CG INSIGHTS

Quarterly perspectives from the CG team

Q2 2026

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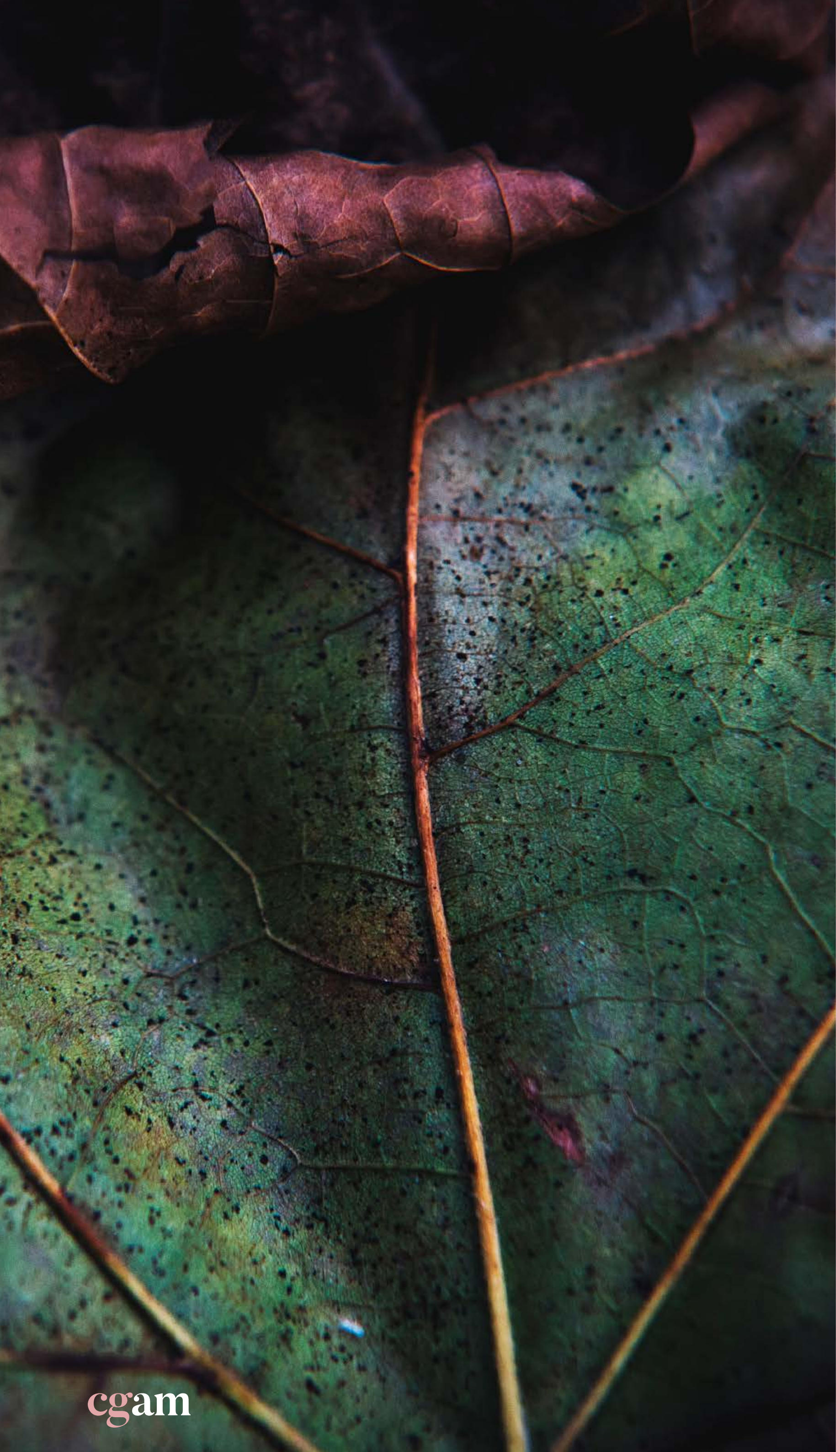

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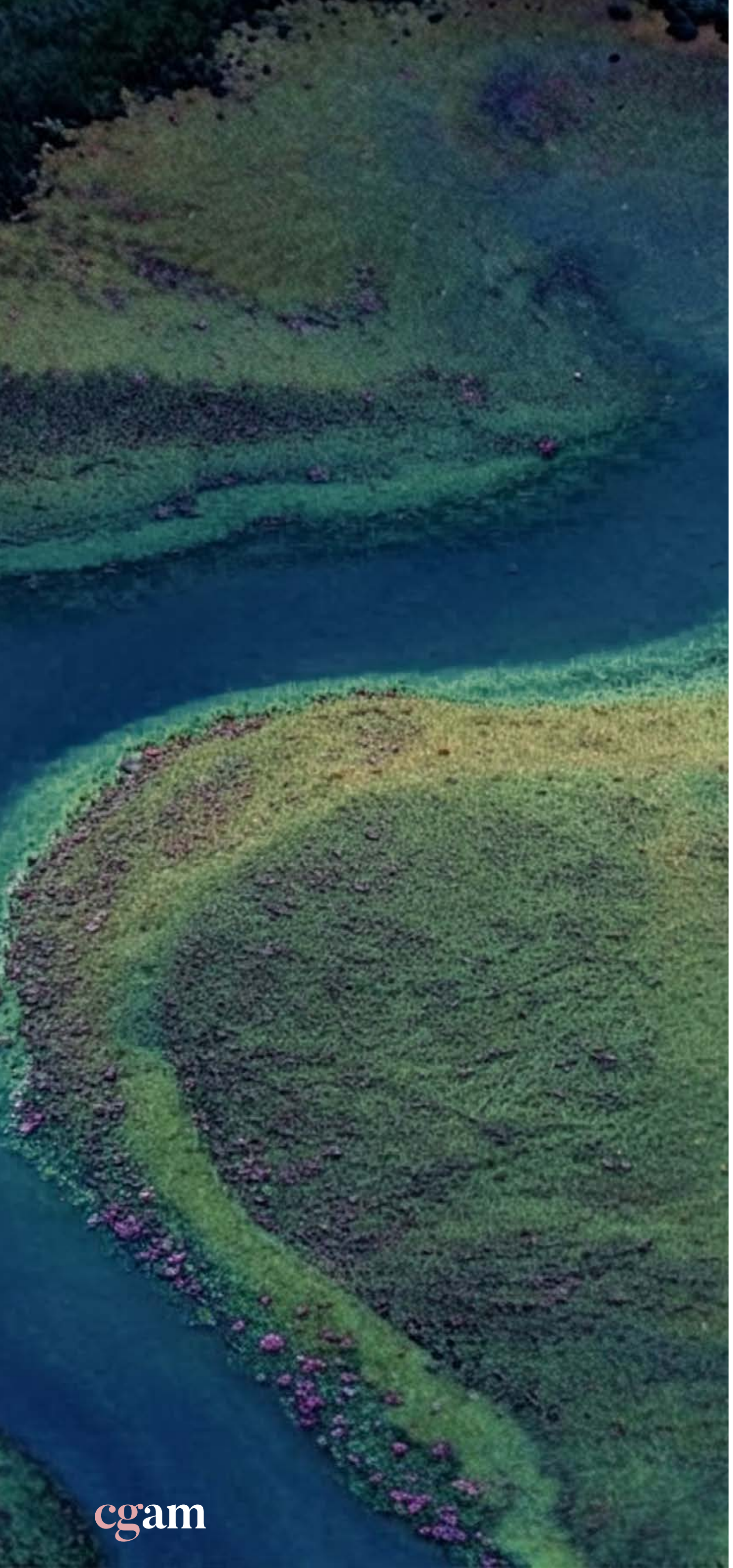


The Beginning of the End

2025 was the year of the debasement trade. This particular trade involved selling US Treasuries and using the proceeds to buy gold. The rationale for this was that successive US governments had undermined confidence in the US dollar as the global reserve currency. This started when the Biden administration effectively cut Russia out of the US dollar system following the Russian invasion of Ukraine. This act sent a message to all eastern-aligned central banks that they could no longer rely on their continued ability to settle transactions and manage exchange rates using US dollar assets. It then continued under the Trump administration, where a general shift towards protectionism was paired with specific threats to undermine the value of US assets held by foreigners – for example, Stephen Miran's proposal not to pay interest on foreign-held Treasuries, and Trump's stated desire to depreciate the US dollar.

This ran alongside a fear that the US was also going to run monetary policy which kept interest rates artificially low – another of Trump's stated preferences – and hence sustain elevated rates of inflation into the future. Gold, by contrast, was seen to be an asset which would maintain its value against inflation, could be swapped or sold in a crisis, and had the advantage of not being a claim on an increasingly indebted government which might change its attitude to foreign holders on a whim.

At the beginning of this year, the debasement trade began to unravel. After the outbreak of war in Iran, energy prices and inflation expectations increased rapidly: a genuine inflation shock. But while the US dollar rallied, receiving the bid in a risk-off environment, the behaviour of the price of gold appeared to correlate with the Nasdaq. Far from a safe haven, gold behaved as a risk asset. The final blow to the debasement trade has – perhaps surprisingly – been the appointment of Kevin Warsh as Fed Chair. Originally thought to be a Trump loyalist appointed to lower interest rates, his first press conference showed the opposite: a strongly expressed desire to defeat inflation. We may be entering a new era: higher short-term interest rates in the US, a strengthening dollar, and a much weaker gold price. We have recently exited our small gold holding and will watch with interest!

Curiouser and curiouser

UK politics is not short of material for gilt markets

Keir Starmer is now the sixth UK Prime Minister to resign in the past decade. The recently-elected Makerfield MP Andy Burnham (better known as "King of the North") is odds-on to succeed Starmer. On the whole, gilt markets reacted positively to the news. The reason cited was that the developments reduced the extent of UK political uncertainty.

This is a curious position to take because it begs at least as many questions as it answers – particularly around the fiscal stance of a Burnham-led government. Famously, Burnham made the comment that "we've got to get beyond this thing of being in hock to the bond market". Unsurprisingly, this made markets jittery. Burnham subsequently said that he would keep to the fiscal rules. But he has also said that he would build more council housing, increase defence spending, and nationalise key industries such as water and rail transport. While there might be some job creation as a byproduct to this – reducing the welfare bill – it is difficult to see this set of policies as anything other than more expansionary than the current stance.

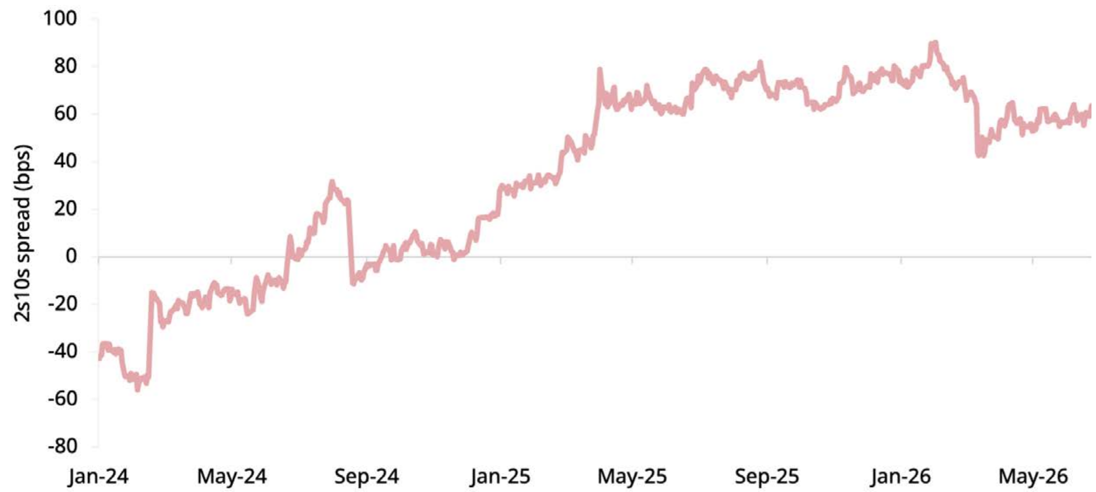
Supposing that Burnham does stick to the fiscal rules, the question becomes how he finances the additional spending. One option is to raise taxes, and one of the main policies cited is to levy a wealth tax of some form. The impact should be analysed with caution as short-term revenue-gathering may translate to longer-term capital flight, and lower growth. The other option, employed by the current chancellor, is to kick the can down the road by increasing spending now, and then promising fiscal contraction later in the five-year horizon of the current fiscal rules.

There is no obvious way to take gilt markets out of this short-term straitjacket. Costlier economic policies imply higher gilt issuance and higher long-term interest rates. The impact may be offset by more taxation – however, as taxes are already a well-cited cause of capital flight from the UK, ill-chosen taxes may over time widen the UK's fiscal deficit through lower growth. While markets may currently feel a sense of relief that some uncertainty has been resolved, looking further ahead, the fiscal dynamics point to a risk of further gilt curve steepening. The challenging gilt market outlook also has the potential to weigh on the value of sterling. Our positioning remains defensive, but as ever, we look on with a mixture of caution and curiosity.

Chart takeaway: In the chart, term premium is measured by the UK 2s10s spread, which is the difference between the 10-year gilt yield and the 2-year gilt yield. Term premium compensates for uncertainty in interest rate and inflation expectations, in part a function of confidence in the UK government's fiscal policies.

1) Source: Bloomberg Finance LP.

Term Premia in the Gilt Market Have Been Rising



Our Investment Judgement

1. The overall stance of fiscal policy will remain expansionary. We expect this to support continued inflation, given the supply-constrained nature of the UK economy. Because of this, we prefer to hold our gilt allocation in inflation-linked gilts over conventionals.

2. The exact path that fiscal policy will take is not clear. But the most foreseeable paths point to higher fiscal deficits – through a combination of higher borrowing and/or lower growth. As a consequence, we continue to favour short duration in index-linked gilts (c. 5 years), given the risk of further curve steepening.

3. There is also a risk that sustained elevated borrowing and weak growth weigh on the value of sterling. Accordingly, we have reduced the sterling exposure in our multi-asset funds to c. 60%.

When margins masquerade as moats

"The key to investing is determining the competitive advantage of any given company and, above all, the durability of that advantage." – Buffett.

With profit margins now more extreme than during the dotcom boom, determining the durability of a company's advantage becomes increasingly difficult. Recent equity market strength has been driven largely by the profitability of semiconductor manufacturers, with the NYSE Semiconductor Index rising 80% in the past three months. Micron's recent results boasted profits 15x greater than the same time last year, with a gross operating margin of 85%, and now commands a larger market capitalisation than Berkshire Hathaway. SK Hynix and Samsung Electronics have also become trillion-dollar companies, and Kioxia has emerged as Japan's most valuable listed company after a remarkable 3500%+ rise in the last year.

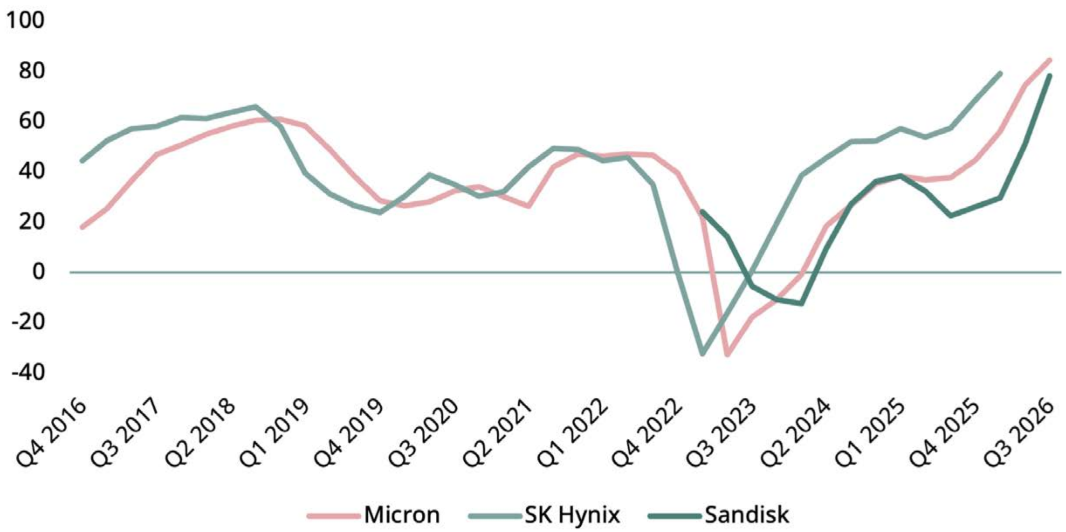
However, a capitalist system does not allow a large number of companies in the same industry to be extremely profitable.
High margins attract investment, encourage substitution, and drive competition. Semiconductor manufacturers are expected to invest over $1 trillion in new fabrication facilities this decade, dramatically increasing supply, while hyperscalers have started to create their own custom-built chips to reduce reliance on incumbent suppliers. Microsoft's Maia, Amazon's Trainium, Google's Ironwood and Meta's MTIA are all early indications that when suppliers earn supernormal profits, customers can become competitors.

The current bull rally has permeated into every part of the equity market, leaving investors more exposed than they likely appreciate.
It is the highly profitable semiconductor stocks that have launched the remarkable run in emerging markets. The Taiwanese and South Korean stock markets are up 60% and 101% in 2026. Previously 'cheaper' markets, such as Japan, are now closely integrated to AI demand with their largest two companies being Kioxia and SoftBank. Even value and small caps indexes have been assimilated into the theme. The MSCI USA Enhanced Value Index's biggest weighting is Micron, representing 24% of the portfolio, and Sandisk is 2.2% of the MSCI Global Small Cap Index, almost 10x the next largest company (TechnipFMC at 0.26%).
The current cycle may be stronger and last longer, but cycles don't just disappear.
To determine if these semiconductor memory manufacturers have real moats, they will need to maintain a monopolistic position throughout a variety of market cycles.
If they don't, it will be hard to hide from a dramatic re-rating across the entirety of the equity market.

Chart takeaway: As we see the demand for semiconductors explode in the current 'super cycle', profit margins for these companies are now at historic levels. However, back in 2023, we saw the same companies produce negative gross margins. The turnaround in fortune has been staggering. Whether these margins prove sustainable will have important implications for equity valuations across the globe.

1) Source: Bloomberg Finance LLP.

Semiconductor Gross Margins Have Historically Been Cyclical



Our Investment Judgement

1. A handful of semiconductor stocks have permeated throughout global equity markets. Investors need to be aware of their exposure to this historically cyclical asset class and recognise that any change to the current demand dynamics will extend across equity markets. We remain vigilant about conventional equity exposure in our portfolio, which is at a historic low (14%).

2. Following the recent rally in semiconductors, we have been taking profits in some of our emerging market trusts with exposure to this asset class. We have been reinvesting into less concentrated collectives to maintain our exposure and still see interesting opportunities in the UK closed end fund market.

3. The monopolistic position of the current market leaders is not set in stone. Members of the so called 'Mag 7' are creating their own in-house capabilities as a response to record profit margins. We favour a diverse range of equity holdings with a particular focus on the UK and Japanese markets.

Backdoor money printing

Consequences of increased financial sector participation in the treasury market

US government debt has been exploded over the past five years. Overseas buyers have turned cautious, the big foreign holders of US debt (Japan & China) have actually reduced their holdings over that time frame.
Who's taken up the slack? By definition, it has been the US domestic sector: households, government entities, insurers and banks. It is this last group, the banks, that have been doing much of the heavy lifting.

When a government borrows money it can do one of two things. It can print the money it borrows which expands the money supply. This approach is usually both stimulative to the economy and inflationary. Alternatively, the government can issue a bond. If the buyer is a household, the effect is much less stimulative because the household's money balances have decreased by the same amount that the government's have risen.

If, however, the buyer of the new bond is a commercial bank (or a hedge fund buying the bond with leverage from a commercial bank), the effect is more nuanced. The bank purchases the bond and simultaneously a deposit is created at the treasury general account at the Federal Reserve.
The government quickly spends this and it reappears as a deposit in the commercial banking system. This is functionally equivalent to "fountain pen" money. This deposit arising from credit creation has the effect of expanding the money supply, and is much the same as if the government had printed the money itself.

For as long as the US continues to run large financial deficits, and they are absorbed by the financial system, we think it is highly unlikely that the US will sustainably achieve its inflation targets.

Our Investment Judgement

1. 3% is the new 2% - for now we don't see inflation coming sustainably to target.

2. Fiscal policy is counteracting monetary policy. Monetary policy will have to be more restrictive than otherwise would be appropriate.

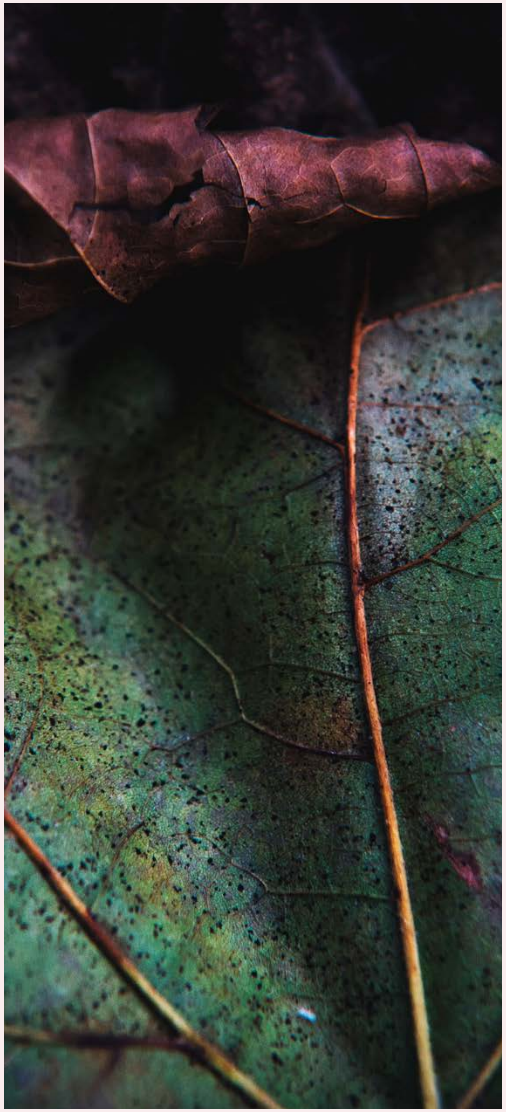
3. This risks steepening of the yield curve and informs our short duration.

Hedge Fund Repo ($bn)

Chart takeaway: Hedge funds and Commercial banks are playing an ever-bigger role in the treasury market.

1) Source: US Office of Financial Research.

Recent Changes to Multi-Asset Portfolio Positioning



PORTFOLIO CATEGORY	CHANGES IN PORTFOLIO POSITIONING
↓ **MANAGED LIQUIDITY RESERVE (29%)** [1] ASSET CLASSES Cash, treasury bills & short duration Government Bonds Short investment grade credit Preference shares	• The managed liquidity reserve has reduced by 3% over the period • Corporate bonds fell from 13% to 10% of the portfolio with limited opportunities to reinvest maturing bonds as credit spreads remained tight
↑ **INDEX LINKED BONDS (48%)** [1] ASSET CLASSES Sovereign inflation linked bonds UK, US and other developed markets	• Allocation to index linked bonds has increased by 2% over the period • UK index linked gilts remain at 20% of the portfolio and have been allocated to the belly of the yield curve, with a duration of 5.0 years • US index linked bonds have increased by 2% to 28% of the portfolio • Duration on the TIPS portfolio was kept short at 4.4 years due to concerns around increasing deficits and unsustainable government spending
RISK ASSETS (23%) ASSET CLASSES Investment Trusts ETFs Non-investment grade credit Gold	• Risk assets were unchanged over the quarter • Realisations from significant holdings in Impax Environmental Markets and RIT Capital Partners were offset by strong asset performance in Emerging Markets and Japan

1) Data refers to Capital Gearing Trust. Weighting to index-linked bonds in CG Absolute Return Fund is 45% (with 32% in managed liquidity reserve)

Asset Valuations and Investor Behavior Summary

PORTFOLIO CATEGORY	UK	US	JAPAN	EUROPE	CG VIEW
INVESTMENT TRUST DISCOUNTS	FAIR				Increasing corporate activity for both conventional and alternative trusts provide a favourable backdrop for investment opportunities, however discounts have narrowed.
EQUITY MARKETS	FAIR	UNATTRACTIVE	FAIR	FAIR	CAPE: UK (21), US (39), Japan (27), Europe (21) US equity markets valuations are at extreme levels with elevated risks of a significant correction
SHORT GOVERNMENT BONDS	ATTRACTIVE	FAIR	UNATTRACTIVE	UNATTRACTIVE	Short duration UK government bonds and short duration JGBs remain attractive, when hedged back to GBP
INDEX LINKED BONDS	ATTRACTIVE	ATTRACTIVE	UNATTRACTIVE	UNATTRACTIVE	Although concerns remain about the long-end of the yield curve, short dated US and UK index-linked bonds look attractive
CURRENCY	BASE CURRENCY	FAIR	FAIR	UNATTRACTIVE	Energy exports should continue to be a relative advantage for the Dollar. The Euro faces headwinds from trade competitiveness against both China and Japan
CREDIT	FAIR	UNATTRACTIVE			Credit spreads remain historically narrow, however, there are selective opportunities in very short Investment Grade credit without significant risk of widening
INVESTOR BEHAVIOUR	FAIR	UNATTRACTIVE	FAIR	FAIR	Despite geopolitical uncertainty, increasing deficits and a concerning economic outlook, US valuations remain close to record highs. Takaichi has proved constructive for shareholder engagement and corporate reform in the Japanese market

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