

A black and white photograph of two mountain goats standing on a dark, layered rock face. The goat on the left is standing upright, facing slightly towards the camera, while the goat on the right is in a more crouched position, looking towards the left. The rock face has distinct horizontal layers and vertical cracks, creating a textured background.

CG insights

Quarterly perspectives from the CG team

2nd Quarter 2025

cgam

What's wrong with the dollar?

Reserve status remains assured, but attraction is diminished

The story that pushed the dollar ever higher over the last decade was crystal clear. **The dollar represented a superior choice on every metric that mattered; liquidity, institutional architecture and relative yield.** Global investors gorged themselves on US assets, pushing up the dollar and their investment returns. Every economic crisis further cemented the dollar as the world's essential currency. A perfect self-sustaining strengthening cycle.

That was until the second election of Donald Trump, at which point this narrative came under serious pressure. First, the new president explicitly wants a lower exchange rate as part of his efforts to reindustrialise. Second, the administration has been intentionally undermining key institutions from within, clashing with the courts, attacking the Federal Reserve and introducing tariffs on allies and foes alike. Third, and perhaps most importantly, **fiscal policy displays a breathtaking lack of discipline** (see the bond commentary). Finally, the interest rate differential between US government bonds and other sovereigns has narrowed, most notably with Sterling and Yen.

Despite these issues there is simply no viable alternative to the dollar as the global reserve currency, for the foreseeable future. The dollar is on one side of 88% of foreign exchange transactions, 54% of export invoicing and makes up 57% of central bank reserves. These factors will ensure King Dollar will outlive this administration, and many future administrations regardless of their actions.

So where does that leave the dollar? The various sustained efforts by the administration to push down the dollar combined with potential investor retreat from US securities risks becoming a self-sustaining weakening cycle. That said the dollar remains the global reserve currency and US treasuries are an irreplaceable asset class. **The dollar deserves a place in portfolios albeit at lower levels than over the past decade.**

The DXY Index (FX rate versus a basket of major currencies)



Chart takeaway: Fifteen years of dollar strength is being challenged

Our Investment Judgement

1. The US dollar remains the largest overseas currency in our portfolios but has fallen from c.25% to c.20% since the start of this year
2. Most of our US dollar exposure is in the form of treasury inflation protected securities (TIPS) providing some protection from an inflationary driven devaluation in the dollar
3. Fortunately, index linked gilt yields have risen to attractive levels providing a suitable alternative for a Sterling fund
4. Our Sterling exposure has risen to its highest level in over a decade

Who's afraid of the long end?

The penny has dropped: US fiscal policy is unsustainable

It is well understood as a matter of public finance that decades of ultra-low interest rates led to the rise of expansionary budgets as insurance against economic downturns. **Recently, real interest rates have increased materially and yet governments continue to delay meaningful fiscal adjustment.** They argue that the *right* spending will allow nations to grow themselves out of debt. With real interest rates above 2% in the US and UK, this appears unlikely.

Bond markets have ramped up their focus on fiscal policy. Over the past year not only has the Treasury curve dis-inverted, but the 2s10s spread has moved by almost 100bps and the benchmark 30-year Treasury crossed 5%.

The conclusion is unequivocal: term premia must rise further. This is as evident from segmental market analysis as it is from quantitative modelling. The Federal Reserve, foreign central banks and dealers which together comprised around two-thirds of Treasury ownership in 2020, now make up only half, meaning that more price sensitive buyers – demanding higher yields – must pick up the slack. The Fed's published ACM estimates of term premium have moved by approx. 150bps over the past two years. The combination of the fiscal plans in the Big Beautiful Bill, the lack of impact of DOGE's efforts, and lack of visibility of tariff revenues suggest that this situation will not improve soon.

So, are we afraid of the long end? Of course - higher long-end interest rates reflect the changed demand dynamics and greater risk that markets attribute to the outlook for public finance, inflation and growth. But the combination of higher starting yields and heavier coupons on new long end issues bring higher running yields and greater convexity to a portfolio. **Faced with this dilemma, we have cautiously reduced duration, favouring the belly of the curve and only allocating to the most convex bonds at the long end. We hope that this will deliver the appropriate balance of yield and caution.**

Evolution of term premia in US government bonds (bps)¹

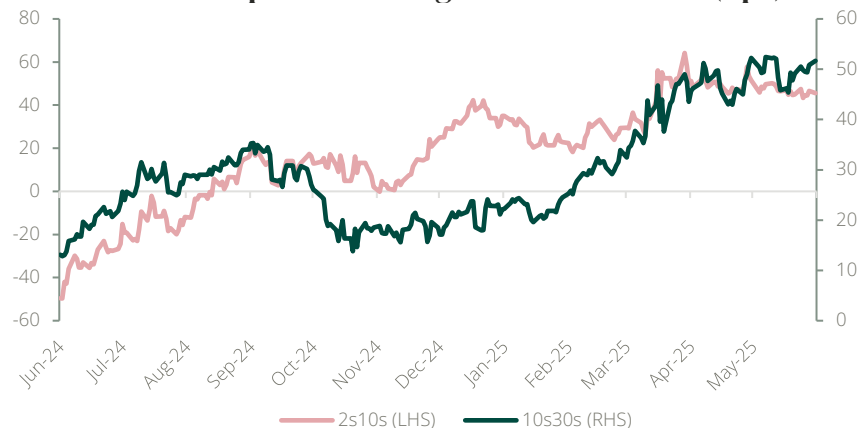


Chart takeaway: Market participants are scrutinising the US yield curve at any meaningful duration. Over the past 12 months, term premia between 2Y and 10Y bonds have increased, but so too have premia between the 10Y and 30Y bonds.

Our Investment Judgement

1. The outlook for long-dated government bonds has deteriorated, particularly in the US where scrutiny has become more heightened
2. We have reduced our TIPS duration from 8.5 years to 8 years
3. We continue to emphasise the belly of the curve (7-10Y) in our positioning, with long-end allocation focused on only the most convex bonds

1. 2s10s" refers to the spread differential between the 10Y and 2Y US government bond (10Y – 2Y), and "10s30s" refers to the differential between the 30Y and 10Y US government bond (30Y – 10Y).

Source: Bloomberg Finance LP.

Is private equity playing pass-the-parcel?

Private equity needs genuine exit activity for discounts to close

While property and infrastructure sectors have seen an increase in corporate action, **tackling discounts in the listed private equity sector could remain more challenging for some time.**

We think there are **three things to consider** for the sector to be attractive:

1. **Earnings growth** and margin expansion that support valuations;
2. Robust **capital allocation policies** with manageable commitments;
3. Increased **realisation activity** across sectors to enable these policies.

Leverage and multiple expansion were responsible for 61% of investment returns from the global private equity sector between 2010-2022. Starting valuations are high, and the majority of private equity debt issued since 2021 was unhedged and, hence, exposed to higher interest rates. Therefore future returns will need to be delivered from operational improvements. It will become tougher to squeeze more out of assets that, on average, have already been held for six years. However, even as holding periods exceed norms, average **earnings growth has been impressive** for listed private equity assets.

Investor pressure has led to a **notable improvement in policies** to tackle discounts. In practice, the **follow-through has been disappointing**, either restricted by the narrow definition of free cash available for buybacks or limited by the overcommitment of balance sheets to new fund commitments.

We will **need to see a meaningful pickup in M&A activity** both to validate valuations and to strengthen balance sheets. But global private equity distributions have fallen markedly, there is a **bottleneck for exits**. This has pushed funds to borrow more at the NAV level to return cash to investors and increased the reliance on secondary sales, more often structured as related party transactions between funds managed by the same firm. **This has improved the - otherwise dire - liquidity but is less good at providing reliable marks.**

In summary, stale valuations, higher financing costs and a greater requirement for operational improvements to generate returns increases our required rate of return.

Global Buyout Distributions and Asset Under Management¹

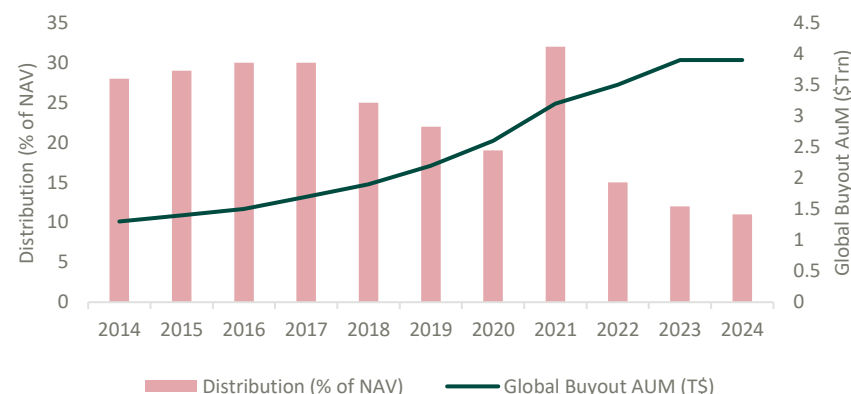


Chart takeaway: Private equity is struggling to return cash to investors as liquidity tightens, and new capital dries up



Our Investment Judgement

1. Capital allocation policies have improved to return more capital back to shareholders
2. Realisation activity from M&A to deliver on these policies has fallen short
3. We have decided to avoid the listed private equity sector in favour of property and core infrastructure where risk adjusted returns are more attractive

¹NAV is net of fund level debt and includes buyout, coinvestment, and coinvestment multimanager fund. AUM through June 2024;

Sources: Bain & company; McKinsey & Co.; ECB, Jefferies

Recent changes to multi-asset portfolio positioning

Portfolio Category	Asset Classes	Changes in Portfolio Positioning
 Dry Powder (34%) ¹	Cash, Treasury Bills & Short Duration Government Bonds Short investment grade credit Preference shares	<ul style="list-style-type: none"> Dry powder has increased by 2% to 34% of the portfolio While credit spreads remain at the narrow end of their range, we have seen some widening, and have taken advantage of attractive opportunities to increase this part of the portfolio to 11% (previously 9%)
Index Linked Bonds (38%) ¹	Sovereign inflation linked bonds UK, US and other developed markets	<ul style="list-style-type: none"> Allocation to index linked bonds remains at 38% We increased our exposure in UK index linked gilts to 15% (previously 9%), favouring allocation to the belly of the yield curve Over the quarter US TIPS have reduced from 28% to 22% of the portfolio, within which: <ul style="list-style-type: none"> 17% is allocated to unhedged TIPS where duration is 8.0 years. As with index linked gilts, our positioning favours the belly of the yield curve 5% remains allocated in short-dated hedged TIPS
 Risk Assets (28%)	ETFs Investment Trusts Non-investment grade credit Gold	<ul style="list-style-type: none"> Risk assets were reduced by 2% over the quarter against a backdrop of an expensive US market and a flurry of corporate action in the Investment Trust universe Two of our largest property positions (Empiric Student Property and PRS REIT) have recently announced that they have received bids which allowed us to reduce our overweight to these names against a favourable price backdrop We reduced our renewables exposure by 1% after a period of strong price performance Gold exposure was reduced to 1.0% of the portfolio

¹) Data refers to Capital Gearing Trust. Weighting to index-linked bonds in CG Absolute Return Fund is 35% (with 36% in dry powder)

Asset Valuations and Investor Behavior Summary

Asset Class Valuations and Summary

	UK	US	Japan	Europe
Investment Trust Discounts	Attractive			
Equity markets	Fair	Unattractive	Fair	Fair
Short Government Bonds	Fair	Fair	Unattractive	Unattractive
Long Index Linked Bonds	Attractive	Attractive	Unattractive	Unattractive
Currency	Base Currency	Fair	Attractive	Unattractive
Credit	Unattractive	Unattractive		
Investor Behaviour	Fair	Unattractive	Attractive	Fair

CG View
Wide discounts remain attractive alongside a variety of engagement opportunities and a backdrop of increasing corporate activity for both conventional and alternative trusts
CAPE: UK (15), US (36), Japan (22), Europe (21) US equity markets looking vulnerable combining elevated valuations and negative momentum
UK T-Bills offer a risk free 4.2% return and short JGBs are attractive, specifically when hedged back to GBP
Both the US and UK index-linked bonds look attractive, particularly at the belly of the curve
Yen is still attractive but faces near-term headwinds from potential tariffs, weak growth and stronger competition from Europe and China
Although credit spreads have widened, they remain historically narrow against a weakening macroeconomic backdrop, particularly in the US
Investor sentiment has been reinvigorated in the US with valuations close to record highs. This is despite the backdrop of policy uncertainty and a concerning economic outlook. Shareholder engagement and corporate reforms in Japan have proved constructive

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