October 8th, 2020

Q3 2020

Dear investors,

Hanway Capital Fund returned **-4.5%** for the quarter reaching a share price of **115.4€** net of fees and commissions. This brings the year-to-date return to **14.5%.** Given the better prospects for the global economy, in recent weeks the fund has turned to position itself decidedly bullish for the end of the year. We believe that the reopening of economic activity together with expansionary fiscal and monetary policies will be a catalyst for the markets, which could be further favored once the political unknowns of the American elections and Brexit dissipate. To do this, the fund has bought equities especially in cyclical sectors that we believe will benefit from an eventual reopening, without abandoning our commitment to commodities as protection against a rise in inflation.

Two parallel realities

At the birth of the Amazon River, the Negro River, with dark waters, and the *Solimões* River, with clearer waters with a clay hue, meet. For six kilometers the waters of the two rivers coexist without mixing due to their differences in temperature, speed and density. This phenomenon is known as the *"Encontro das Águas".*

In the financial market after the pandemic, something similar is occurring. We are witnessing how different assets are pricing totally opposite scenarios:

On the one hand, in the American technology sector, it seems that the world is doing better than ever. The largest and leading companies in the world suffered slight declines in March, but quickly recovered. From there, they have raised to all-time highs to reach multiples not seen since the dotcom bubble. Apple, for example, after rising about 60% this year, is trading at a sales multiple of 8x, like it was in 2007 after the launch of its first iPhone.

We find it hard to believe that being the most valuable company in the world with a market capitalization that exceeds two trillion dollars, its current opportunities for growth and innovation are similar to those it had in 2007. This is not a criticism of Apple, which is a good company, but not

necessarily a good investment. Currently, many technology companies are trading with exaggerated growth expectations, which even if they are met, would not leave much more room for increases. That is why we think that the technology sector currently offers more risks than opportunities.

On the other hand, most equities continue to discount a very unfavorable scenario. The prices of the sectors especially linked to the economic cycle (industrial, tourism, aeronautical, financial) are telling us that the world will take many years to recover from this setback. Many of these equities have barely moved away from the March lows and therefore reflect the enormous uncertainty that surrounds us.

Due to the enormous weight that the technology giants have reached in the benchmark indices, their impressive increases so far this year have managed to distort the evolution of those indices in which the technology sector has a lot of weight (i.e. S&P 500), leaving behind those indices in which the technology is barely existing (i.e. Ibex 35). The table below analyzes the relationship between the weight that the Information Technology sector has in each index and its evolution in the first nine months of the year:

Index	Country or Region	Technology weight on index	2020 Return (USD)
S&P 500	USA	28.2%	+5.6%
Nikkei	Japan	16.3%	+2.8%
DAX	Germany	13.6%	+0.7%
Eurostoxx	Europe	15.6%	-8.7%
Ibex 35	Spain	6.3%	-25.2%
IBOV	Brazil	1.0%	-41.7%

How would global equities have behaved if the technology sector did not exist? We can see in the following graph that, although the MSCI World has fallen only 4% since the beginning of the year, without the technology sector (which represents 22%) it would have fallen 9%.

Fear of missing out

Famous investor Stanley Druckenmiller, who worked for George Soros from 1988 to 2000, explains his experience during the dotcom bubble in this interview:

> *"I'll never forget. On January 2000 I went to Soros' office and told him: "I am going to sell all the technology stocks. All of them. This makes no sense. We will wait for the next opportunity". And so we did, but then I saw how other funds that were still in the sector rose 3% every day. And I was watching it from the sidelines, and it was killing me. As weeks went by, they were up 50% for the year and I was only 7% up".*
>
> *"We reached March and although I felt that we were approaching the bursting of the bubble, I could not avoid it. I picked up the phone three times that same week, but I told myself not to do it. Do not do it. In the end I did it: I bought $6bn in tech stocks, right at the highest point. Six weeks later I had lost $3bn and Soros had fired me".*

When Druckenmiller is asked on what he had learnt from that experience, he answers flatly: *"I learned absolutely nothing".* He knew that he was going against his most basic investing principles and that he was making a mistake. But still he couldn't resist the pressure of staying on the sidelines.

Not being invested in the sector that rises the most is especially hard because of that feeling that everyone around you is profiting and you are making a mistake. But we reiterate our position with respect to the vast majority of the tech companies mentioned above. Not because they are great innovative companies, they make a good investment. The multiple that the market is asking to buy them currently presents more risks than opportunities and despite all expectations of infinite growth being met, the current price would already reflect it. However, multiple risks such as regulatory are increasing, in which more and more voices demand greater control over what some already call technological monopolies.

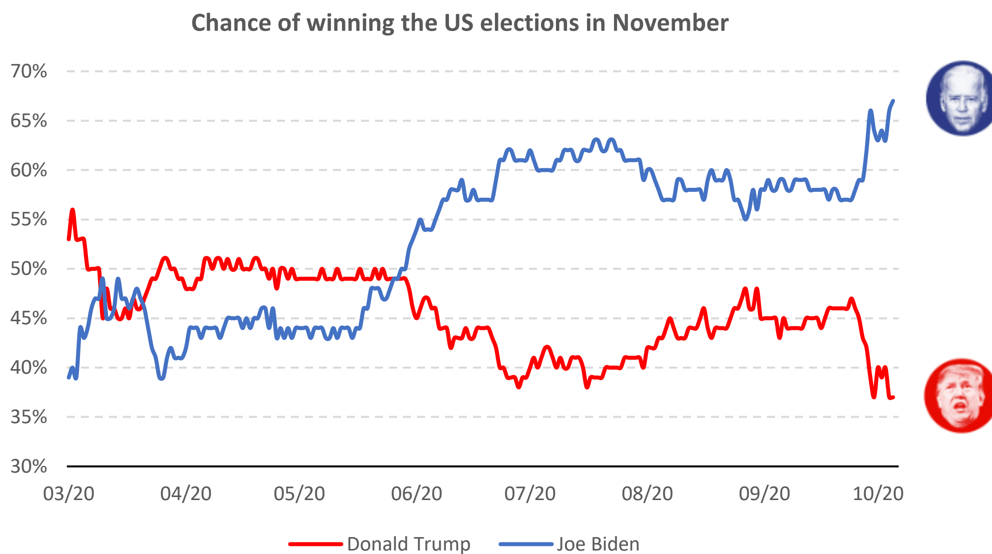
Joe Biden against the curse of history

Just six months ago, Donald Trump's victory in next month's American elections was taken for granted. The coronavirus has been the black swan in the president's career that has not only sunk his economy and caused a historic health crisis, but also has ended up infecting him a month before the elections. The probability of a victory for Democratic candidate Joe Biden has soared with an advantage of up to thirty points ahead of the current president.

Donald Trump and his policies are part of a global movement that is not exclusive to the US. Throughout the Western Countries, the idea that globalization has left many people behind and that emerging countries such as China have cannibalized industrial jobs of the middle class is common. Economic protectionism and America First diplomacy will hardly go away even if the Democratic candidate wins. This movement could be slowed down and therefore Biden would be navigating against the course of history, but it is evident that this will not prevent us from heading towards a less globalized world, with greater difficulties in the movement of people and capital. As a sample, 66% of Americans currently say they have a negative opinion about China, a rise of 20 points since Trump took office and that will hardly be changed with a Joe Biden's victory.

Many Senate seats are also up for election and this time it will be particularly important. If the Democrats also manage to seize the upper house as the polls point out, Biden's economic and social agenda can be easily deployed and we could, for example, see a strong push in the energy transition and in public spending.

Finally, we must mention the remote possibility of an unprecedented constitutional crisis. In the case of a very tight electoral result with a tight victory for Joe Biden, Donald Trump, who has already pointed out a hypothetical electoral fraud several times, could refuse to accept the result and generate an institutional crisis that would bring down the financial market for the uncertainty that it would cause. This scenario has been largely dismissed due to the increase in the advantage of the Democratic candidate, but we should remember that the New York Times gave Hillary Clinton a 90% chance of winning on election night 2016.



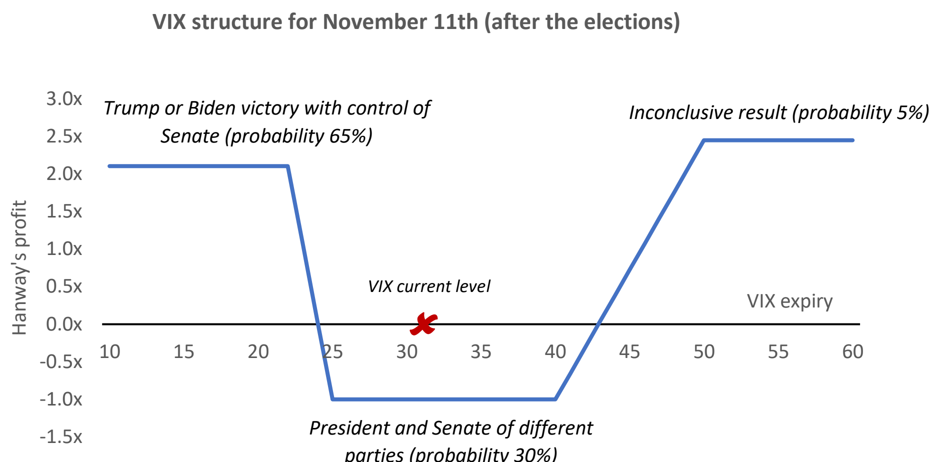
Management report

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

1. **Long positions**: Global markets have had a transitional quarter, with slight rises. Once again equities were the best economist and the strong gains in the second quarter anticipated the improvement in the economy that we are witnessing. However, we believe that the rotation from defensive to cyclical sectors is yet to come and therefore we have positioned ourselves strongly in the second group. The fund has increased its equity position from 30% to 65%, focusing on assets closely linked to the business cycle - prioritizing small-caps, southern European and industrial sector companies. The fund also maintains positions in the health sector and has recently opened a position in the renewable energy sector framed within the theme of energy transition, which is gaining prominence in the political arena. In this quarter, equities contributed 2.2% to the fund's return.

2. **Volatility positions:** Our great success for 2020 has not worked this quarter: starting from high levels, volatility has hardly changed during downturns (for example, on September 2nd and 8th). Looking ahead to the American elections and since we believe that it is a binary event - if there is a clear winner volatility will go down, if there is not it will shoot up - the fund has

bought a position in volatility of volatility, which we try to show below. During this period, volatility has subtracted 3.3% from the return.



3. **Dividends position:** After a great second quarter, European dividends have slowed their rally 30% below where they were before the pandemic. We continue to believe that this is a unique opportunity and that is why we have considerably increased our position in the futures of 2022, the year when the virus' effects should be a thing of the past. These positions have subtracted 1.5% from the fund's quarterly performance.

4. **European banks:** Banks have not performed this quarter either just like dividends, which reached their peak at the beginning of June. Despite that the merger of CaixaBank with Bankia seems like the starting signal for the numerous mergers that the sector needs, this does not solve the banking structural problems (negative interest rates). The fund has considerably reduced this position, which still subtracted 1.3% from the quarter's result.

5. **EUR vs. USD position:** The euro has risen sharply this quarter, momentarily reaching 1.20 against the dollar, although it has undone part of that rise in recent weeks. A victory by Joe Biden and his promise of more public spending could be the trigger that the euro needs to resume its climb and break the ceiling of 1.20. That would benefit the fund's currency position, which this quarter has reduced returns by 0.4%.

6. **Commodities:** The numerous stimulus packages and liquidity injections have meant that, as counterintuitive as it may seem, the level of citizens' savings have increased during the pandemic. In the medium term, we believe that when economies reopen, all this savings will make its way into consumption and cause price increases, especially if governments and central banks hesitate to withdraw stimulus. The protection we have opted for in this scenario is to add to our position in precious metals, other commodities related to agriculture and industrial uses. These positions, which already represent 14% of the fund, have reduced the fund's return by 0.2%.

This has been a transitional quarter for the markets. After the most abrupt economic stop in history, the economy has been gradually reopening. Volatility, which remains at relatively high levels, reminds us that partial or total lockdowns are still possible and that the pandemic and consequently the dire economic situation has not been left behind. After long reports on whether the recovery would be in V, U or L shape, it has ended up in a K shape. On the one hand, the technology sector has taken off

reaching dizzying valuations, and on the other the service sectors have collapsed. However, we believe that as the situation returns to normality this imbalance will correct itself in favor of cyclical stocks.

On the other hand, it remains to be seen in the long term, what the consequences will be of the hyper-expansive monetary and fiscal policies cocktail that is being carried out. If economic theory is true, everything points towards the return of inflation, although 2020 has taught us not to take anything for granted.

"By a continuing process of inflation, government can confiscate, secretly and unobserved, and important part of the wealth of their citizens."

- 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%				**14.5%**

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