carbon leakage' get free allowances to support their competitiveness.

How does the EU ETS contribute to the goal of climate neutrality?

The EU ETS covers around 40% of total EU emissions and has already proved to be the key tool for emissions reduction.

Since 2005 (when it was introduced) EU emissions have been cut by 41% in the sectors covered.



** total net emissions including international aviation for EU27*

The reform will result in further emissions reductions, bringing the EU closer to climate neutrality.

Which sectors are currently covered



The EU ETS covers approximately

10 000
companies



electricity and heat generation



energy-intensive industry sectors (e.g. oil refineries, steel industry, cement, glass and paper production)



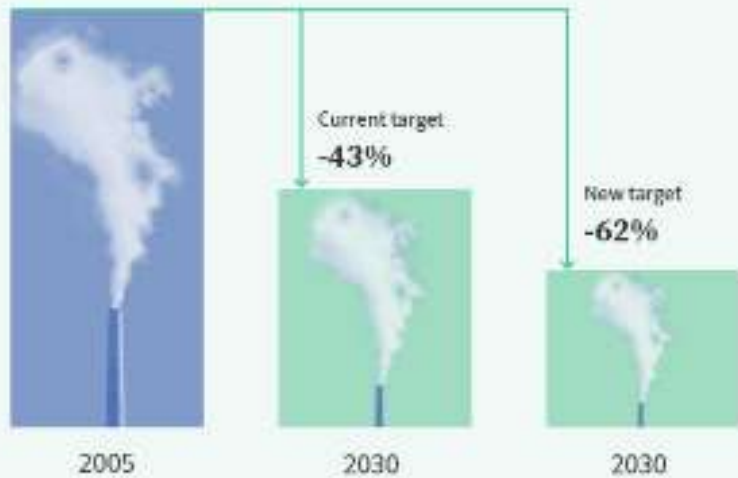
commercial aviation (flights within the European Economic Area)



What will change with the reform?

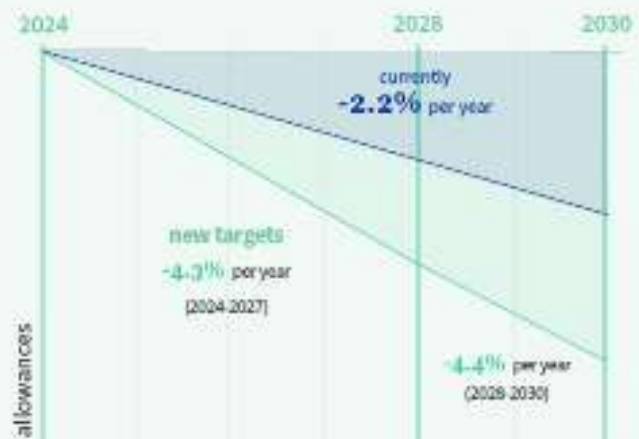


more **ambitious** emissions reduction goals



faster reduction of the cap,
fewer allowances on the market:

reduction of
117 million allowances
over two years



What will change with the reform?

the ETS to cover new sectors:



→ extension to **maritime transport**
(Introduced gradually between 2024 and 2026)



→ a separate new ETS for **buildings, road transport and fuels** for additional sectors



gradual phasing out of free allowances for certain sectors (in parallel with the introduction of the **carbon border adjustment mechanism** – a carbon pricing system applicable to energy-intensive products imported into the EU in order to avoid carbon leakage)



increased funding
for decarbonising ETS sectors

→ **modernisation fund**
→ **innovation fund**



Up to €65 billion to address the carbon pricing impact of the proposed ETS for buildings and road transport and fuels for additional sectors

→ a part of revenues from allowances for buildings, road transport and fuels for additional sectors will contribute to the social climate fund (protecting the most vulnerable people and companies from the carbon pricing impact of this new ETS system)

For more information on 'Fit for 55', please see here;

<https://www.consilium.europa.eu/en/press/press-releases/2022/12/18/fit-for-55-council-and-parliament-reach-provisional-deal-on-eu-emissions-trading-system-and-the-social-climate-fund/>

Alternatively you can Google this headline and it should be first in the search results; **'Fit for 55': Council and Parliament reach provisional deal on EU emissions trading system and the Social Climate Fund**

Before I move on to precious metals markets, I just wanted to highlight a podcast called the Jay Martin Show from December 13;

"Structural Supply Deficit in Carbon Market Will Send Prices Much Higher: Lawson Steele"

In my opinion Lawson Steele (Head of Carbon Analysis at Berenberg) is the foremost expert in all things relating to Carbon markets. When Lawson is speaking, I'm all ears.

Here's the link to the Apple podcast;

<https://podcasts.apple.com/gb/podcast/structural-supply-deficit-in-carbon-market-will-send/id1576920284?i=1000590080331>

Here's the link to the Spotify podcast;

<https://open.spotify.com/episode/3aSztTi1Dq5uty5UyBICkQ>

8.

Precious Metals

Precious Metals experienced their fair share of volatility in 2022 but widely outperformed most assets. We continue to view Precious Metals as a very important component to our portfolios because they are not correlated to other asset classes.

I'm quoting here from page 18 of Incrementum's excellent once a year 'In Gold We Trust' report and forgive me for posting it again but I think it is very insightful.

"The average annual performance from 2000 to 2022 is 9.2%. During this period, gold has outperformed virtually every other asset class and, above all, every other currency – despite significant corrections in the meantime."

Gold performance since 2000 in various currencies (%)										
Year	USD	EUR	GBP	AUD	CAD	CNY	JPY	CHF	INR	Average
2000	-5.3%	1.2%	2.4%	11.2%	-1.9%	-5.4%	5.8%	-4.2%	1.4%	0.6%
2001	2.4%	8.4%	5.3%	12.0%	8.8%	2.4%	18.0%	5.5%	5.8%	7.6%
2002	24.4%	5.5%	12.3%	13.2%	22.9%	24.4%	12.2%	3.5%	23.7%	15.8%
2003	19.6%	-0.2%	8.0%	-10.7%	-1.3%	19.6%	8.1%	7.4%	13.9%	7.2%
2004	5.6%	-2.0%	-1.7%	1.5%	-2.0%	5.6%	0.8%	-3.1%	0.1%	0.5%
2005	18.1%	35.2%	31.6%	25.9%	14.1%	15.1%	35.9%	36.3%	22.8%	26.1%
2006	23.0%	10.4%	8.1%	14.3%	23.3%	19.0%	24.2%	14.1%	20.7%	17.5%
2007	30.9%	18.4%	29.2%	18.0%	12.0%	22.5%	22.5%	21.8%	16.9%	21.4%
2008	5.4%	10.0%	43.0%	30.5%	28.7%	-1.5%	-14.2%	-0.8%	30.0%	14.6%
2009	24.8%	21.8%	13.0%	-1.6%	7.9%	24.8%	27.9%	21.1%	19.2%	17.6%
2010	29.5%	38.6%	34.2%	13.9%	22.8%	25.1%	13.2%	16.8%	24.8%	24.3%
2011	10.2%	13.8%	10.6%	9.9%	12.7%	5.2%	4.5%	10.7%	30.7%	12.0%
2012	7.1%	5.0%	2.4%	5.3%	4.2%	6.0%	20.7%	4.5%	11.1%	7.4%
2013	-28.0%	-30.9%	-29.4%	-16.1%	-23.0%	-30.1%	-12.6%	-29.8%	-19.1%	-24.3%
2014	-1.8%	11.6%	4.4%	7.2%	7.5%	0.7%	11.6%	9.4%	0.2%	5.6%
2015	-10.4%	-0.2%	-5.3%	0.6%	6.8%	-6.2%	-9.9%	-9.7%	-5.9%	-4.4%
2016	8.5%	12.1%	29.7%	9.4%	5.3%	16.1%	5.4%	10.3%	11.4%	12.0%
2017	13.1%	-0.9%	3.3%	4.6%	5.9%	6.0%	9.0%	8.3%	6.3%	6.2%
2018	-1.5%	3.0%	4.3%	9.0%	6.8%	4.1%	-4.2%	-0.8%	7.3%	3.1%
2019	18.3%	21.0%	13.8%	18.7%	12.6%	19.7%	17.2%	16.6%	21.3%	17.7%
2020	25.0%	14.7%	21.2%	14.1%	22.6%	17.2%	18.8%	14.3%	28.0%	19.5%
2021	-3.6%	3.6%	-2.6%	2.2%	-4.3%	-6.1%	7.5%	-0.6%	-1.7%	-0.6%
2022 YTD	-0.7%	7.9%	8.9%	3.7%	1.3%	5.6%	10.6%	7.5%	3.7%	5.4%
Average	9.3%	9.1%	10.7%	8.6%	8.4%	8.3%	10.1%	6.9%	11.9%	9.2%

Source: Reuters Eikon, Incrementum AG, figures as of 05/18/2022

Source: <https://ingoldwetrust.report/wp-content/uploads/2022/05/In-Gold-We-Trust-report-2022-english.pdf>

Gold has acted relatively strong in spite of a recent rise in real interest rates and in spite of a rise in the Dollar. If it can hold up relatively well in this environment then I believe it should have significant upside as other central banks play catchup with the FED and the Dollar turns down, particularly given that there are signs of speculative excess in the Dollar market.

The breakout above \$1800 per ounce looks very bullish to us, particularly combined with our Dollar view. If it can sustain above this \$1800 area then we have a target of \$2500 an ounce in 2023.

Silver is Gold's crazy little brother. Where Gold goes it follows but it is historically about 3 times more volatile so it can dramatically outperform or underperform Gold. Silver is different in many ways though as it is not just a monetary metal, it is also an industrial metal and is an important component in many green technologies. Silver tends to outperform Gold during inflationary periods so it is no surprise that it nearly doubled Gold's gains last year (euro denominated terms). We believe Silver put in an important bottom around \$17.50 an ounce last summer. It needs to get above \$25.00 in sustained trade in order to really get going on the upside. It may take a few attempts, but we think a sustained trade above that \$25 area would represent a changing of the guard to a resumption of the bull market which began in early summer 2020, in which case, we would be targeting \$35 an ounce and possibly \$50 an ounce.

Precious Metals Mining Companies were very volatile as well last year and certainly underperformed the precious metals that they mine. We mainly hold two ETFs in the space, a Gold Miners ETF and a Silver Miners ETF. The Gold Miners ETF gained about 2% (euro denominated terms) in 2022 and the Silver Mining ETF has posted around -16% in 2022 (again, in euro terms). They are very volatile instruments. Central bank liquidity removal has not been kind to riskier assets and precious metals miners are considered some of the riskiest, but there are some great things happening fundamentally, we believe Precious Metals Miners are extraordinarily attractive. See below from the brilliant Tavi Costa of Crescat Capital;

A Profusion of Macro and Fundamental Drivers

With arguably the most conservative management teams in the history of gold and silver companies, there is no shortage of fundamental and macro reasons to deploy capital in this industry:

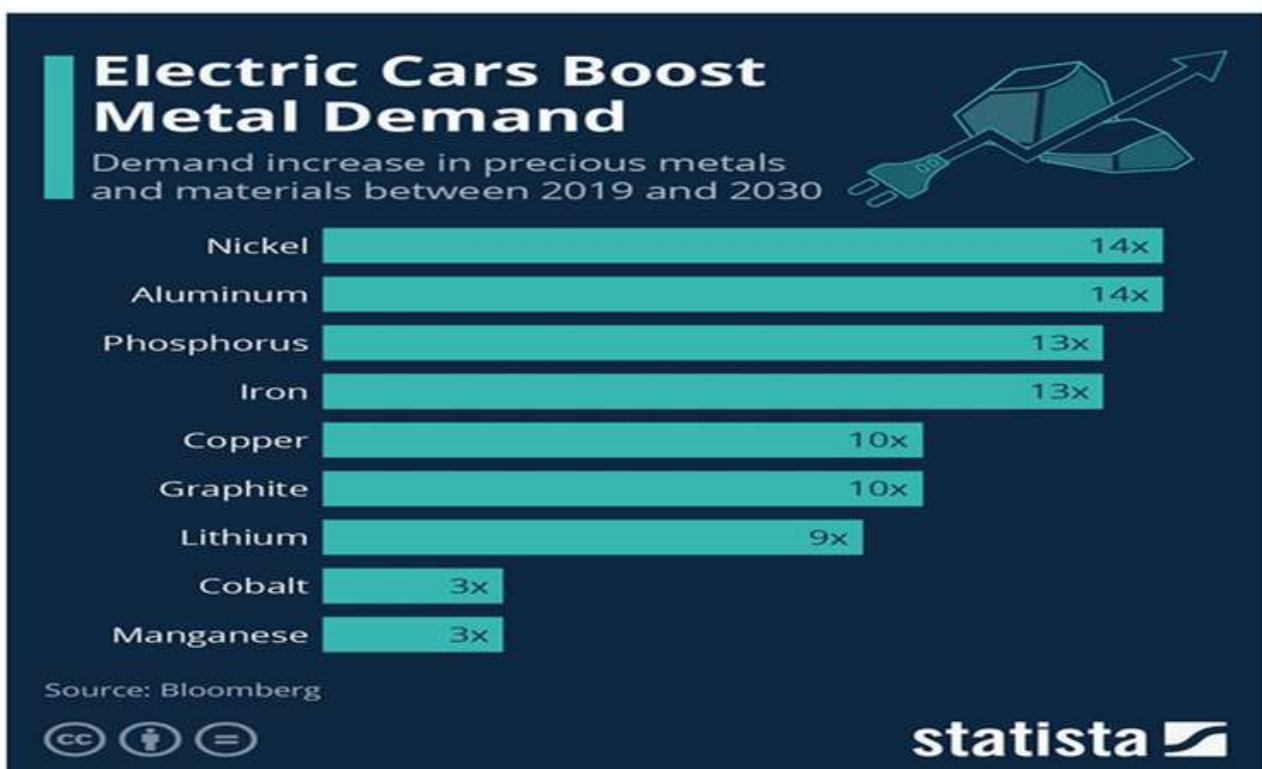
- Companies generating near-historic levels of cash flow
- Miners buying back stocks near-record levels at historically cheap valuations
- Highest dividend yields in history
- Major balance sheet improvements after a long deleveraging period
- Highest cash levels in decades
- CAPEX cycle at depressed levels after a long downtrend signalling a market bottom
- An early-stage M&A cycle developing
- Lowest P/E ratio for the metals and mining industry since 2008
- Gold supply is likely to remain suppressed as we enter a secular declining trend for production
- Lack of new high-grade precious metals discoveries
- No new gold or silver projects are expected to become large producing assets for years
- The mining industry as a percentage weight in the S&P 500 Index near all-time lows
- Overly bearish sentiment for precious metals while the crypto industry implodes
- Gold-to-silver ratio starting to decline from extreme historic levels
- The growth-to-value transition likely to favor highly profitable, low valuation, and counter-cyclical growth businesses such as gold and silver miners today
- Over 70% of the US Treasury curve inverted, giving a strong signal to buy gold and sell S&P 500 indexing strategies
- Rising labor costs, natural resource shortages, reckless deficit spending, de-globalization, and ultimately further debt monetization will likely fuel an inflationary decade that favors investments in tangible assets
- Investors increasingly considering gold as the quintessential offensive asset to counterbalance their falling traditional 60/40 stock and bond portfolio
- Most portfolios remain severely under allocated toward metals, especially gold
- Central banks being forced to buy gold to improve the quality of their international reserves
- Precious metals' prices relative to money supply is near all-time lows

The ultimate supporting thesis to invest in the mining industry boils down to what we call the “Trifecta of Macro Imbalances”: excessive debt-to-GDP levels, highly elevated inflation rates, and financial assets at near record valuations. These economic issues necessitate a financially repressed environment where the cost of capital must remain lower than inflation, even in a structurally higher interest rate environment. As a result, in our strong view, all roads eventually lead to gold.” – Tavi Costa, Crescat Capital

That is just an excerpt from an excellent piece entitled ‘Mining Industry Renaissance’. You can read it here;

<https://www.crescat.net/mining-industry-renaissance/>

Not all assets suit all investors, but where appropriate we have a selective focus in industrial metals. I showed this image last Qtr but it provides important perspective for the long term and adds colour to the commodity theme.



We are very focused on companies and ETFs that have exposure to this space.

9.

Conclusion

To conclude we've aligned our portfolios as best we can for a continued inflationary environment and will continue to have that stance until the data tells us otherwise. We think central banks will be forced to keep hiking interest rates until something breaks and with employment data still quite strong in the western world, we believe central banks have strong reasons to continue with interest rate hikes and other forms of liquidity removal.

We think Crude oil prices are headed higher in the coming years and the knock-on effect of that will mean central banks will have to be even more aggressive. We continue to position portfolios to benefit in that environment.

The ultra- low interest rate environment has disappeared completely.

Regardless, we are heartened by how well our portfolios at Baggot Investment Partners have performed relative to peers, in what has been an extraordinarily challenging environment.

Please do let us know if you wish to discuss your portfolio at any time.

We appreciate your faith and trust in us.

Kind regards,
David Flynn
Chief Investment Strategist and Director
dflynn@baggot.ie

The logo for Baggot Investment Partners, featuring the word "BAGGOT" in a large, bold, white sans-serif font, with "Investment Partners" in a smaller, white sans-serif font below it, all set against a dark blue square background.

BAGGOT
Investment
Partners

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