SOMERSTON
ASSET MANAGEMENT

SOMERSTON RAINY DAY FUND

INVESTMENT LETTER No.1 AS AT 30 JUNE 2024

Portfolio Objectives: The fund seeks to provide readily realisable, positive returns, during most forms of financial market adversity, while maintaining good value in benign environments.

Strategy: We use a fundamental Multi Asset Strategy to identify attractive investment opportunities that are likely to benefit from adversity. We have a 5-year investment horizon.

Performance: The Somerston Rainy Day Fund (US Class) fell by -1.1% in the month.

Performance (%) (US Class)													
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2024						-1.1%							-1.1

Allocation			
Name	% Long	% Short	Net %
Gold Bullion	29.1%		29.1%
Gold Royalty	6.8%		6.8%
Gold Miners Equities	0.8%		0.8%
Silver Bullion	1.9%		1.9%
Gold and Precious Metals	38.6%		38.6%
Equity Long Short	17.3%	-17.6%	-0.3%
Volatility and CTA	16.2%		16.2%
US Inflation Linked Bonds	14.1%		14.1%
Carbon	3.0%		3.0%
Anti Beta	2.6%		2.6%
Cash and Cash Equivalents	25.8%		25.8%
Total All Assets	**117.6%**	**-17.6%**	**100.0%**

Top Ten Holdings		
Name		% Fund
Kilo Gold Bars (32.15 oz)	Bullion	25.3%
36 South Carry Neutral	Long Volatility	3.6%
Aspect Divers Trnd-A USD	CTA	3.5%
Franco-Nevada Corp	Royalty	2.8%
AGF US Market Neutral Anti-B	Equity Long Short	2.6%
One River Dynamic Convexity	Long Volatility	2.6%
One River Risk Responders	Long Volatility	2.2%
Royal Gold Inc	Royalty	2.1%
Wheaton Precious Metals Corp	Royalty	1.9%
36 South-Kohinoor Core FD-B	Long Volatility	1.9%
Total for Top Ten		**48.5%**

Commentary

The Somerston Rainy Day Fund (SRDF') launched on 1 June 2024. The timing of its launch is more a function of pulling all the legal and regulatory pieces together rather than a view on the outlook. We make no forecast of when the 'rain' may come, or how hard it may fall, but owning assets that are attractively valued and which typically thrive in adversity, is our main activity, and presently, we see an unusually high number of candidates that fall in that category.

Our largest holding is Gold and precious metals (38.6%). Over the last 25 years, (since Gordon Brown sold the UK's gold pile at an average price of $275/oz), gold has delivered a total annualised return of 9.0%, outperforming even the best performing regional equity market, with the S&P returning an annualised 7.7% and government bonds that have delivered a 3.4% rate of return. Yet, despite this stellar performance, gold's rate of return has largely only matched the rise in Global Money Supply (measured as M2 in USD in Europe, China, USA, Japan, South Korea, Canada, Taiwan, Brazil, Switzerland, Australia, Mexico, and UK). As Government debts rise, and public debt issuance swells, it is unsurprising to us, that international reserve managers are once again increasing gold bullion in preference to government debt (Chart 1).

Global debt, excluding contingent liabilities like pensions and future healthcare costs, amounts to approximately $300 trillion. In contrast, global public equity is valued at about $100 trillion, whereas gold's market cap is around $16 trillion, or one-twentieth of the global debt value.

In recent years gold has been performing significantly better than the total return from government debt. This trend is closely linked to worsening government fiscal budgets. The dotted line in Chart 2 is the relative performance of Gold versus 20 + year US government debt. The blue line is the US fiscal deficit as a percentage of nominal GDP. Whatever the US election results, neither political side has any plans to address the fiscal deficit and consequently, we expect gold's outperformance of US government debt to be underpinned.

Gold is held in physical form, in the fund's name, individually segregated and allocation in vaults outside the financial system.

Our next largest allocation is to strategies that are directly linked to an increase in volatility (16.2%). The fund allocates to large, experienced managers with a long track record in this area. The Fund will not always have such a large allocation to this sleeve of the strategy, but presently, as chart 3 illustrates, volatility for many financial assets is towards their lower bound for the past 20 years. Moreover, volatility is generally a product of market liquidity and there are several measures which show liquidity is nowhere near as plentiful as it once was. It is also worth noting, that the launch of Zero days to expiration options ('0TE') has led to a massive increase in speculation in option markets. This has caused certain distortions which the managers are taking advantage of. Participants in this new product are generally sellers, causing a general cheapening in option prices across the spectrum.

Chart 1 -Gold is once again regaining its share of Global International Reserves

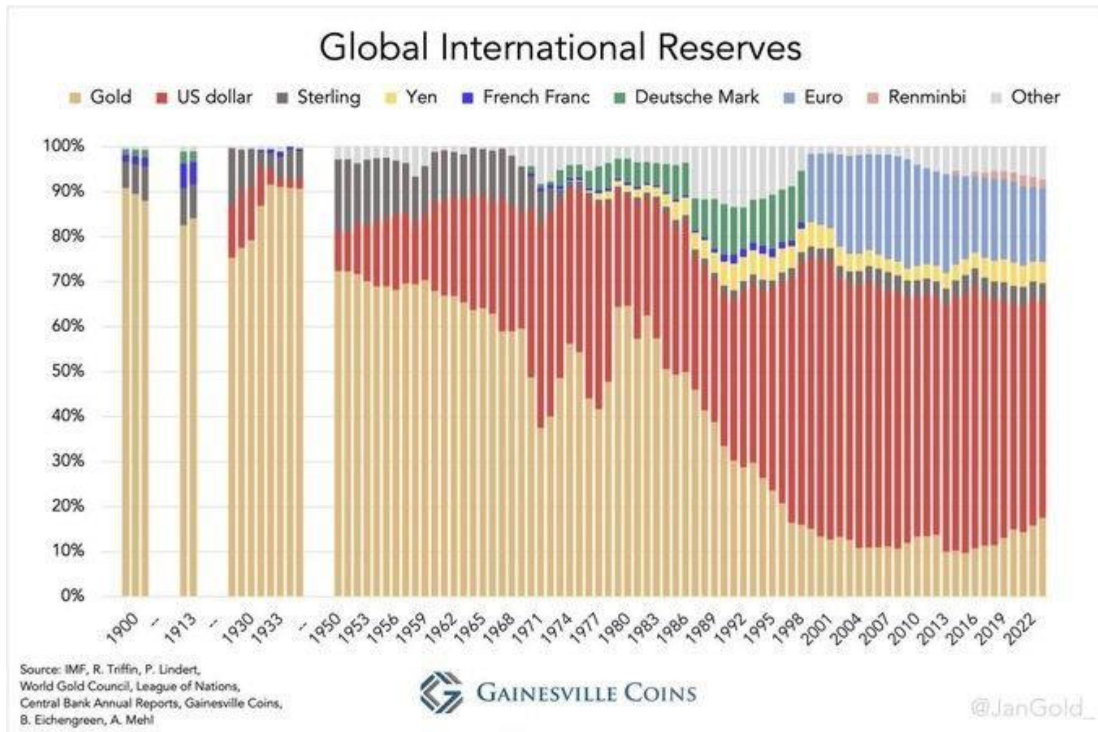


Chart 2 – Gold performance relative to long dated US governement treasuries is influenced by the extent of the fiscal deficit

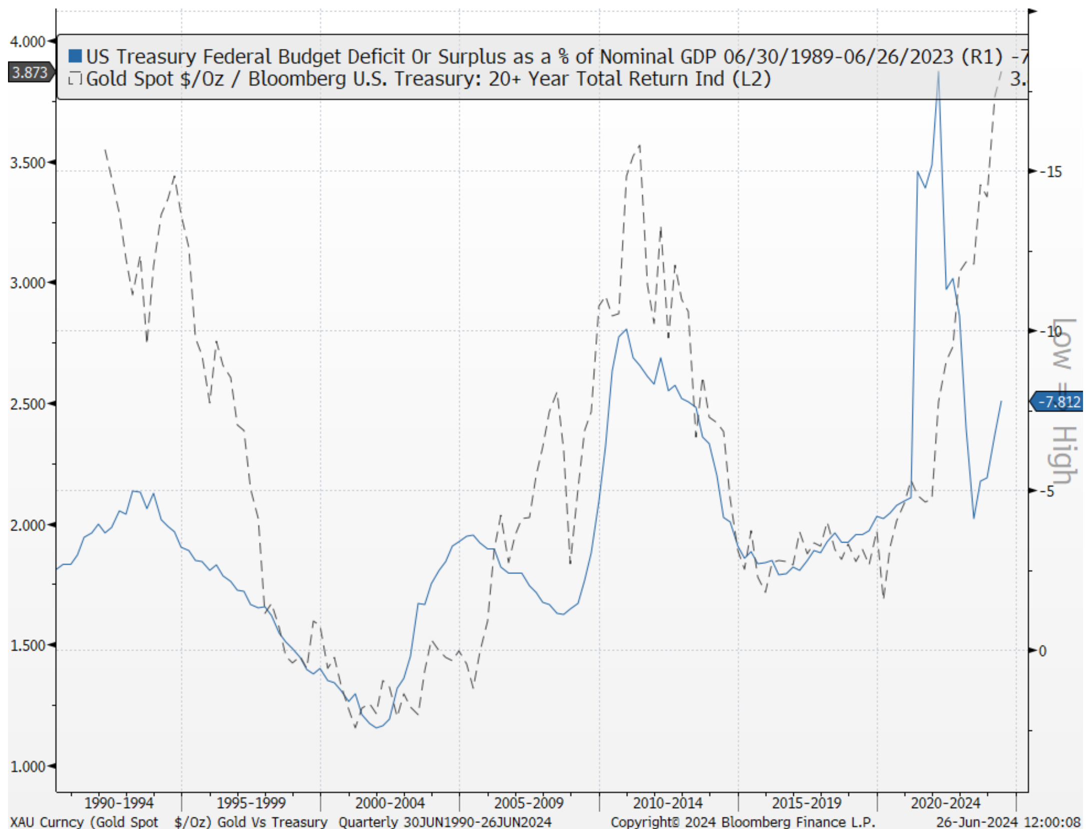
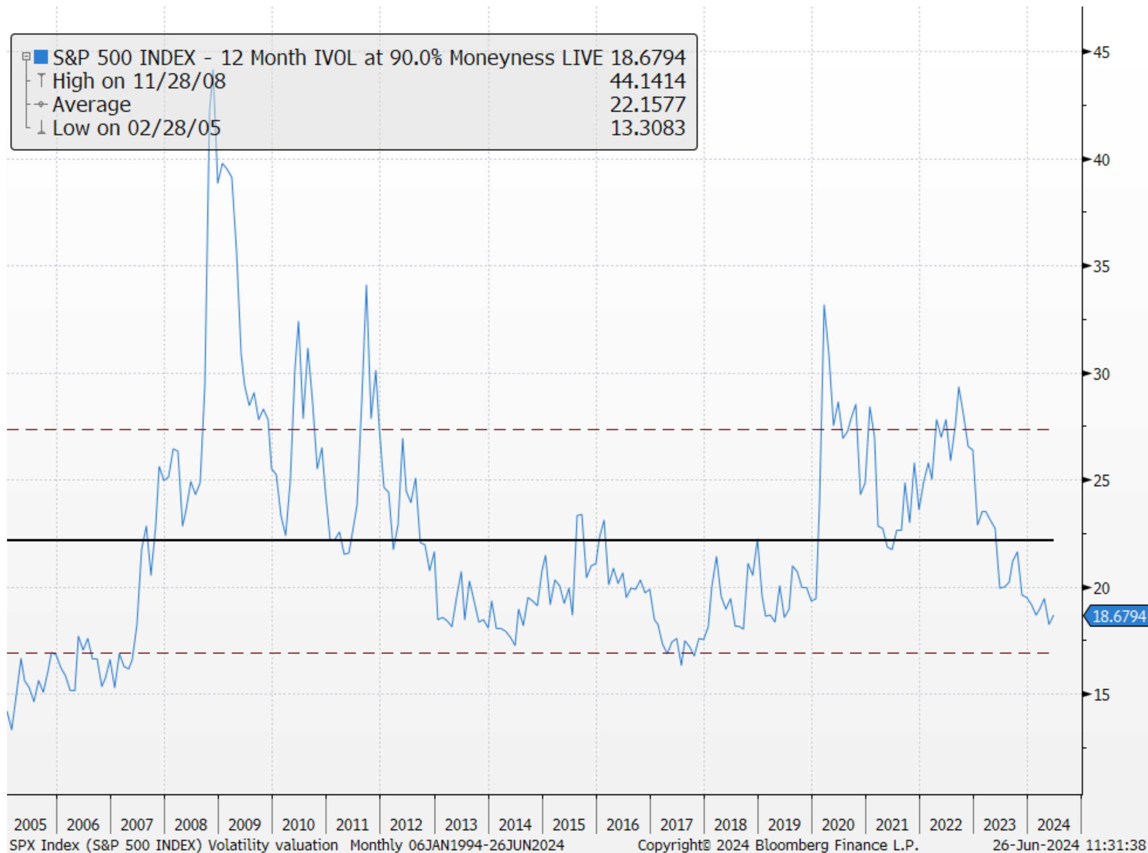


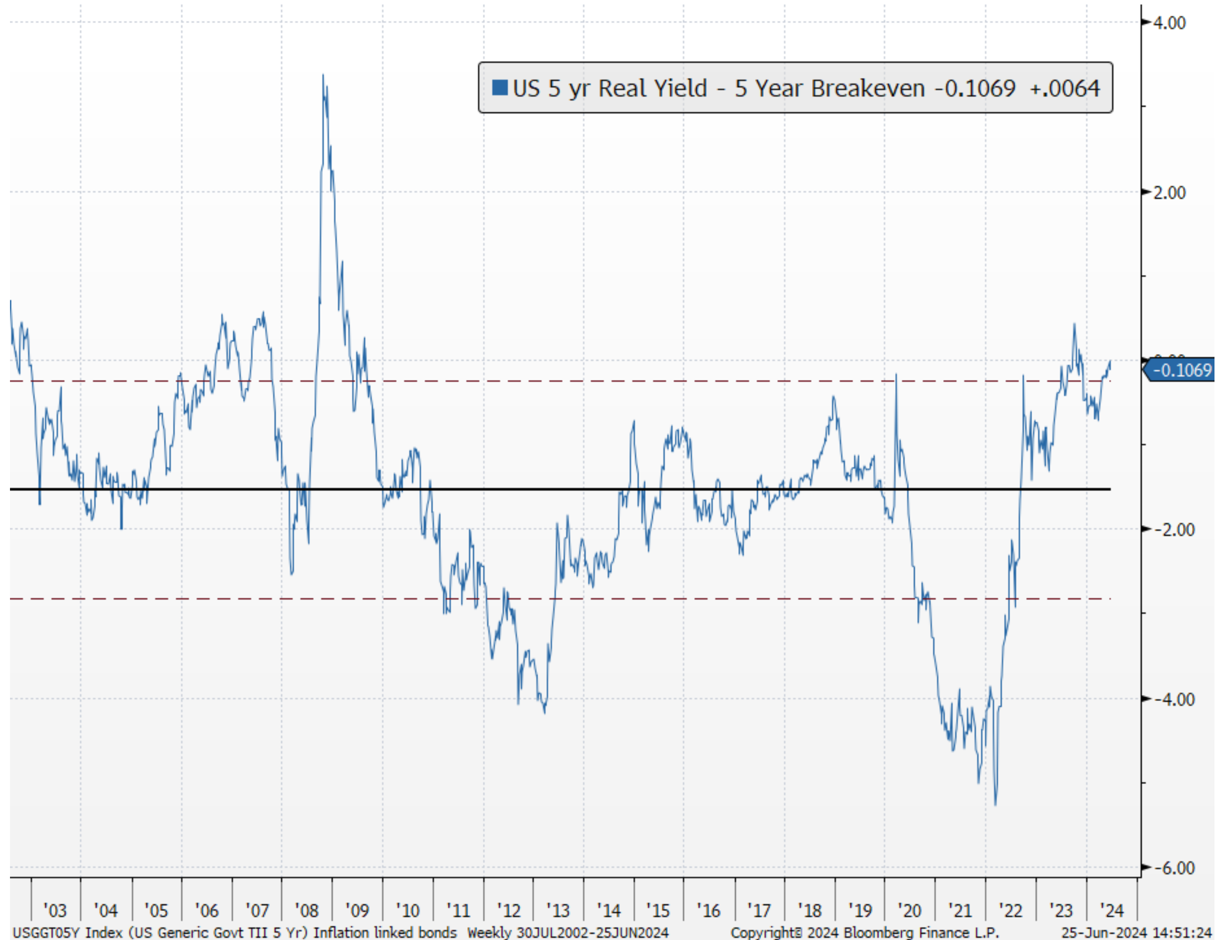
Chart 3 – A representation of equity volatility. The implied volatility of the 10% out of the money 12 month put on the S&P 500 Index.



With seemingly no end in sight for global debt, we expected a period of financial repression where real yields are kept artificially low (or indeed negative), and inflation is allowed to be at higher levels – much as we saw post World War II. Yet real yields have roared back. **Chart 4** shows US 5-year real yields are 2.1% and implied inflation is 2.2%. Owning inflation linked bonds when real yields are high and implied inflation is low is an attractive proposition at any time. If we have a 'Grey Swan' event such as escalation in the middle east causing inflation to surprise to the upside, these bonds will directly benefit from the increase in realised inflation until maturity.

In a similar vein, we consider an allocation of 25.8% to 3-month US T Bills, yielding 5.3%, as giving the fund a decent return and preserving optionality.

Chart 4 – this chart shows the difference in real yields and implied inflation. When the blue line is high, it shows real yields are high and implied inflation is low – an ideal time to own inflation linked bonds.



The last major allocation is an equity long short strategy where the fund is long companies with defensive/low beta characteristics, and short companies whose revenue is linked to the economic cycle. This strategy is likely to benefit from both an equity bear market and widening of credit spreads and critically, the valuation of defensive companies is far more attractive than cyclical companies.

There are many different types of adversity causing asset prices to perform in various ways. Yet the present circumstances and valuation of the typical 'risk off' strategies/assets, gives us comfort that now is as good a time as any to launch the Somerston Rainy Day Fund.

Nick Wakefield

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