January 13th, 2022

# Q4 2021

Dear Investors,

Hanway Capital Fund has returned **6.9% this quarter** reaching a share price of **€145.6** net of fees and commissions. This brings the fund's full year return to **13.7%.** With inflation in Western countries comfortably above 5%, investors have been pushed into risk assets such as equities, which have once again completed a great year. But this propensity for risk has caused major distortions in the financial market, leaving us with some episodes that we could hardly explain outside a context of excess liquidity such as the current one.

## The meme stock movement

At the beginning of 2021, a company's name of little relevance was breaking news: GameStop. This chain of physical video game stores was having financial difficulties due to the pandemic, which led some investors to short the stock hoping for the share price to fall. However, the opposite happened: many small speculators coordinated through the social network Reddit to buy the company's shares and thus force the short sellers to close their position. A situation known in the market as a short squeeze.

GameStop rose 1,864% in 20 days and left several hedge funds, such as Melvin Capital, on the verge of bankruptcy. The meme stock movement was born, an army of small retail investors frustrated with the system that organized on internet forums to manipulate upwards the price of the stocks most affected by the pandemic to send an anarchic and anti-system message to the world.


After video game stores closed to the public because of the pandemic came a movie theater chain with no audience (AMC), a bankrupt car rental company (Hertz) and a cell phone company that has become irrelevant (BlackBerry).

This is undoubtedly a speculative bubble since the aim of these buyers is not to hold on to their investment for a long time but to sell it quickly to the next speculator. The main differential element with respect to other manias of the past is that its strength lies in fury and not so much in greed. We are talking about a leaderless movement, whose members only share the ambition to get rich quick to break a system they believe is rigged against them.

Throughout this report we will review a few examples of inconsistencies, excesses and even absurdities that have occurred this year as a symptom of the excess liquidity that central banks have induced.

## Cryptocurrencies

No one doubts that blockchain (the technology behind cryptocurrencies) opens up immense opportunities for the economy. However, we will focus on talking about cryptocurrencies as an investment asset.

There are only two types of assets that we humans can own. On the one hand, we have those that entitle us to receive an income. If we own shares, we will receive the future profits generated by a company, if we own bonds we will receive interest in the form of a coupon, if we own real estate we will receive an income from rents, etc. On the other hand, there are assets that do not generate any monetary flow and whose only value derives from social consensus. Here we would find for example gold, art pieces or cash.

There’s no doubt that cryptocurrencies should be included in the second type of assets. Owning them does not generate any income, so their value will derive from the collective consensus on their value. In this sense, bitcoin could be compared to the dollar or the euro, which also have no intrinsic value beyond the value we all collectively assign to them.

Nevertheless, and leaving aside the energy problems that the daily use of bitcoin would generate, States and central banks would never relinquish the immense power that gives them control over the monetary base. If the volume of transactions ever came close to the dollar, its prohibition would not be long in coming. After all, whoever is using cryptocurrencies today as a currency of exchange for goods and services are mostly criminals who aim precisely to be far from the control of governments.

This is why we believe that cryptocurrencies and especially bitcoin should be understood rather as a safe haven value, just like gold. However, one of the essential characteristics of a safe haven security is its scarcity, and there are currently more than 16,000 cryptocurrencies competing to dominate the market. All of them add up to a value of $2.5 trillion, that being 5.4 times the value of all Ibex 35 companies combined.

Among them we can find some that reflect the immaturity of the asset. Dogecoin, with a value of $25 billion (the value of Ryanair), was conceived by two engineers who created it as a "joke" in honor of the dog meme. Later came SHIBA INU, worth $22bn (equivalent to Telefonica), named after the breed of dog that appears in the Dogecoin logo.

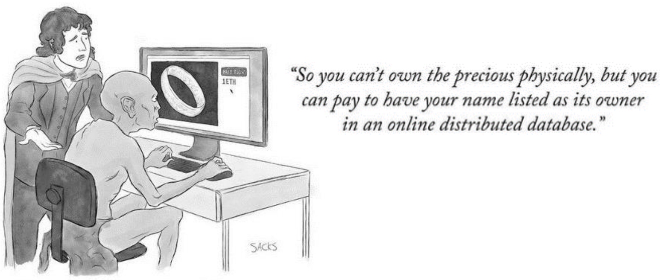
For those of you who are still following (we are aware that it’s not easy), we cannot fail to mention the cryptocurrency SquidGame, appeared in honor of Netflix’s blockbuster " Squid Game". After rising 44,100% in 72 hours, the developers disappeared with $2.5 million, and the price plummeted 99.9%. And of course, there’s cryptocurrency Omicron, which increased 10-fold when news of the new variant of the Coronavirus broke.

Although of all the cryptocurrencies universe, the most systemic is Tether. It is the third largest coin with a value of $78bn, and acts as a stable coin, promising to always be able to maintain the parity of 1 tether = 1 dollar. To achieve this, the company behind the asset would necessarily have those $78bn in dollars deposited in its accounts. Otherwise, we could be talking about the biggest scam in history, slightly surpassing Bernie Madoff's $65bn.

It may sound unbelievable, but no one knows where Tether's funds are deposited. On their website they claim to have at least $30bn in very short-term corporate debt: this would make them the seventh largest holders of this type of debt in the world. However, no trader on Wall Street has ever heard of them.

### NFTs

A Non-Fungible Token (NFT) is a cryptographic token that represents something unique stored in the blockchain. In other words, it is an online property registry in which digital art is traded. Proponents argue that this art, while digitally produced and therefore replicable by anyone with access to a smartphone, is just as valuable as classic work by Picasso or Da Vinci. Currently the market for NFTs is estimated at $10bn and all kinds of celebrities have joined.




In this market we can find goals from Leo Messi, tweets from Jack Dorsey and even a cover of The Economist, but without a doubt the ones that stand out the most are CryptoPunks. Their creators, echoing Salvador Dalí's famous phrase, "don't be afraid of perfection, you will never reach it", created these wonderful, pixelated pieces of digital art following Van Gogh's impressionist technique. On June 10 one of them, #7523 sold through Sotheby's for $11.7 million. Obviously NFTs can only be purchased through cryptocurrencies.

## SPACs and electric vehicles

Equities have not been without excess either. A Special Purpose Acquisition Company (SPAC) is a company without substance that is publicly traded while waiting to find an unlisted company to merge with and thus facilitate its IPO. One such SPAC, Digital World Acquisition Company, announced on October 20th that it had found its candidate: Trump Media & Technology Group. TMTG, founded a few months earlier by the former American president, had at that time zero dollars in revenues, as well as no employees and no corporate headquarters.

The only information available about this company is a 20-page PowerPoint on its website vaguely describing the intention to create a social network called Truth Social. Sure enough, DWAC's stock shot up 845% in just two days to a market value of $4bn.

Allying with the former U.S. president is not the only way to get the markets' attention. Car rental company Avis, for example, used its November 2nd quarterly results presentation to let slip that it would be increasing its fleet of electric cars. Surely not even its CEO, Joe Ferraro, imagined that a simple sentence would cause its stock to soar 220% in a matter of minutes.

Still on electric cars, on November 10th, the stock markets welcomed Rivian, dedicated to the manufacture of electric trucks. Its market capitalization soon surpassed that of General Motors, the largest American manufacturer. No one seemed to mind that GM sells almost seven million cars a year and Rivian has not yet managed to produce any.

Although undoubtedly the biggest beneficiary of the current optimism towards electric cars and market excesses has been Tesla and especially its founder Elon Musk, for months now the richest person in the world. On October 25th, rental company Hertz communicated that, in its drive to modernize its vehicle fleet, it planned to buy 100,000 Tesla cars. Within hours, this purchase worth $4bn drove Tesla's stock market value up by $133bn.

Tesla is the sixth most valuable company in the world. Its value has climbed so fast that it is now worth virtually the same as all other automotive brands combined. Its value is nearly 25x sales; never has a company reached a $1trn valuation with so little profit. In late 1999, just before the dotcom bust, Microsoft was trading at 18x sales, but once the bubble burst, it took 16 years to recover its price per share.

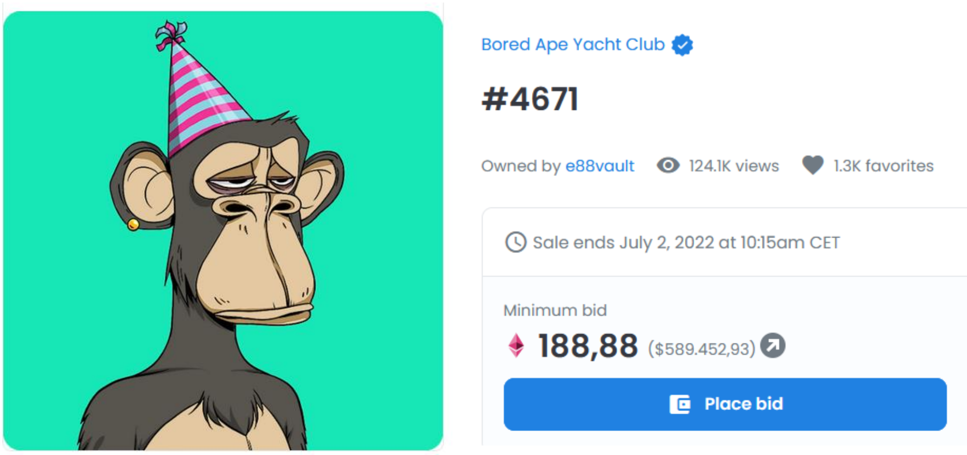
No one doubted that Microsoft was and is a great company, but it was a disastrous investment for anyone who bought in the late 1990s. Similarly, the automotive sector has doubled in value in the last three years. The market is either telling us that in the future we will all have two cars, or that there has been excessive speculation in the sector.

## The market's psychology

Markets in general, not just financial markets, are rarely in equilibrium. There are times of euphoria when valuations are decoupled from reality by excessive optimism, and times of panic and despair to the point of capitulation. When optimism is localized in a certain sector or asset, we can speak of bubbles, but when it is generalized in all assets, we speak of excess liquidity.

Central banks have pursued an ultra-expansionary monetary policy that has ended up inflating all assets to unprecedented levels and causing uncomfortable social inequality. This report has focused on some anecdotal excesses in the financial market, but there are plenty of examples in all areas. Real estate markets that make it impossible for young people to afford housing, private equity funds paying exorbitant multiples or unprofitable start-ups worth billions.

While it is never a good idea to try fighting a bubble, persistent inflation that forces central banks to aggressively raise interest rates may be the trigger that stops the music playing. As in the musical chairs game, when that day comes liquidity will quickly dry up and those who can't find a seat will be faced with the difficult task of explaining to their grandchildren why they invested all their savings in a drawing of a primate.



## Management report

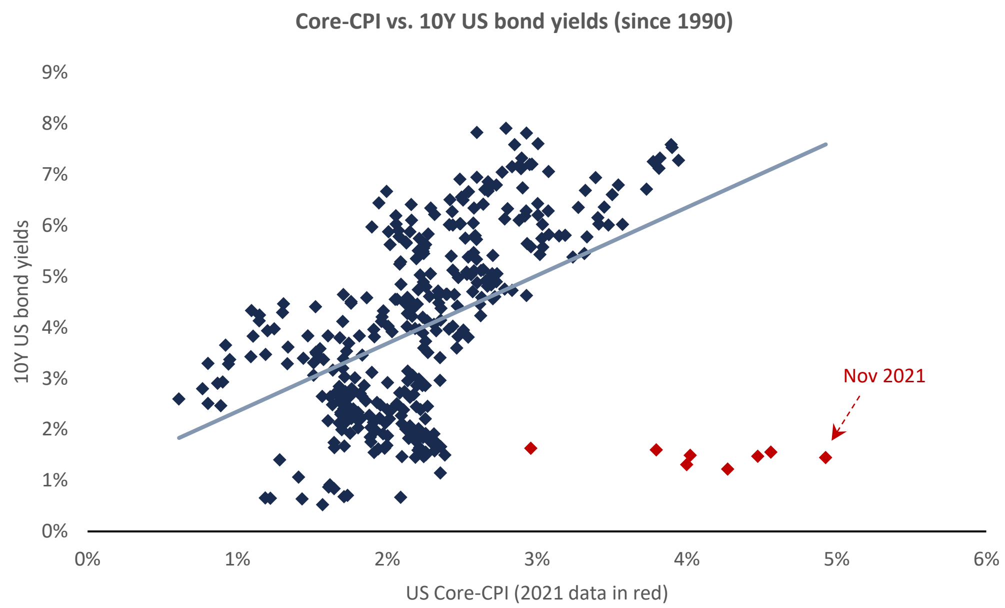
Let us now analyze the fund's individual positions for this quarter:

1. **Equity position**: For a third consecutive year, the last quarter has once again been very positive for equity markets. We will be paying much attention to the next communications from central banks, because if they finally decide to fight inflation aggressively, a lot of capital that has entered the stock market in the absence of alternatives could leave it quickly. This asset currently has a weighting of less than 50% in the fund, avoiding those sectors whose valuation seems unjustified to us. This quarter, equities have added **+2.1%.**

2. **Precious metals:** Gold and silver have ended a bad year on a good note, moving away from the lows they set on September 29th. Since then, they have held up surprisingly well to rising bond yields and a strong dollar, which tend to weigh on their price. The fund's position in precious metals and mining added another **+0.9%** to the result.

3. **Commodities:** The rise in commodity prices has taken a breather at the end of the year. After six quarters in a row with rises of over 5%, commodities have suffered slight declines. The fund has slightly reduced its weight in this asset, as we expect consumption to shift from goods to services in the coming months. The impact of this position on the fund has been minimal this quarter, contributing **+0.2%** to performance.

4. **Short position in fixed income:** The historical correlation between CPI and bond yields seems to have broken this year. As the chart below shows, over the last 30 years the interest on the 10-year US bond has barely moved 100 basis points up or down from annual core inflation. This 2021, we have seen spreads of over 300bps. As long as fixed income continues to ignore this inflation data, this position will erode the fund, as it has done this period by **-0.6%**.




5. **Emission rights position:** On December 16th, the President of the European Commission Ursula von der Leyen assured that the increase in the price of electricity is almost exclusively due to the increase in the price of gas, and that the increase in the price of $CO_2$ has a very marginal impact on consumers. The bet on forcing companies to make the energy transition

is proving very profitable for the fund. This quarter this has been our best investment, contributing **+4.3%** to the result.

*“Markets can remain irrational longer than you can remain solvent”*

- John Maynard Keynes

Regards,
Hanway Capital

## Appendix: Hanway Capital Fund historical returns

| | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | Year |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **2019** | - | - | - | - | - | - | - | - | - | - | -0.4% | 1.2% | **0.8%** |
| **2020** | -2.9% | -3.0% | 18.3% | 4.6% | -0.4% | 3.2% | -2.3% | 0.5% | -2.7% | -1.9% | 9.1% | 3.8% | **27.0%** |
| **2021** | -1.9% | 2.8% | 3.0% | 1.2% | 0.6% | 0.9% | -0.8% | 1.5% | -1.1% | 2.4% | 1.3% | 3.1% | **13.7%** |

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