April 17th, 2024

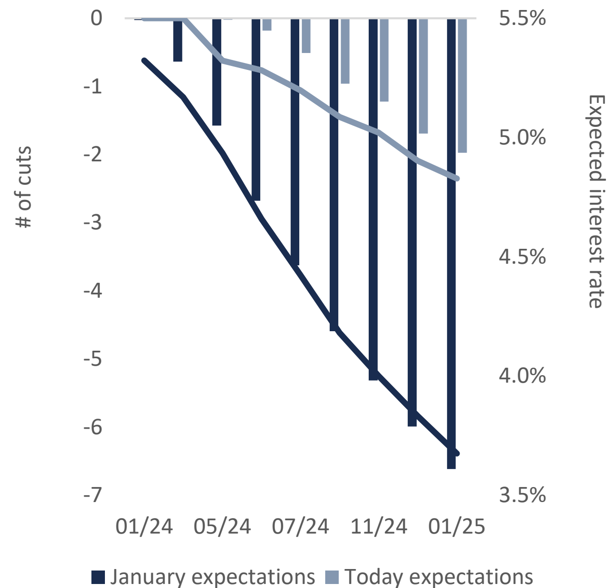
Q1 2024

Dear investors,

Hanway Capital Fund has returned **-3,8% this** quarter, dropping to a share price of **€135.2** net of fees and commissions. Hanway began the year with the conviction that as investors unwound their expectations of rate cuts (they expected up to seven rate cuts by 2024), the markets would correct some of the excess of 2023. The first premise has been fulfilled, with only two rate cuts expected this year, but stock markets have still continued to set all-time highs. Far from remaining stubbornly in the same position, we have decided to listen to the message that the market has been sending us for weeks: Washington elites do not want Donald Trump back in the White House. The only way to avoid it is to overheat the economy and financial assets until November. That is why the Fed will shake the carrot (without delivering it) whenever necessary. We have abandoned the bearish positioning that has hurt us so much in recent months and have opened new themes that will give growth to the fund.

Rate cuts will take longer to happen, if they happen at all, but it is the expectation that matters

After the Fed's December meeting, Jerome Powell ruled out further rate hikes and put the focus on rate cuts. The market went so far as to discount as many as 7 rate cuts by 2024 in January. In our view, that optimism explained the rally in which markets ended 2023, but it did not match reality. We believed the economy and inflation would continue to surprise on the upside due to still high levels of household and corporate savings and strong economic activity.



That part of our diagnosis turned out to be correct: since inflation in the United States hit a low in June 2023, it has been unable to break the 3% barrier and still remains far above the 2% target set by its central bank. The publication of this data has forced investors to adjust their projections downwards, and right now only two interest rate cuts are expected in 2024. However, the stock market reaction has been diametrically opposed to what we expected. We believed that, if it was the expectation of lower interest rates that had triggered last year's recovery, the moderation of these forecasts would undo some of the euphoria in equities. After all, it is difficult to explain that company valuations are back to the same levels as when interest rates were at 0%, now being at 4-5%.

To understand the reason for this projection, it is worth looking back a couple of years. In mid-2021, inflation started to pick up above 2%, but central banks attributed this to the supply chain disruptions caused by the pandemic. For this reason, they initially assured that they would not alter their ultra-loose monetary policy: in December 2021, the president of the European Central Bank, Christine Lagarde, assured that it was *"very unlikely"* that they would raise interest rates during 2022.

The message changed radically at the beginning of the following year. Faced with inflation data that came dangerously close to 10%, central banks initiated the most aggressive rate hike in 40 years. Moreover, they indicated that above all they wanted to avoid the mistakes of the last inflation episode in the 1980s, when they declared victory prematurely and suffered a second wave of price increases as a result. They reminded us that controlling inflation is the most important part of their mandate, and that they were even willing to generate a recession with the increase in unemployment that this would imply in order not to lose control over prices.

The year 2023 brought very good news in this regard. Inflation moderated during the first half of the year from 9.1% in the United States to 3.0%. The market quickly began to discount that rate hikes were over and rate cuts were not long in coming. We thought it was too premature, but Powell proved them right at the Fed's December press conference: he said that the cuts *"had been a topic of discussion in the committee"*, and the stock market rallied.

The problems began at the turn of the year: inflation stubbornly refused to come down. The January data, which showed core inflation rebounding by 0.4% month-on-month, was flagged by central banks as a statistical anomaly due to seasonal effects. But the February and March data have continued to surprise on the upside, and are closer to accelerating back towards 4% inflation, rather than closer to the 2% target.

Therefore, the Fed's last meeting on March 20th seemed the perfect occasion for Jerome Powell to show his concern about these data and rule out rate cuts this year. However, the Fed chairman performed an exercise of wishful thinking: he insisted that inflation was trending downwards, assured that the January and February data were mere bumps in the road and repeated that the central bank's next move would be a rate cut. During the press conference, in which he dodged journalists' questions with evasions, the stock markets soared to record highs.

The 1992 precedent: *it's the economy stupid!*

What has changed in recent months: why was the priority in 2022 to contain price rises at all costs, while in 2024 the central bank will tolerate high inflation so as not to harm economic growth and unemployment? The answer is sadly to be found in the November presidential elections, in which Americans will be forced to choose between two candidates who are both over 78 years old: Donald Trump and Joe Biden.

Undoubtedly, in the memory of the members of the Federal Reserve are the 1992 elections. The incumbent was George H.W. Bush, father of the president who lived through the 9/11 attack. His presidency has recently been claimed by many historians as successful, actively participating in the reunification of Germany and achieving a landslide victory in the Gulf War. However, he lost the election for his second term to a Bill Clinton who was a complete unknown and whom no one trusted. What went wrong?

During Ronald Reagan's presidency, immediately preceding Bush's, the United States experienced an unprecedented economic boom. When Bush came to power in 1988, the economy was still expanding, but the first problems began to appear: the public debt had tripled in 10 years and inflation, after many years of respite, was picking up again. Alan Greenspan, who had been appointed chairman of the Fed in 1987, quickly raised rates from 6.5% to 10%. The economy slowed for the remainder of Bush's term, eventually entering a recession in 1991, just before the election.

Despite Bush's many foreign policy successes, Clinton realized that what really mattered to Americans was the economy. Using the now celebrated *"it's the economy, stupid",* Clinton emphasized the high levels of unemployment that peaked at 8% just before the election. The result is common knowledge: Clinton swept the election.

Until his death in 2018, George H.W. Bush remained convinced that Greenspan's lack of diligence in lowering interest rates as the economy worsened cost him re-election. In fact, throughout 1992 the Bush administration pressured Greenspan to accelerate his rate cuts, but he was unmoved: he said that if policymakers really wanted to restore public confidence in the economy, they had to reduce the fiscal deficit.

This episode could not resound more with the current situation: like Bush, Biden is running unthinkable fiscal deficits in an expanding economy. But unlike 1992, he has the cooperation of the Federal Reserve, which is willing to overheat the economy to help him get re-elected. In fact, the polls that favoured Trump at the end of last year have evened out since the Fed announced its plans to cut rates and triggered euphoria in the stock markets.

Keep the music playing

The consequences of this expansionary fiscal and monetary policy are already beginning to be felt, and we believe this trend will continue through November. We are heading for a few months of huge nominal growth, and that will drive up the price of all assets. The price of stocks and real estate, of course, but also the price of gold, bitcoin, and commodities. The only asset that will suffer, we believe, will be fixed income as long-term interest rates resume their climb.

Hanway Capital failed to spot this trend at the turn of the year, as we believed that, if inflation picked up, central banks would act responsibly by tightening, and that would cause markets to correct. Hence our positioning for the first quarter of the year was negative for equities, and this explains most of our negative performance during this period.

However, in mid-March we recognized that this positioning was not appropriate in an election year when it is in the interest of politicians for assets to go into the elections strong. We therefore closed our short positions in equities as downside protection. We remain cautiously positioned as markets rarely move in a straight line and the road to November is likely to be volatile, but we see no point in stubbornly sticking to a thesis that simply isn't working.

The decision to return to betting on asset rises has been well thought out and calculated, and we believe it is worth doing so in very specific themes and assets where we foresee clear growth in the coming months. These are the sectors on which we have placed our bets with conviction:

- **European defence:** The rhetoric of European rearmament has yet to be reflected in the earnings of European defence companies. The geopolitical situation that threatens our borders has been a revulsive for our leaders, who are waking up from a long idyll that has offered so many decades of stability. The stockpile of armaments and defence shields is obsolete, and whoever occupies the White House next year, Europe can no longer afford to outsource its protection to America. We are facing a boom in the European defence sector that will take years to renew and modernize its entire stockpile, peace or no peace.

- **Cardiovascular healthcare companies:** The revolution of GLP-1 hormone and derivatives being exploited by companies such as Novo Nordisk and Eli Lilly is a turning point in the treatment of obesity on a global scale. Drugs such as *Ozempic* or *Wegovy* are proving not only to help people with obesity to lose weight but are also showing a drastic reduction in all types of cardiovascular pathologies. The potential market is gigantic (38% of the world's population suffers from obesity or overweight), and the incentive for public administrations to include these treatments in their portfolios is imperative because of all the savings that will be generated by avoiding future pathologies derived from overweight. The sector has enormous growth potential and is not as expensive as the technology sector.

- **Nuclear energy:** Last February, the European Union chose to classify nuclear energy as "strategic" for decarbonization and the energy transition. This should have an impact on the

attitude of European governments to rethink the closure of nuclear power. We have decided to bet on uranium as a raw material because its supply and production is highly compartmentalized in countries with volatile geopolitical situations and the scarcity of the material augurs its revaluation in the medium term. The abandonment of fossil fuels to move to a greener economy is impracticable in the short term without nuclear energy. Guaranteeing a stable electricity supply cannot be achieved with solar and wind energy alone, which, although essential, cannot be the only energy sources in the energy mix. Proof of this is that despite the bad reputation that has historically accompanied nuclear power plants, there are currently 60 reactors under construction and 110 planned. All this will boost demand for uranium.

- **Gold:** Those of you who have been with us for some time know the predilection we have for this safe-haven security. We abandoned the theme more than a year ago out of frustration with its performance, but in recent weeks, gold has radically changed its dynamic. Despite the most extreme bout of inflation in 40 years, gold hit a 40-year high in July 2020, and it has taken almost four years to regain that mark. We blame the explanation on rising interest rates, which reduces the attractiveness of owning assets such as gold that do not generate any income. However, in recent weeks the story has changed completely. With inflation picking up in the US, and the Fed flirting with a rate cut, coupled with the spectacular US treasury deficits of recent months, investors have quickly returned to the narrative that gold is the only asset that can protect them from currency debasement. This dynamic could be exacerbated if US government spending continues to run rampant in an economic boom. At the same time, if the Fed ends up lowering rates we could see the gold ounce continue its upward path.

The year has not started as we expected, in terms of market movements and fund performance. But precisely one of our differential values is flexibility, and this allows us to adapt quickly to changing scenarios. We always try to explain transparently how we see markets, and in this case we have no qualms about acknowledging our failures and detailing the steps we are taking to remedy them. We are confident that this second quarter we will be able to return to the upward path.

Management report

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

1. **Dividends position**: After almost four years invested in European dividend futures, we have sold the last position we held. We entered the asset class in April 2020, when the market began to fear that governments would limit how much profit companies could distribute in the context of a global pandemic. This bet on economic recovery has certainly worked, and in the last quarter it brought us **+0.9%.**

2. **Volatility positions:** Equities have had one of the quietest quarters in recent memory, and that is never good for volatility investments. There have barely been 3 days of declines of more than 1% in equities, and US indices have not strayed more than 2% from their all-time highs at any point. In this context, it is not surprising that the volatility contribution to the fund these months has been **-2.7%.**

3. **Short Equities position:** Our biggest bet to start the year, a short position in equities waiting for corrections, could not have been less successful. Stocks have continued on their unstoppable path and if in the last quarter of last year they rose by 12%, this year they have risen by 8%. Companies have continued to present good results and the eternal promise of lower interest rates has continued to support valuations. As we have mentioned throughout this letter, at the close of the quarter we had closed this short position, which this quarter has reduced the fund's result by **-2.3%.**

4. **FX position:** Even the Bank of Japan's first interest rate hike since 2007 has not stopped the yen's fall, which is already at its lowest level since 1999 at ¥155/$. The central bank seems determined to intervene to stem its currency's decline, but the dollar's strength limits its moves. We still like the asset as a hedge against unforeseen events, but this quarter our currency positions have subtracted a **-1.3%** of the overall result.

5. **Precious metals:** As detailed in the previous section, we have once again added a significant position in gold to the fund, given that the stars are aligning for the asset to return to work: a rebound in inflation, falling interest rates and runaway public spending. In the first quarter, it has contributed **+0.2%** to the fund’s performance.

6. **Short Fixed Income position:** We have also regained from previous years a commitment to long-term interest rate hikes. Central banks are able to control the near side of the debt curve, but long-term debt is in the hands of the market. The only way for investors to protest a fiscal cliff is to increase the cost of countries' debt, and we believe that is what they are going to do. Over the period, this position has contributed +1.4% to the fund.

“When the facts change, I change my mind – what do you do, sir?”

- John Maynard Keynes

Regards,
Hanway Capital

Appendix: Hanway Capital Fund historical net 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%**
2022	-1.7%	0.0%	2.1%	1.8%	0.8%	-6.1%	3.0%	2.6%	2.1%	1.9%	-2.2%	-1.7%	**+2.0%**
2023	1.1%	0.5%	-3.1%	-1.0%	-1.2%	-3.7%	-0.1%	1.2%	1.6%	0.2%	-1.0%	0.2%	**-5.4%**
2024	-2.5%	0.2%	-1.5%										**-3.8%**

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