gleneagle
asset management

Gleneagle Asset Management
Gleneagle Investment Fund (GT Momentum Portfolio)

November 2020 Review

The GT Momentum Portfolio gained 12.25% for the month of November as several key thematics and news events that we had discussed in recent months came to fruition.

The key single driver was the positive news regarding a Covid-19 vaccine that generated immense optimism in the travel and leisure industry – where our Qantas holding was positioned to capitalize on this outcome. I wrote back in the August monthly review that phase 3 trials were due at the end of October and, if positive, would create a substantial scramble for airlines, cruise liners and hotel companies. On a risk-adjusted basis Qantas was our preferred investment and the share price gained 28%

While some of the US airlines rallied by a greater amount and a larger profit would have been made investing in those companies, the downside risk to their share prices in the event of failed vaccine trials was too great. The US airline industry is highly competitive and in serious financial trouble with support required from the US Government. On the flip side, 70% of Qantas's earnings over the past decade came from domestic travel and its loyalty business so the reaction to negative news would be more muted making Qantas the safer bet. We still hold Qantas in the portfolio have reduced the holding given much of the positive reaction we were looking for has unfolded.

The second key thematic that I discussed in the past and proved to be a solid tailwind is the push for renewable energy and the demand that this new energy source will have on commodity prices, specifically rare earths. In the July monthly review, I noted that Lynas Corp (LYC) had become a core holding on the basis of the above thematic. Being the only major rare earth producer outside China and with increasing US-China tensions, it clearly is a very strategic asset. Lynas share price rose 36% over the month to reach its highest level since 2013.

This month Goldman Sachs joined our bullish view on commodities driven specifically by demand from the expansion of renewable energy and EV infrastructure. This is welcomed support for our long-held optimism and the potential for the next major up cycle for commodities to be underway that could last well into 2021 and beyond. We hold positions in other commodity producers and explorers to give the portfolio an exposure to a diversified range of base metals, oil and bulk commodities.

The final key driver to the month's performance and one that we see as a strong emerging thematic is rising long-term bond yields and the benefit this provides to the banking sector. Shortly after completing my note last month, a significant position was taken in the local banks (majors and regionals) which broadly gained 20% over the month.

We were very quick to act on the potential for the banks to stage a strong and rapid rise on the back of;

- the RBA committing $100 billion to its bond buying program
- the RBA indicating that official interest rates were unlikely to rise for the next three years
- the Federal Government relaxing responsible lending laws
- domestic property prices improving
- Government incentives kick-starting housing demand

However, the real trigger point came after having dinner with a close friend who owns a very successful mortgage business. After several lean years due to the Royal Commission into mortgage lending, he noted that he was “the busiest he has ever been” and “it was like someone just turned the tap on” such was the sudden jump in mortgage demand. This sudden demand spike was industry wide and not specific to just his business.

Accompanying these comments, the ASX-listed mortgage providers were showing promise and so too the building materials companies such as Fletcher Building and Boral (which we profited from in September and October). All these individual developments combine to underpin one strong tailwind for a banking sector that had been depressed and unloved by investors with fund managers being underweight the sector for some time. Investors returning to the sector could lead to a buying scramble and although a solid rally was seen last month, we believe there is potential for significantly higher levels to be seen into 2021.

All the central bank stimulus and Government spending that we have been discussing in recent months first has an impact on equity market valuations. Next, other financial assets and speculative areas begin to rise like commodities as investor confidence and broad speculation becomes more rampant. Hard assets like property also begin to rise and the general economy begins to strengthen. Reflecting this lift in economic activity and inflationary pressures long-term bond yields begin to rise in anticipation of central banks eventually requiring cooling the economy by increasing interest rates.

Banks unfortunately for the past decade have seen their net interest margins contract as global bond yields have declined to record lows and in some cases into negative yields. Clearly being in the business of lending money when interest rates are so low has generally not been good business. However, we believe this is rapidly changing and signs are already emerging that long-term bond yields are on the rise and a dynamic shift in the global economy that could see this emerging trend run for several years. The ultimate low point in bond yields could be in place and what were serious headwinds for the banking sector are reversing to now be tailwinds.

The portfolio has increased its exposure to the Australian banks as a result but also taken a direct short position in Australian 10-year bond futures to profit from the environment of rising rates, be it the result of a stronger economy or rising inflationary expectations.

A final point to note, on January 5th, 2021 voters in Georgia return to the polls to re-elect their Senate representatives in two electorates. Within the state of Georgia on election day the winner must not only capture the most votes but also greater than 50% of the votes. Both Republican winners failed to capture greater than 50% of the votes and as a result there is a “do-over”. The key is that the current Republican majority in the Senate is held by just two seats and if these two electorates fall to the Democrats then the political landscape that has supported markets in November could quickly change.

As a result, we will be conducting a deep review of our entire portfolio ahead of that election and during the seasonal Christmas rally, where we expect a positive year-end will give us the opportunity to crystalize on some of our current positions.

Until next month,

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