BAGGOT Investment Partners

General Update

OCTOBER 2023

We build and maintain portfolios for clients which address their specific needs

Baggot is a Central bank regulated investment manager. We specialize in designing and monitoring investment strategies that are built using global investment products and assets. Where almost all financial advisors and brokers would simply refer your business to a large external manager, in return for a commission, we use in-house expertise to actively manage your assets.

We offer Investment strategies across various risk profiles. In many cases, we build portfolios in-line with our client's specific needs (CGT focus, Income focus, etc.).

As a principle at Baggot, we do not charge upfront fees or expose our clients to lock-up periods. You can add or withdraw funds at any time and switch between strategies at no extra cost.

If you would like a review of your current investment strategy or to discuss future investment opportunities please contact us.

Call 01-699 1590

Peter Brown
Managing Director

CONTENTS

01.

Portfolio Performance

Before getting into our product returns it should be noted that return numbers include all charges, which is not the case for our peers. Our peers show you returns before taking account of all charges. If we reported our returns before accounting for all charges, our returns look significantly higher than our reported numbers.

BMA 4, our medium risk multi-asset product posted a return of 4.93% in Q3 bringing YTD returns to 6.9%. The benchmark Irish Life MAPS 4 posted a gain of 1.36% in Q3 bringing YTD returns to 6.39%. BMA 4 outperformed the benchmark by 3.57% in Q3 and 0.51% YTD. Looking further back, BMA 4 beat the benchmark by about 10% between January 2020 and the end of 2022. A three year period. Conservatively taking account of all charges and costs in the way we do at Baggot, BMA 4 would likely be somewhere in the ballpark of 15% outperformance during the prior three year period. An astonishing level of outperformance for a medium-risk portfolio strategy.

BMA 5, our multi-asset product with a medium-high risk profile posted 5.55% returns in Q3 bringing YTD returns to 10.25%. The benchmark Irish Life MAPS 5 posted a loss of – 1.2% in Q3 bringing YTD returns to 5.19%. BMA 5 has outperformed the benchmark by 6.75% in Q3 and 5.06% YTD.

After outperforming the benchmark by 11.4% in 2022, BMA 6, our multi-asset product with a high-risk profile, posted a 7.17% return in Q3, bringing YTD gains to 14.37%. The benchmark Irish Life MAPS 6 posted a loss of – 1.68% in Q3 bringing YTD returns to 7.2%. BMA 6 outperformed the benchmark Irish Life MAPS 6 by 8.85% in Q3. Since the start of 2022, BMA 6 has beaten the benchmark by 20.25%! That is not a typo.

BEI, our global equity income focused product (medium-high risk profile) lost – 1.21% in Q3, bringing YTD returns to 1.13%. The benchmark Setanta Equity Dividend Fund lost - 0.78% in Q3 bringing YTD returns to 2.2%. BEI underperformed the benchmark by - 0.43% in Q3. It has underperformed the benchmark by – 1.07% YTD. BEI generated 4.5% income and posted a total return of 5.23% in 2022 while most other equity investment products got buried.

BME, our higher risk profile equity focused product posted a gain of 9.3% in Q3, bringing YTD returns to 5.6%. The benchmark MSCI World lost - 0.97% in Q3 bringing YTD returns to 11.92%. BME outperformed the benchmark by 10.27% in Q3, however YTD it is still underperforming by - 6.32%. From a manager's perspective, if you want beat your benchmark on an annualised basis, you have to be willing to deviate strongly from it when you have conviction in your view. Keep in mind that BME outperformed the benchmark by 13.65% in 2022.

Before I move on, I'd just say that the five products mentioned would be our more popular investment products but we do have other investment products that have been tailored more to the specific needs of some clients which have all posted very competitive returns over the years. For any further information contact pbrown@baggot.ie.

02.

Market Returns Summary

Q3 Asset Class Returns

Asset class return numbers noted below are all based in Euro denominated terms. Data taken from unhedged (currency) European UCITs ETFs, which include costs as well as dividend payments.

For perspective when comparing returns, the EURUSD lost – 2.7% in value in Q3.

Equity Returns (Euro denominated returns)

Q3 Leaders

MSCI India, FTSE 100 and MSCI Japan.

Q3 Laggards

Euro Stoxx 50, German DAX and Euro Stoxx 600.

Q3/YTD Equities Performance

S&P 500

-0.9% / 13.6%

NASDAQ 100

-0.5% / 35.7%

Euro Stoxx

-4.9% / 13.1%

German DAX

-4.8% / 9.9%

Stoxx Europe 600

-2.1% / 8.7%

FTSE 100

1.4% / 8.1%

MSCI EM Asia

-0.7% / 2.2%

Vanguard FTSE EM

0.8% / 2.3%

MSCI China A Shares

-0.7% / -9.0%

MSCI Japan

1.1% / 11.9%

MSCI Word

-1.0% / 11.9%

MSCI Latin America

-2.0% / 13.6%

MSCI India

5.2% / 8.2%

MSCI Asia Pacific ex-Japan

-0.6% / -0.2%

Bond Returns (Euro denominated returns)

Q3 Leaders

EM Bonds, European Inflation Linked Bonds and European Investment Grade Ultrashort dated Bonds.

Q3 Laggards

Global Aggregate Bonds, 10+ Year Treasury Bonds and US Inflation Protected Bonds.

Q3/YTD Bonds Performance

US 10+ Year Treasury Bond ETF

-9.6% / -8.0%

German 10+ Year Bund ETF

-7.3% / -4.8%

EM Bond ETF

-0.2% / 1.5%

Europe Aggregate Bond ETF

-1.7% / 0.5%

US Inflation Protected Bonds

-0.3% / -0.3%

Global Aggregate Bond ETF

-1.2% / -1.5%

Europe Inflation Linked Bonds

-3.0% / 0.5%

Europe Investment Grade Ultrashort dated Bond ETF

1.0% / 2.3%

Q3 Precious Metals (Euro denominated returns): Q3/YTD

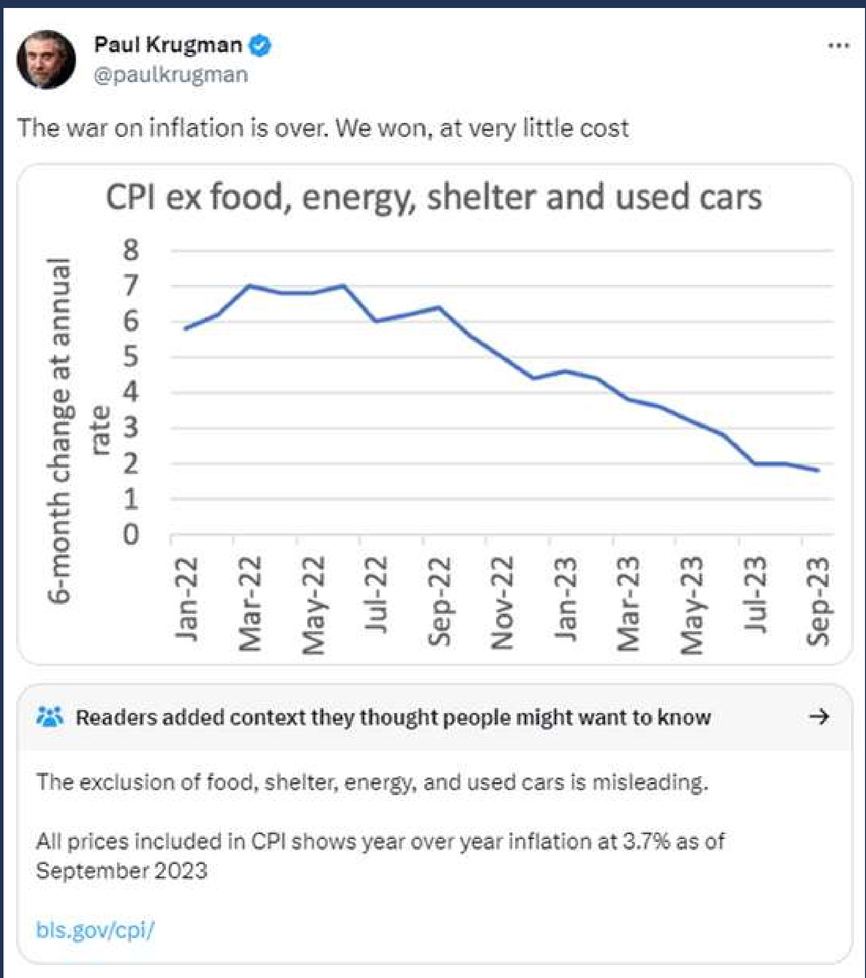
Gold

-0.5% / 2.8%

Silver

1.5% / -5.4%

We continue to be in this period of rising inflation and rising interest rates which is dominating all aspects of markets. It may seem odd that we are more focused on US inflation data and interest rate policy but it began its interest rate hiking cycle first and for the time being it is still the reserve currency of the world, so it has the greatest effect on the global economy. The US (FED) may be the first major economy where we see an end to rising interest rates. They have paused their hiking cycle but there is no indication that they will change course or begin cutting interest rates. Other central banks (including Europe) are still further behind in their paths. Before we get into the inflation topic, have a look at this priceless little political propaganda snippet;



Well I guess inflation doesn't really matter if you don't need to eat, travel or heat your home. What a laugh. Markets disagree with Krugman that the war on inflation is over and so do I.

The US was first into this rate hike cycle and we believe they will be first out, but given recent economic data we think it is also quite possible that we get stronger than expected inflation going forward and possibly a resumption of interest rate hikes. Why? Well take a look at recent economic data; we got hotter than expected CPI and PPI data (inflation data), better than expected Retail Sales data, better than expected Industrial Production data and better than expected Capacity Utilization data....All the experts have been calling for recession for quite a while now and it is just not happening. I don't have a crystal ball and maybe the slowdown will happen in the future. There are some troubled sectors, but generally speaking a recession is not happening yet. There may be some kind of economic contraction but it may not look anything like what we've grown accustomed to over the last 4 decades. It looks much more likely to be an inflationary period as opposed to a deflationary period. Bond markets are confirming this so far. You had a very temporary flight to safety bid in longer duration US treasury bonds and the US Dollar on the back of turmoil in the Middle East. Then over the next 48 hours, US 10 Year Treasury yields rose from 4.58% to 5.25% and the Dollar did something very peculiar. It fell. You got a hard reversal of the flight to safety trade in response to lots of strong economic data in the US. Importantly, Gold (another place where safe haven flows usually go during turmoil) did not reverse, it went higher. What was the market response to this? Commodity strength. Uranium, Oil & Gas, Metals, Mining, Gold, all the inflation trades went higher while all the interest rate sensitive stuff like Tech, Semiconductors, Utilities, Commercial Real Estate, went lower.

Will there be a recession or not? Who cares? Answering that question is not going to make you any money. The big question that matters is whether we will have an inflationary future or not. Everything already pointed to an inflationary future before you brought war-time spending into the mix. Every time I look at the news, Biden (and his European pals) are writing another $100 Billion cheque for war;

"WASHINGTON, Oct 17 (Reuters) - U.S. President Joe Biden may consider a supplemental request of about $100 billion that would include defense aid for Israel, Ukraine and Taiwan, multiple sources familiar with the request told Reuters on Tuesday."

Source: https://www.reuters.com/world/biden-considering-100-bln-funding-request-that-includes-israel-ukraine-aid-2023-10-17/

Did you see the bold part of that quote? Taiwan too. War is inflationary and it just went into hyper-drive! Not to mention this defense aid is funded by debt that is denominated in Dollars and Euros which has been weaponised. I'm not making a political statement here and I'm not standing up for Putin or Russia. I'm just stating important facts that affect the financial wellbeing of our clients....So Russia invades Ukraine and the West decides that they can confiscate Russian assets that are sitting in Western banks. Not only Russian government assets but it went further than that, they confiscated private Russian assets as well. The rest of the world took notice.

The Chinese, the Saudis, India, must be thinking – what do you mean you can confiscate my assets if you don't like what I am doing? I mean today it might be Russian assets you are confiscating because they went into the Ukraine, but tomorrow it could be another country (or citizens of that country) whose assets you seize because they aren't woke enough or because they don't have the same moral code as you. The US weaponised the reserve currency of the world. America consume many more goods and services from these countries than they export to them and consequently the US runs large trade deficits. Historically you buy stuff from China or Oil from Saudi (everyone needed Dollars to buy Oil, not just Americans), etc and they would take those Dollars and buy safe US assets (mostly US Treasury Bonds) with that money, thereby funding the US deficit. This ensured that there would always be demand for US debt. That game is ending. These countries are now setting up deals to exchange their goods and services to each other in their own currencies. This is really good for Emerging Markets (EM). Let's say you are India and you sell steel to Brazil in return for Brazilian Real. What do you do with the Brazilian Reals? You probably buy Brazilian Government Bonds. Now that is a very simplified example, but the point is, that these countries have taken notice. They do not like the weaponisation of western currencies and they are doing trade deals to cut Dollars (and other western currencies) out of the mix. I cannot stress enough how important of a change that is or how inflationary that is for the western world! Markets are starting to take notice as well. Just look at the difference in performance between Emerging Market Government Bonds and Western Government Bonds. It is staggering! Generic EM Government Bond ETFs are outperforming US Government Bond ETFs of similar maturities by nearly 10% this year! My favourite EM Government Bond Fund, the T Rowe Price Emerging Markets Bond Fund (Euro share class) has an average maturity of 10.9 years, so very similar to US 10 Year Treasuries or German Bunds in terms of maturity. This fund is up 3.58% YTD and 5.3% in the last 12 months. Meanwhile Western Government Bonds have been absolutely vaporized! What's even more interesting is that this fund has a risk profile of 3.

Risk Rating	Volatility Ranges	
	Equal to or above	Less than
1	0%	0.5%
2	0.5%	2%
3	2%	5%
4	5%	10%
5	10%	15%
6	15%	25%
7	25%+	

US 10 Year Treasuries used to have a risk profile of 2. Now, because volatility has increased so much in the last 2 years, the risk profile is US Treasuries are more like a risk profile of 5.

People forget that central banks only control the interest rate at the front of the yield curve. They do not control interest rates in longer durations. The market dictates interest rates in longer durations. The US and some other western nations are running huge deficits and have bitten the hand that finances them (via bond purchases) by weaponising their currencies. Now these buyers are not showing up at Government Bond auctions like they used to. How does this get compensated for by the Bond market? Interest rates at the longer end of the interest rate curve will ultimately have to rise to a level that sufficiently compensates the holder for taking the risk. That's how.

Now add into this tinder box the fact that Western governments are spending money they do not have, like crazy, during a time when we are not even remotely close to recession type conditions. If they are spending money like that now, what do you think they will do if we actually do have a recession? They'll spend twice as much money, they'll run even crazier deficits and if there is nobody to buy the bonds they'll issue to fund their reckless spending, they'll just ramp up the printing presses again. They'll do Quantitative Easing again – print money to buy their own bonds, which keeps longer term financing rates down, but also trashes the purchasing power of money. In our humble opinion, all roads in the west lead to inflation.

In my view it is much riskier to have lots of cash than it is to own commodities and hard assets because you have this finite supply of assets that are valued in infinitely printable currency which is getting printed in ever increasing volumes.

It's not all bad though. Government issued debt is a government liability, but that liability is someone else's credit. Think about it; Biden does the Inflation Reduction Act (Should have been titled the Inflation Increasing Act because that is what it does – it increases inflation). The estimated cost of this bill is $1 Trillion Dollars. Much of this money goes to climate change initiatives, which ends up in the private sector. This act is very supportive of the hard assets/commodities that will be needed to decarbonise the US economy. Never mind that it is a bit of a farce. $4 Trillion has been spent in the last decade on Solar, Wind and other green initiatives. During that same period the world has gone from being 83% dependent on fossil fuels to 81% dependent on fossil fuels! This was during a period of mostly benign inflation as well. If they had spent that money on nuclear power (zero carbon emissions) instead, energy costs would be significantly lower now and the world would be far less dependent on fossil fuels. I digress.....The point is that government liability (debt issuance) is a public credit and this public credit makes its way into corporate balance sheets, wages, commodities, etc and this creates opportunity for savvy investors.

03.
Bonds

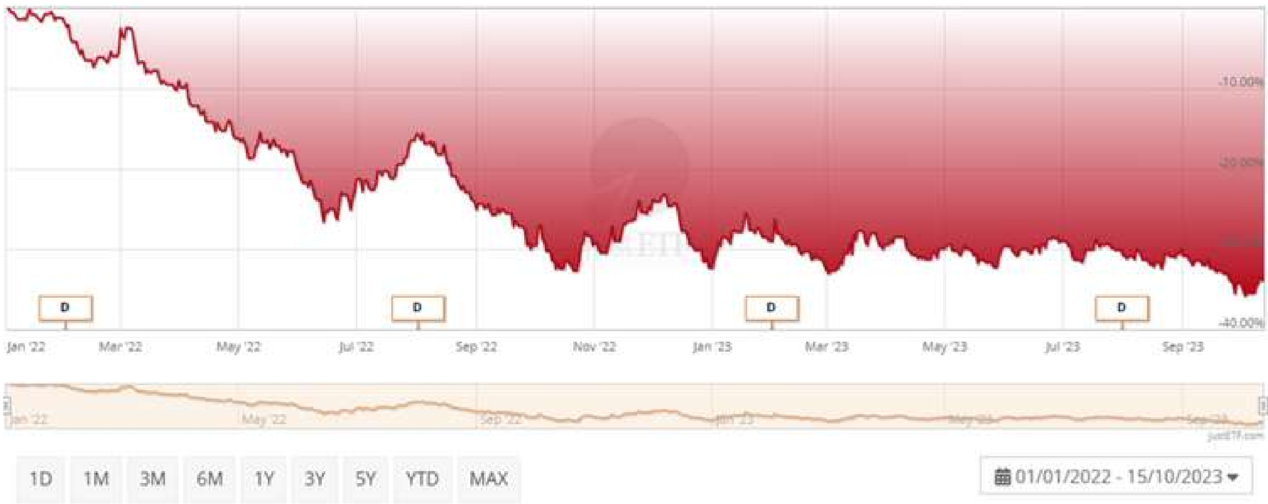
In our medium to low risk multi-asset products we have to hold euro denominated bonds in order to decrease the overall risk level of the investment product in question. In those investment products we have favoured investment grade, ultra-short duration bonds over long duration bonds, since before the rate hiking cycles began in the US and Europe. This is a stance that has served us very well. Our position has gained 2.6% this year while long duration bonds continue to implode.

For perspective, let's take a look. Since 2022 was the worst year in modern history for western government bond markets, we'll look at total returns (%) from Jan 2022 to current. The "D" at the bottom of the images shows where dividends have been paid. The % return does take account of these dividends in performance. Hence the term "total return".

Here's our position, the Ultra-short dated European Investment Grade (0 - 1 Yr fixed and 0 – 3 Yr floating rate);

For the period of 21.5 months, it has gained a total return of 2.08%. At the absolute worst point during the period, it was down - 0.93%. Performance bottomed right around the time the ECB began hiking interest rates in the autumn of 2022.

Here is the Bloomberg 10+ year European Government Bond ETF for the same period;



For the period of just over 21.5 months, it has had a total return of – 33.82%. At the absolute worst point during the period, it was down – 35.81%, on Oct 3, 2023 (just a couple weeks ago). That's the steep price you pay for doing irrational things (like lending governments money at negative interest rates).

This goes to show how important it is to be in shorter duration Bonds when central banks are hiking interest rates.

Here's our position from the start of 2023 to current;

YTD it has gained about 2.58%. Given we are now into Q4 and that interest rates are still rising, I'd expect total returns at year end for 2023 to be around 3.5% for the year. It isn't fully compensating us for inflation but our returns are catching up with the rate of inflation faster than anything else you can own in the Bond world and it sure as heck beats sitting on deposit with an Irish Bank earning 0.5%. Keep in mind these bonds carry a risk profile of one, the lowest possible.

At some point long duration bonds will be investible again, when real rates (the difference between inflation and interest rates) are sufficiently positive again. Until then (contrary to what western governments would have you believe with their ex-food ex-energy inflation reporting) there is absolutely zero incentive to take on the risk of lending money to governments or corporates on longer term time horizons. At this moment in time if we were going to move out the risk profile spectrum in the bond portion of our multi-asset portfolios, we would be looking at Emerging Market Bonds where real rates are high and inflation rates are generally coming down.

04.
Equities

From a longer term perspective we remain bullish on value equities. Particularly those with exposure to commodities. We continue to be bearish the Dollar and pretty much all other western world currencies, due to reckless fiscal policies and the weaponisation of the Dollar and other western currencies (which we've already spoken about in this piece). A weaker Dollar is usually good for global trade, so we continue to favour non-US equities, particularly Emerging Markets.

The group of stocks known as the "Magnificent 7" which includes Apple, Microsoft, Amazon, Nvidia, Alphabet (Google), Tesla and Meta (Facebook) makes up nearly 30% of the S&P 500 index. That group of stocks trades on an avg P/E ratio of 47! If you buy that group of stocks you are paying 47 years' worth of current earnings for it today. Paying a high price for something isn't always a bad thing. You have to look at the price of a company relative to its growth rate to see if there is any real value on offer or not. If you buy a company at 50x earnings but it is growing at 150% then it is cheap relative to its growth rate. If you pay 50x earnings for a company growing at 25% then it is expensive relative to its growth rate. India for instance, trades on a high valuation, but it's worth it because it is growing rapidly (By 2027 the IMF predicts that India will be the world's third largest economy).

Most pensions and other passive general investment schemes have their largest equity exposure in "Magnificent 7" stocks for no good reason. US equity indices have the largest market cap in the world, so they get the highest allocation for that one reason alone. Price is what you pay, but value, (or lack thereof) is what you get. When you pay a lower price for something, there is a higher margin of safety built into the investment.

Let's look at one example, of many. The MSCI Latin America trades on a P/E of 7.8 and pays a dividend yield of 7.2%, and let's not forget that inside a pension wrapper that dividend income accumulates tax free.

INDEX PERFORMANCE — GROSS RETURNS (%) (SEP 29, 2023) / **FUNDAMENTALS (SEP 29, 2023)**

	1 Mo	3 Mo	1 Yr	YTD	3 Yr (Annualized)	5 Yr (Annualized)	10 Yr (Annualized)	Since Dec 31, 1987 (Annualized)	Div Yld (%)	P/E	P/E Fwd	P/BV
MSCI EM Latin America	-2.27	-4.64	20.15	13.40	15.63	3.25	0.62	13.00	7.23	7.80	8.44	1.56
MSCI Emerging Markets	-2.57	-2.79	12.17	2.16	-1.34	0.94	2.45	9.35	3.08	14.12	11.55	1.59
MSCI ACWI	-4.10	-3.30	21.41	10.49	7.39	6.99	8.11	7.84	2.17	18.70	15.48	2.66

Source: https://www.msci.com/documents/10199/5b537e9c-ab98-49e4-88b5-bf0aed926b9b

The MSCI USA Index trades on a P/E of 22.9 and pays a dividend yield of 1.57%. We would much rather have exposure to Latin America than we would the US right now.

INDEX PERFORMANCE — GROSS RETURNS (%) (SEP 29, 2023) / **FUNDAMENTALS (SEP 29, 2023)**

	1 Mo	3 Mo	1 Yr	YTD	3 Yr (Annualized)	5 Yr (Annualized)	10 Yr (Annualized)	Since Dec 31, 1987 (Annualized)	Div Yld (%)	P/E	P/E Fwd	P/BV
MSCI USA	-4.69	-3.07	21.62	13.53	9.52	9.87	11.81	10.73	1.57	22.88	18.38	4.10
MSCI World	-4.28	-3.36	22.58	11.55	8.60	7.80	8.84	8.01	2.06	19.45	16.13	2.89
MSCI ACWI	-4.10	-3.30	21.41	10.49	7.39	6.99	8.11	7.84	2.17	18.70	15.48	2.66

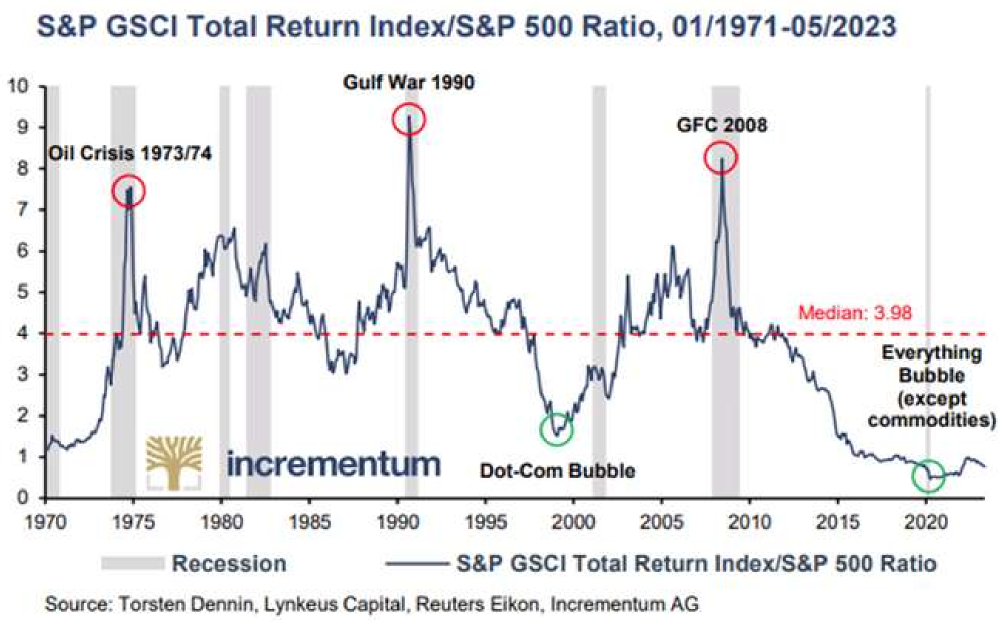
Source: https://www.msci.com/documents/10199/67a768a1-71d0-4bd0-8d7e-f7b53e8d0d9f

You basically get 3 units of the MSCI Latin America, for the price of one unit of the MSCI USA. There's also the added kicker that Latin America index has exposure to assets that tend to do well during inflationary environments. This is most certainly not the case for the big US indices.

5.
Commodities

Regarding commodities we remain broadly very bullish from a longer term perspective for a few reasons. Firstly, almost all commodities are exceptionally cheap relative to Equities and Bonds. The image below plots the price of commodities as measured against the US stock market going back to 1900. When it is rising, commodities are outperforming equities and when it is falling equities are outperforming commodities. See this from Incrementum's "In Gold We Trust" report (page 111);

"Now let's look at the performance of commodities relative to the stock market. Loyal readers know that the following chart has been by far the most-cited chart of the 'In Gold We Trust' reports in recent years. It impressively shows that the relative valuation of commodities compared to equities remains historically extremely cheap and has just stabilized at this historically low level over the past few years. Compared to the S&P 500, the GSCI Commodity Index (TR) has barely recovered from its historical low of April 2020, and it has not yet been able to break out of the phase of extreme weakness since 2015. The ratio currently stands at 0.87, which is miles away from the highs and still well below the long-term median of 3.98."



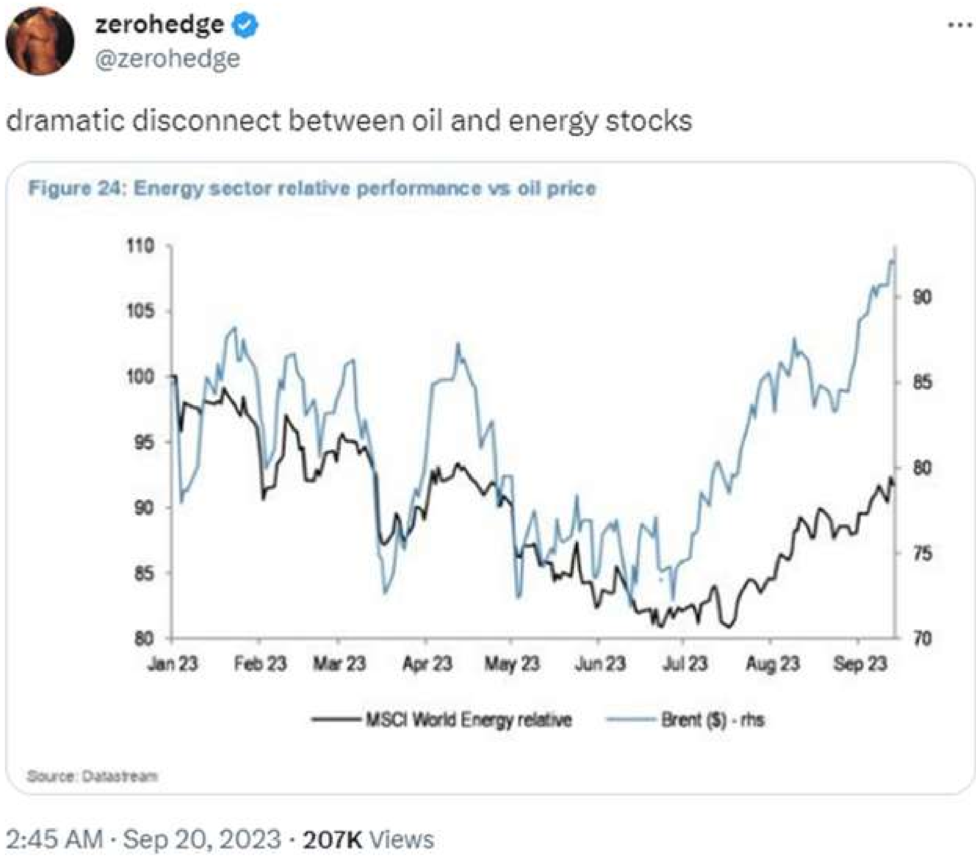
Source: https://ingoldwetrust.report/wp-content/uploads/2023/05/In-Gold-We-Trust-report-2023-english.pdf

Just because something is cheap does not mean it will rise in price but it does mean that you get a higher margin of safety built into the price. Secondly, the supply of a broad majority of commodities is constrained relative to longer term demand. Why? Because getting the stuff out of the ground is very capital intensive. Capital goes where it is treated best and before this interest rate hiking cycle began, nobody wanted to invest in capital intensive businesses when they could invest money in mega cap companies that could borrow money for nothing and use that money to buy back stock, synthetically driving stock prices higher. Before interest rates went up dramatically this phenomenon left many commodity companies out in the cold starved for capital. It takes years to turn a Copper, Cobalt, Nickel, Lithium, etc, deposit into a producing mine. You can't just press a button. There is a serious time lag. This virtually guarantees that there will be a shortage of supply of many commodities relative to demand in the coming years. Third, Dollar weakness is broadly supportive of commodities.

So what do we like in the commodity space? With commodities generally being as cheap as they are relative to other assets, we think it's a good time to have broad based exposure. Within the investment products we manage where commodity exposure is appropriate (risk rating), we've expressed our views via diversified commodity equity investment trusts and ETFs that benefit from CGT tax treatment. That said, we also have more targeted exposure in our multi-asset products to precious metals (portfolio insurance), uranium (nuclear is zero emissions & uranium is in very tight supply) and carbon credits (full government backing, in limited supply).

We feel really good about those three commodities for very different reasons but the one thing they all have in common is that they are not correlated to bonds and equities so they add true diversification.

We also love Energy companies right now because they're cheap even relative to Oil & Gas, they throw off excellent free cash flow and global demand is through the roof while supply is very constrained looking further out in time.



Contemplate on that image for a second. Commodities are very cheap vs Equities and the Energy sector is cheap vs Energy. It's a double whammy of value.

6.

Conclusion

To conclude, we remain confident in the way our portfolios are constructed. Our multi-asset portfolios provide true diversification when you really need it, in an uncertain world.

Please do let us know if you wish to discuss your portfolio at any time.
We appreciate your faith and trust in us.

Kind regards,
David Flynn
Chief Investment Strategist and Director

If you would like a review of your current investment strategy or to discuss future investment opportunities please contact us.

pbrown@baggot.ie

or call 01-6991590

BAGGOT
Investment
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