Auscap Newsletter

Auscap Long Short Australian Equities Fund

JANUARY 2021

AUSCAP ASSET MANAGEMENT

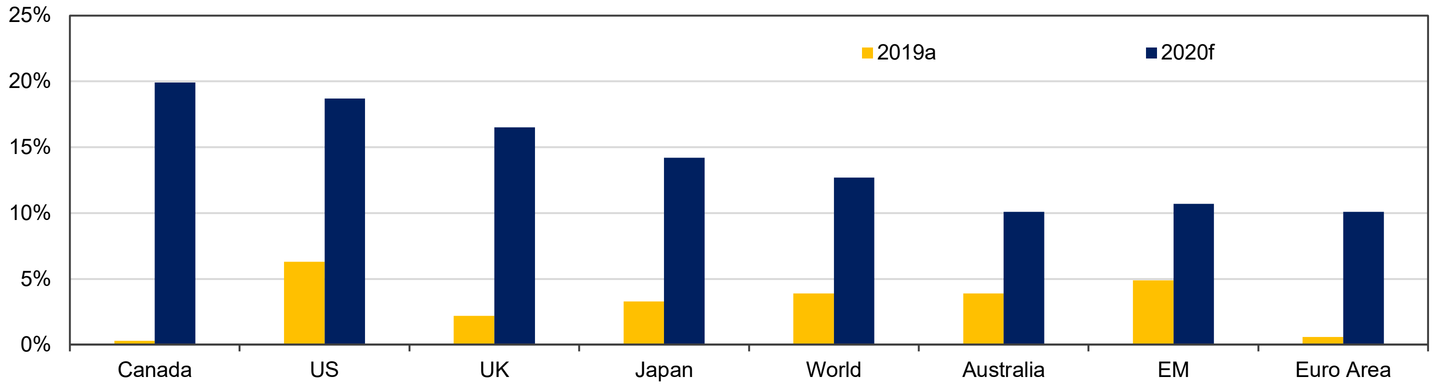
Auscap Asset Management

The Cost Of Carrying Cash

Many investors realise that there is a cost of carrying cash. It is the opportunity cost associated with returns foregone if the cash were invested elsewhere. However cash also provides optionality, such as when a market dislocation creates an opportunity to invest at distressed prices, and cash provides liquidity, a means of buying goods and services if you have an unexpected reduction in income. Cash is considered a safe asset, but over time the cost of holding cash can vary considerably. When assets are cheap, and interest rates are low, the opportunity cost of holding cash can be very high. Ironically these are the points in time when cash holdings tend to increase. By contrast, the cost of cash can be very low when asset prices are high and interest rates are rising, with higher interest rates making the cost of holding cash lower and high asset prices reducing prospective asset returns and increasing the value of the optionality cash provides.

The amount of money in circulation is also an important consideration. The real value of assets to their owners does not change materially from day to day. If the amount of fiat currency in circulation increases dramatically, we should logically expect that the value of the assets in cash terms should increase *ceteris paribus*. In these circumstances it is not necessarily the real value of assets that is rising, but the fact that the value of cash is declining. As a result of COVID-19, these considerations are becoming increasingly important given the increase in money supply occurring across the world, action that could be described as a broad debasement of fiat currencies.

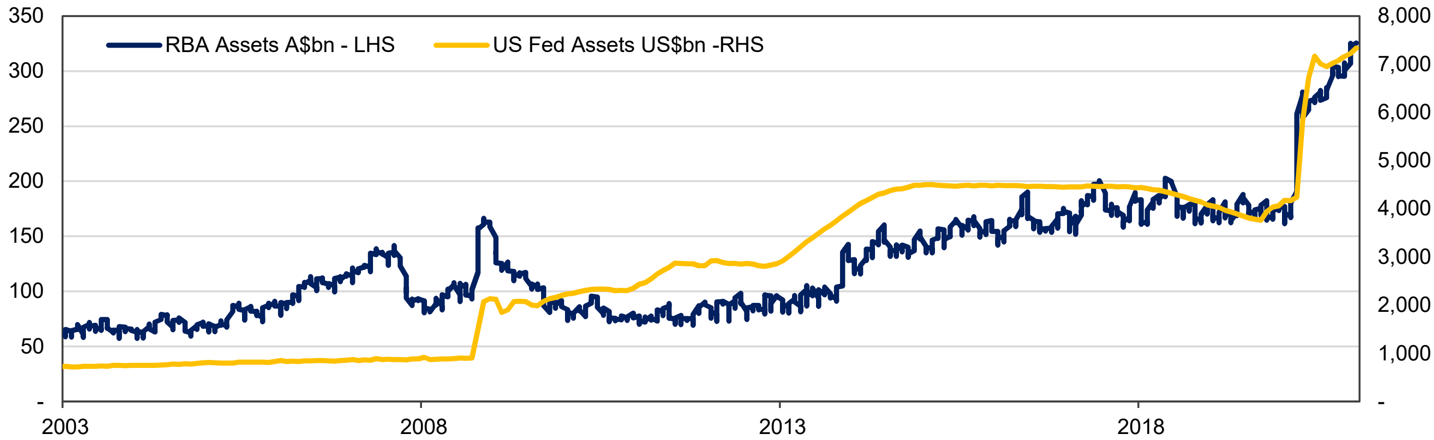
2020 General Government Fiscal Deficits (% of GDP)



Source: IMF as of October 2020, Auscap

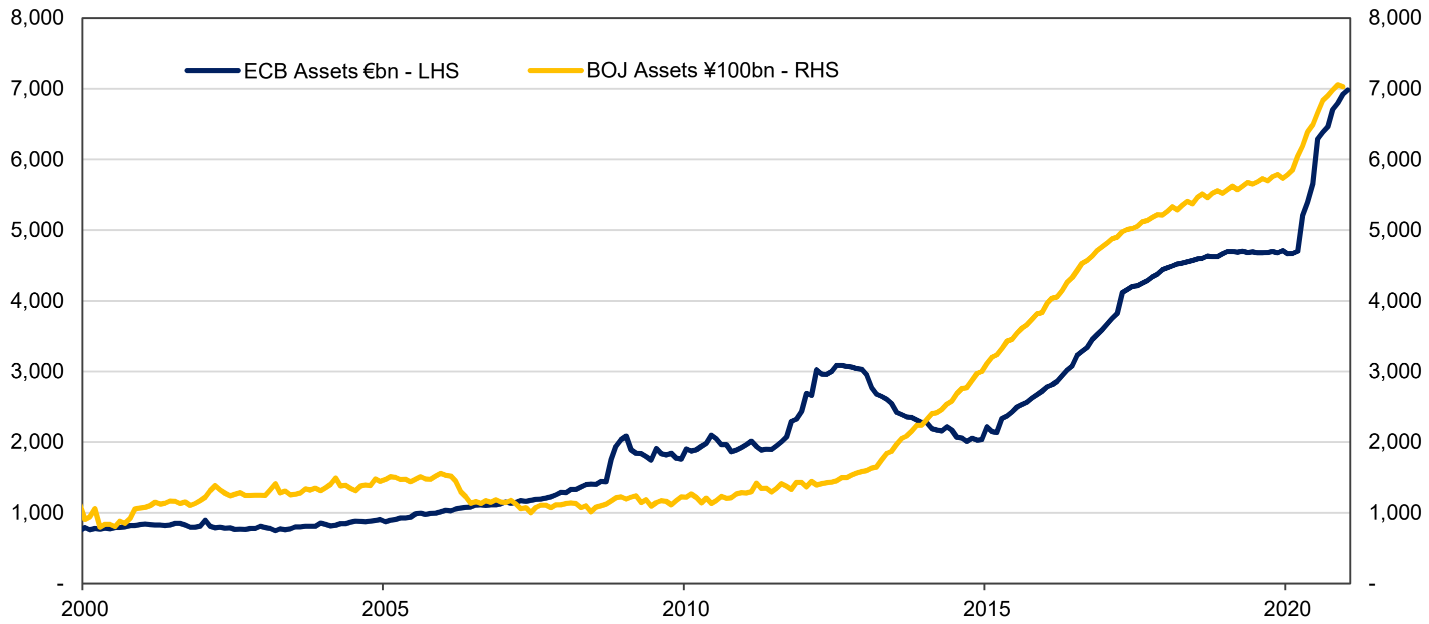
Governments around the world are running up far greater fiscal deficits as a result of the pandemic. These deficits are being enabled by low interest rates which reduce the cost of Government debt. This can be partly attributed to central bank quantitative easing programs which are designed to lower yields through asset purchases. The Reserve Bank of Australia has announced a three year yield target and a $100bn bond purchase program. Numerous other central banks have also announced large quantitative easing policies. As a result the value of assets held by central banks around the world has exploded since the onset of the pandemic.

Central Bank Assets



Source: Reserve Bank of Australia, US Federal Reserve, Federal Reserve Bank of St Louis, Auscap

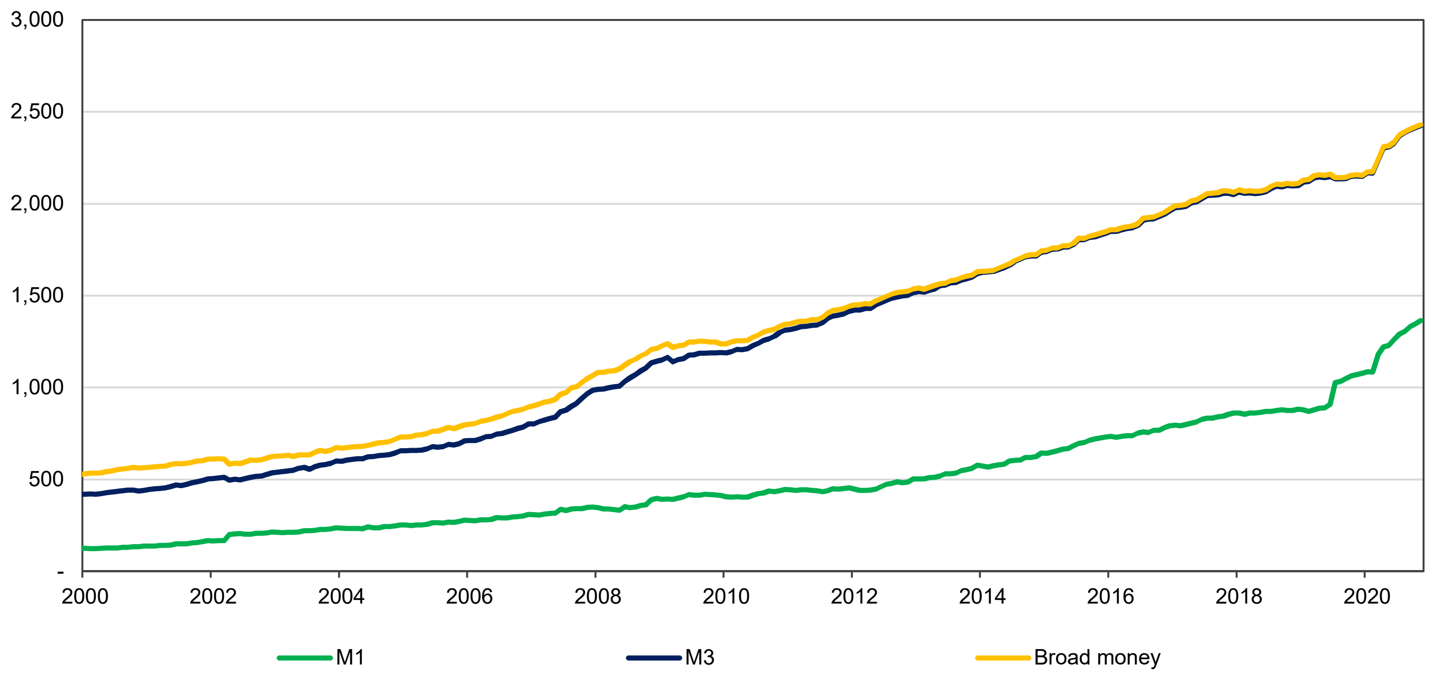
Central Bank Assets



Source: US Federal Reserve, Federal Reserve Bank of St Louis, Auscap

This has seen a sudden increase in money supply across the major economies globally. Broad Money is a measure of the amount of money in circulation in an economy[1]. In Australia, Broad Money has increased 11.8% between February 2020 and November 2020. This contrasts with annualised growth of 7.3% over the preceding 20 years, and growth of 3.0% in the year from March 2009 as the world emerged from the Global Financial Crisis.

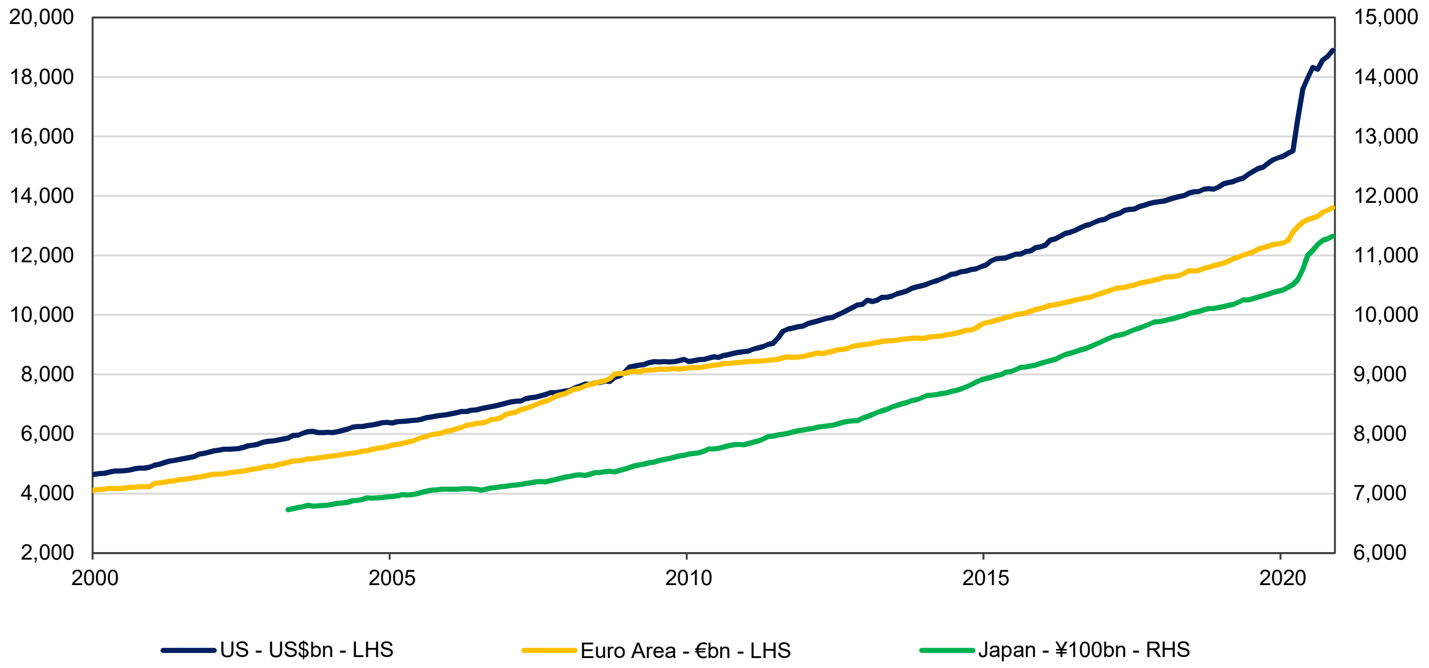
Australian monetary aggregates (A$bn)



Source: Reserve Bank of Australia, US Federal Reserve, Federal Reserve Bank of St Louis, Auscap

Over the same 9 month period M2, a measure of the amount of currency and short deposits in existence, has increased 22.5% in the United States, 8.9% in Europe and 8.2% in Japan. This compares to annualised growth rates in these regions of 6.0%, 5.4% and 2.8% in the prior 15 years.

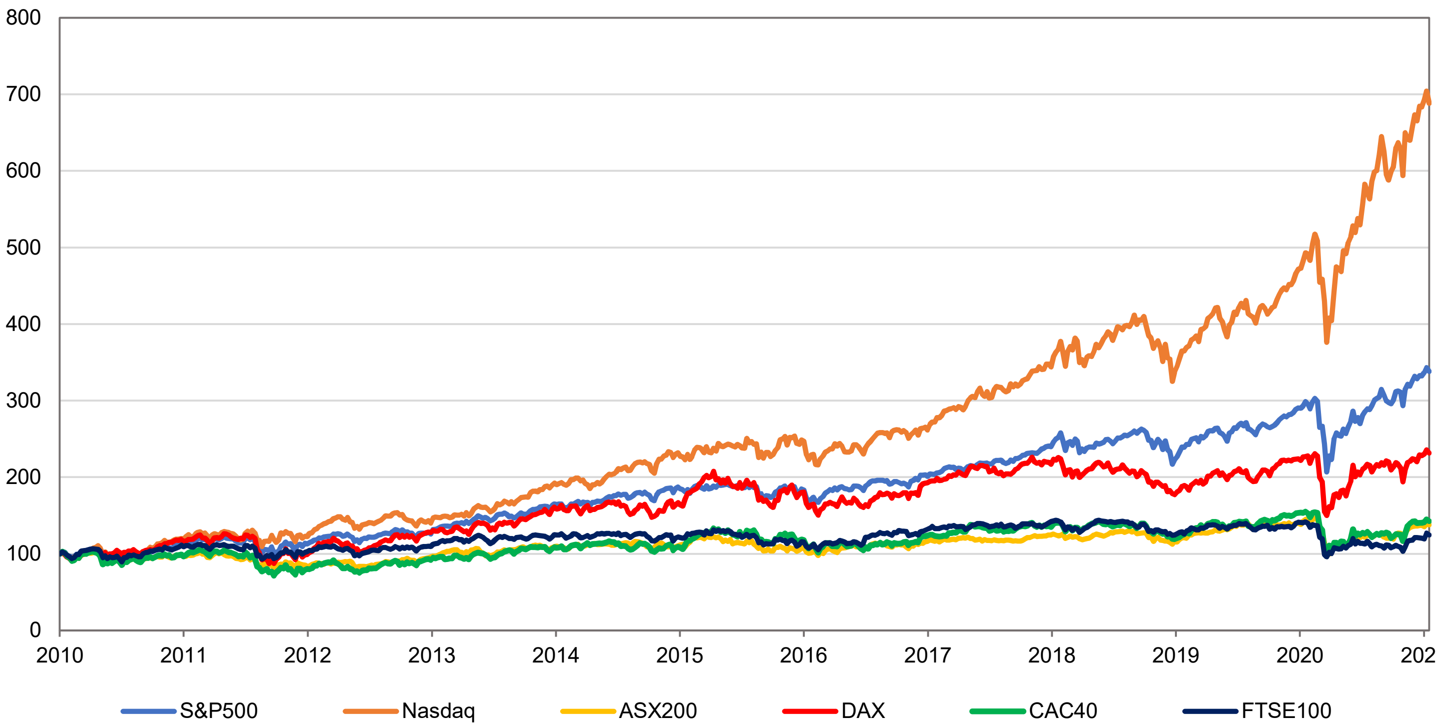
M2 by region



Source: US Federal Reserve, Federal Reserve Bank of St Louis, ECB, Auscap

It leads to an interesting question: to what extent is the global rally in markets simply recognising the diminished value of fiat currencies? Cash could well be an expensive asset to hold in a money printing world. Everyone is familiar with the recent performance of equities markets, despite the fact that there are still some wounds on the global economy from the COVID-19 crisis.

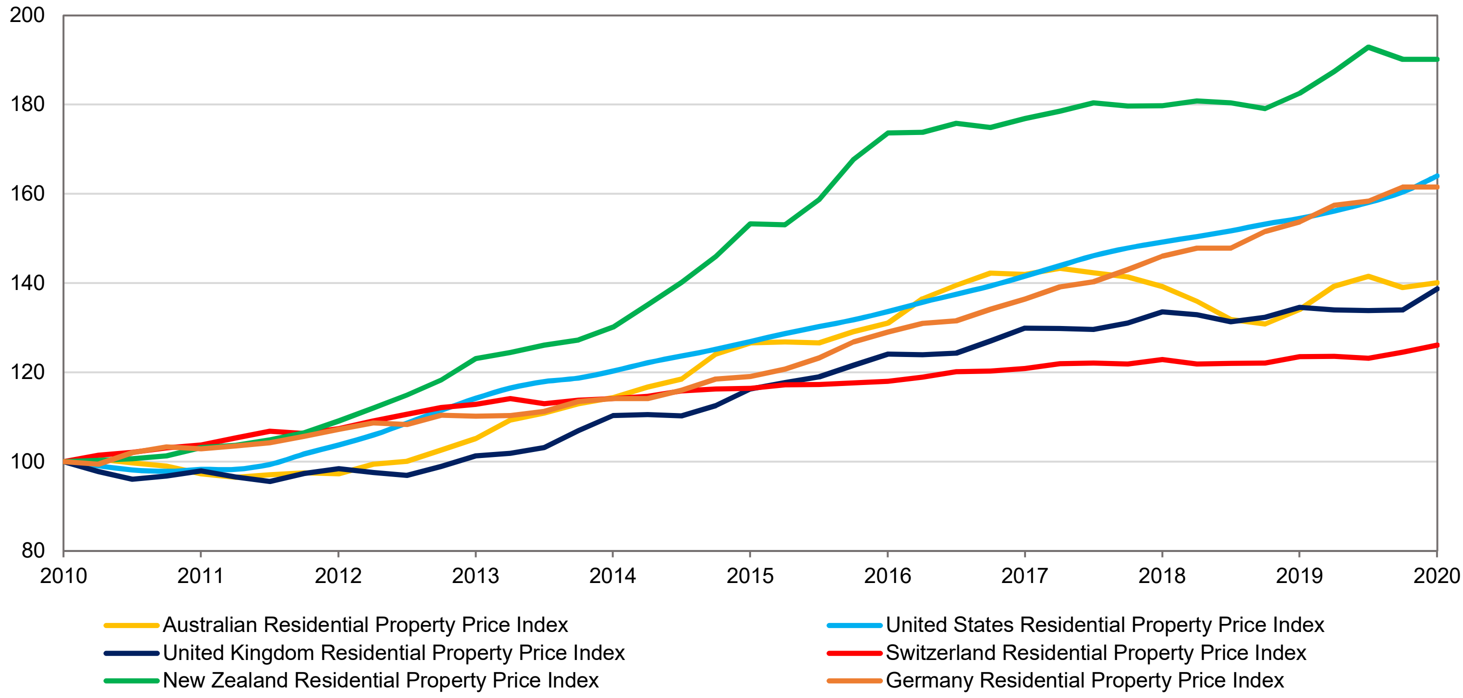
Select Global Indices (Rebased to 100 on 1 January 2010)



Source: Bloomberg, Auscap

But equities markets are not the only asset class to be experiencing appreciation. We have seen continued increases in global residential property markets at the exact time most commentators expected property price declines.

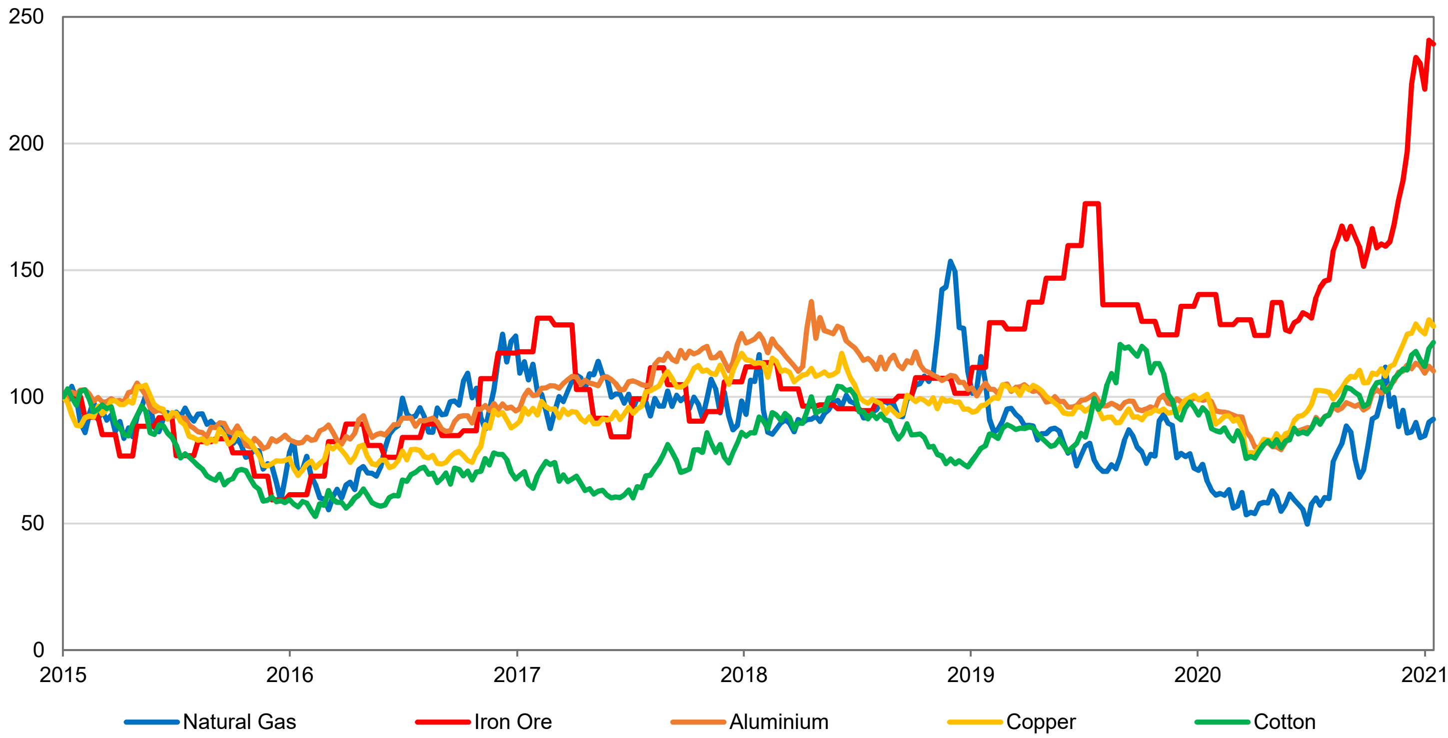
Select Residential Property Indices (Rebased to 100 on 1 January 2010)



Source: Bloomberg, Auscap

Industrial commodities are surging. Iron ore is at the forefront of this as construction demand for steel lifts as a function of co-ordinated global stimulus driving infrastructure and property development.

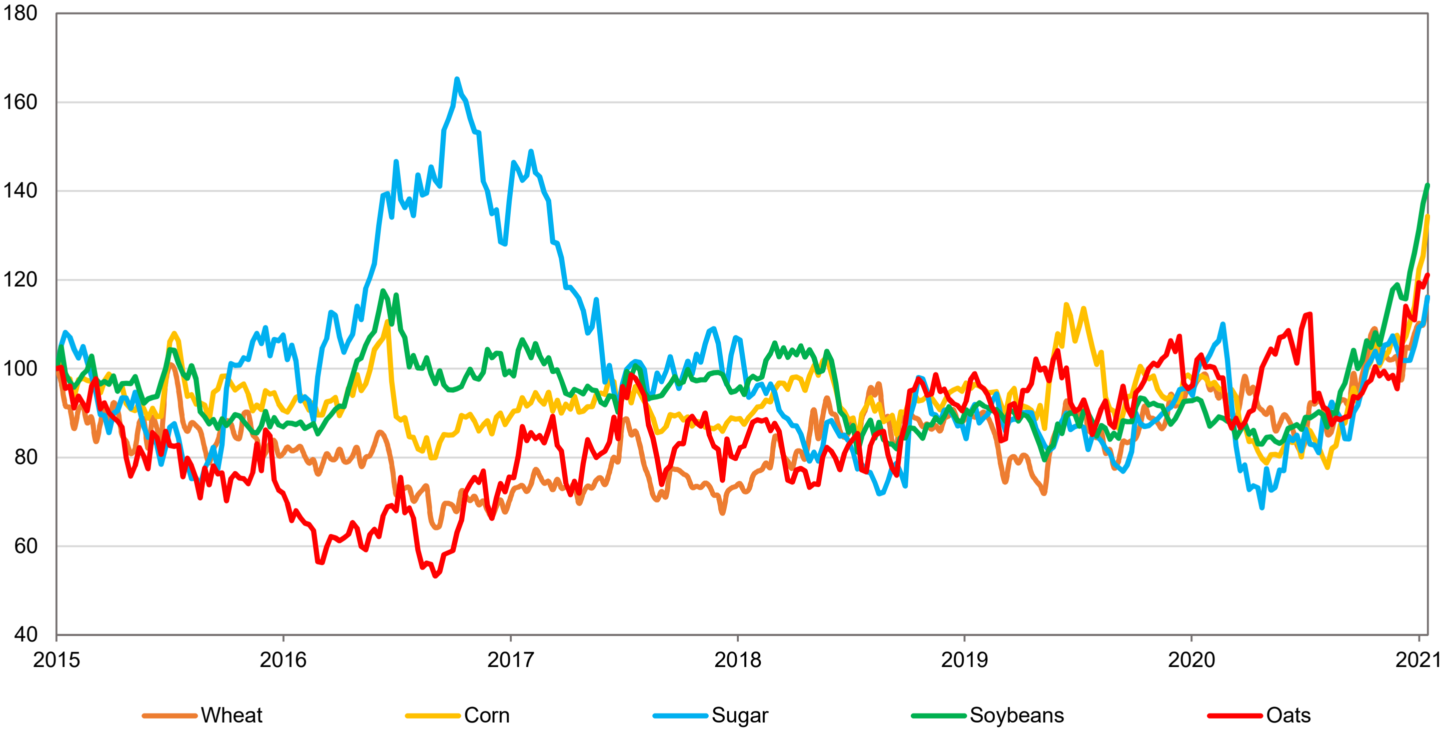
Select Commodity Prices (Rebased to 100 on 1 January 2015)



Source: Bloomberg, Auscap

Many agricultural commodities are also rising, pointing to food inflation. The UN Food and Agriculture World Food Price has risen 6.5% in the year to 31 December 2020.

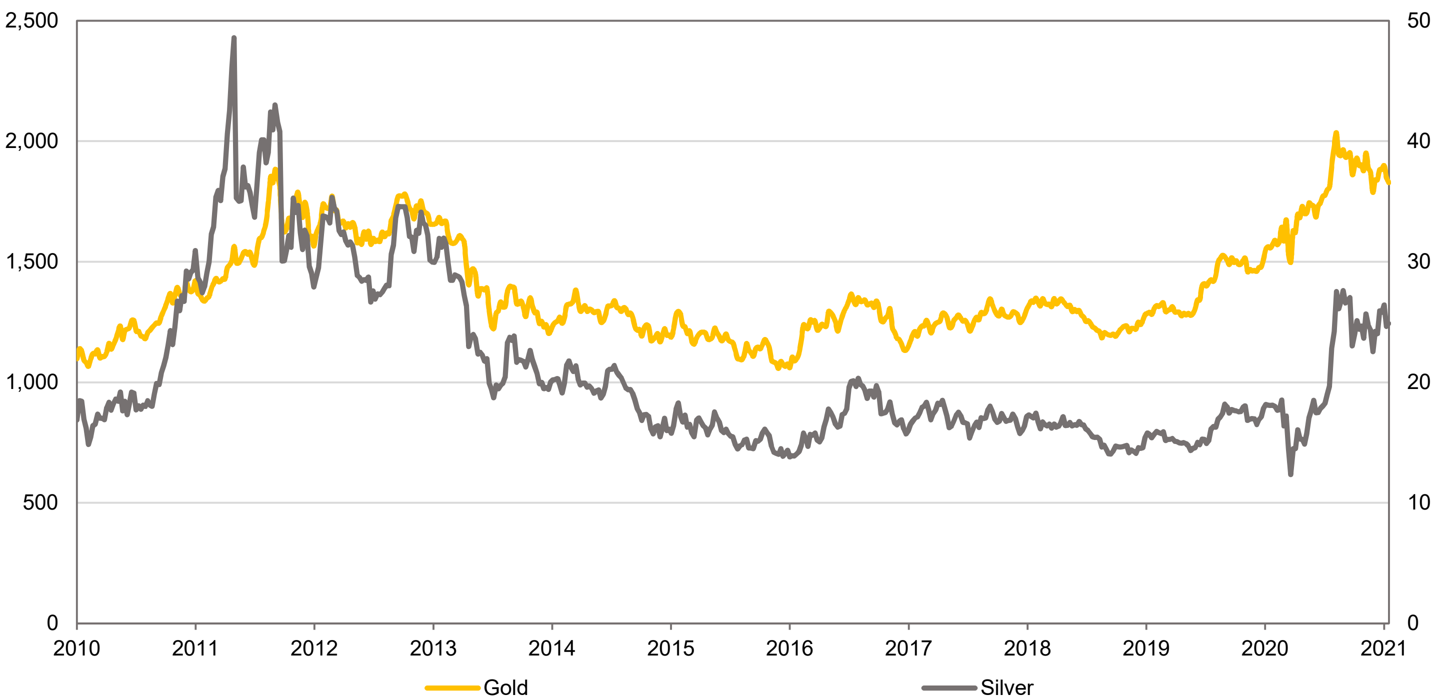
Select Commodity Prices (Rebased to 100 on 1 January 2015)



Source: Bloomberg, Auscap

Precious metals are up strongly since the onset of COVID-19.

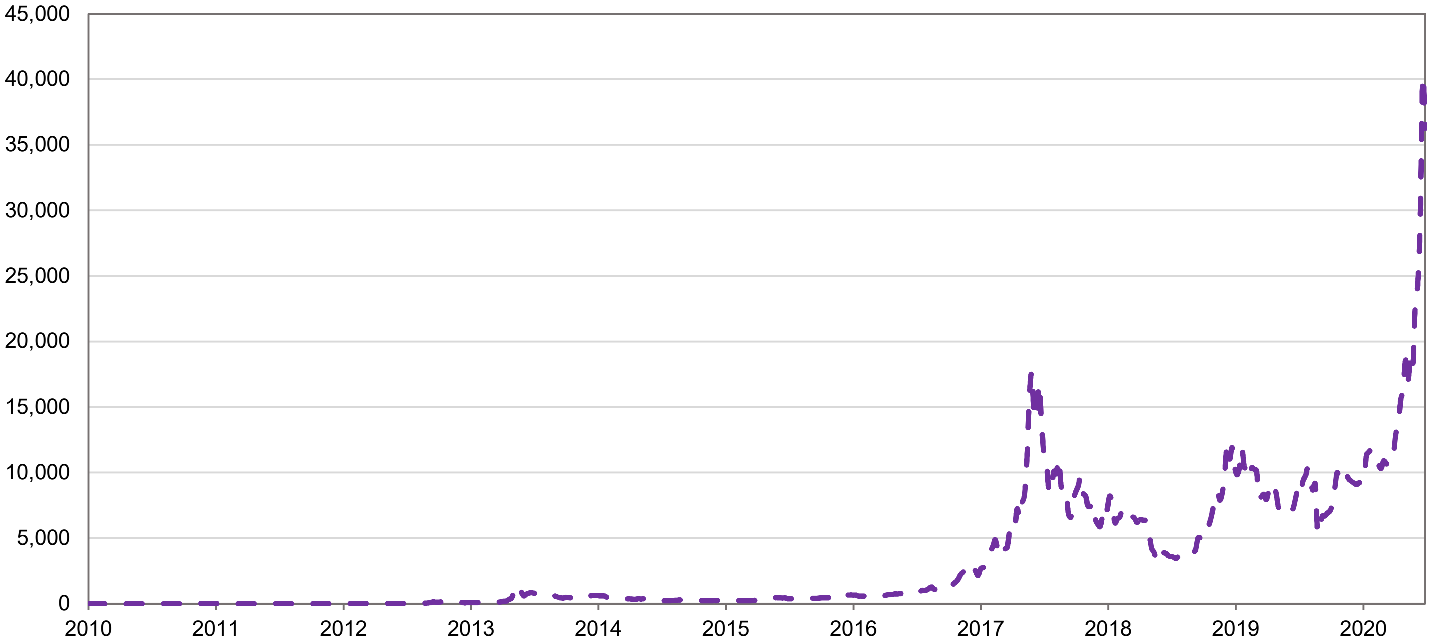
Select Precious Metal Prices (US$/oz)



Source: Bloomberg, Auscap

Bitcoin, an asset that has been framed as a hedge against money printing, has seen its price move higher exponentially.

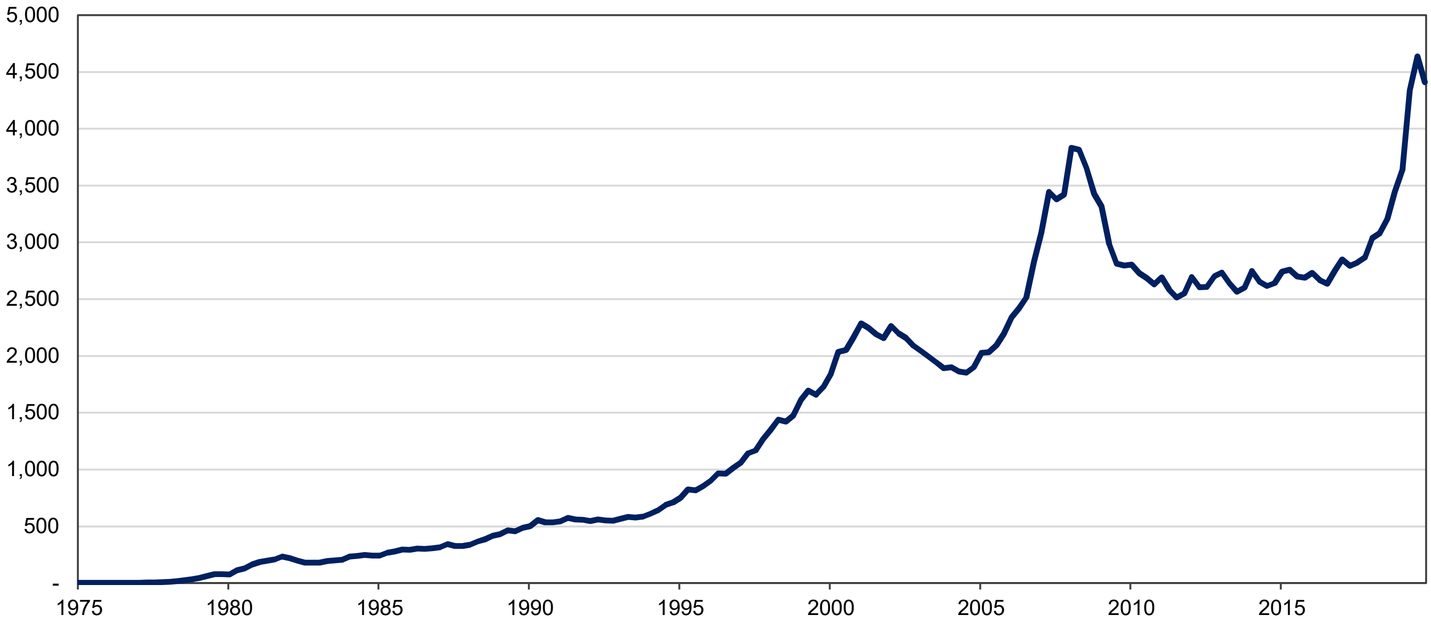
Bitcoin Price (US$)



Source: Bloomberg, Auscap

No doubt some of this is being driven by market speculation. Where this is the case the market will correct naturally over time. Speculation is always a dangerous pursuit. But it is worth noting that in a money printing world, the appeal of holding significant levels of cash, which earns very little and is at significant risk of decline in terms of purchasing power, may continue to diminish as perceived pandemic risks recede. This is in the context of cash sitting in money market funds being at close to record levels.

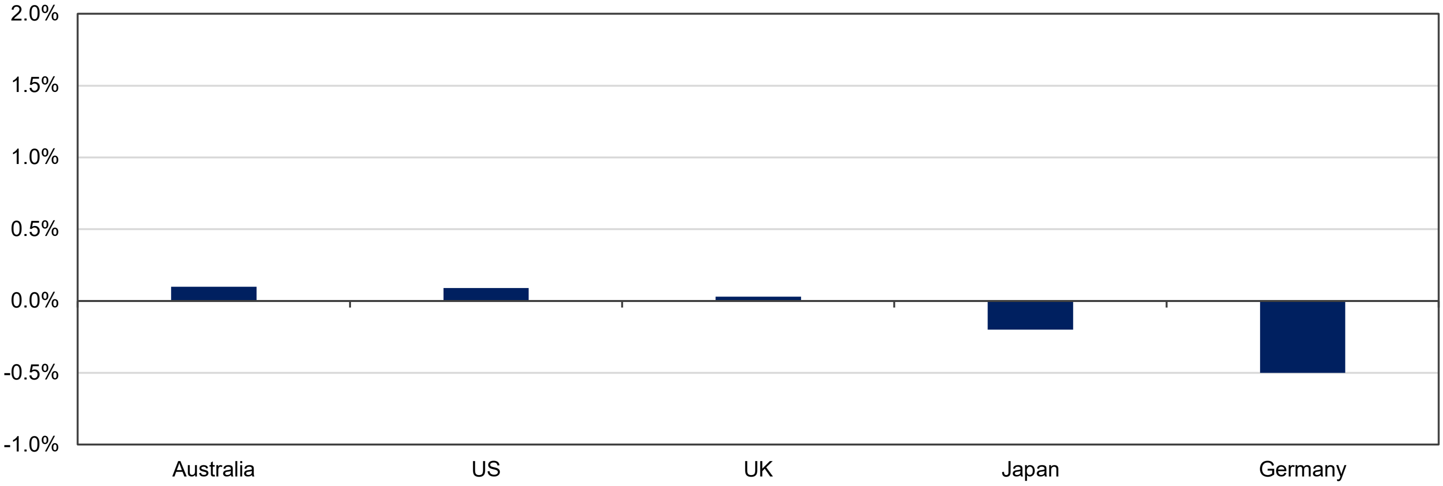
US Money Market Funds, Total Assets (US$bn)



Source: US Federal Reserve, Federal Reserve Bank of St Louis, Auscap

There is still $4.4 trillion sitting in US money markets essentially yielding nothing. In other words, these investors are happy to receive almost no return on their cash in a world in which Governments are printing new currency at the fastest rate in a long time.

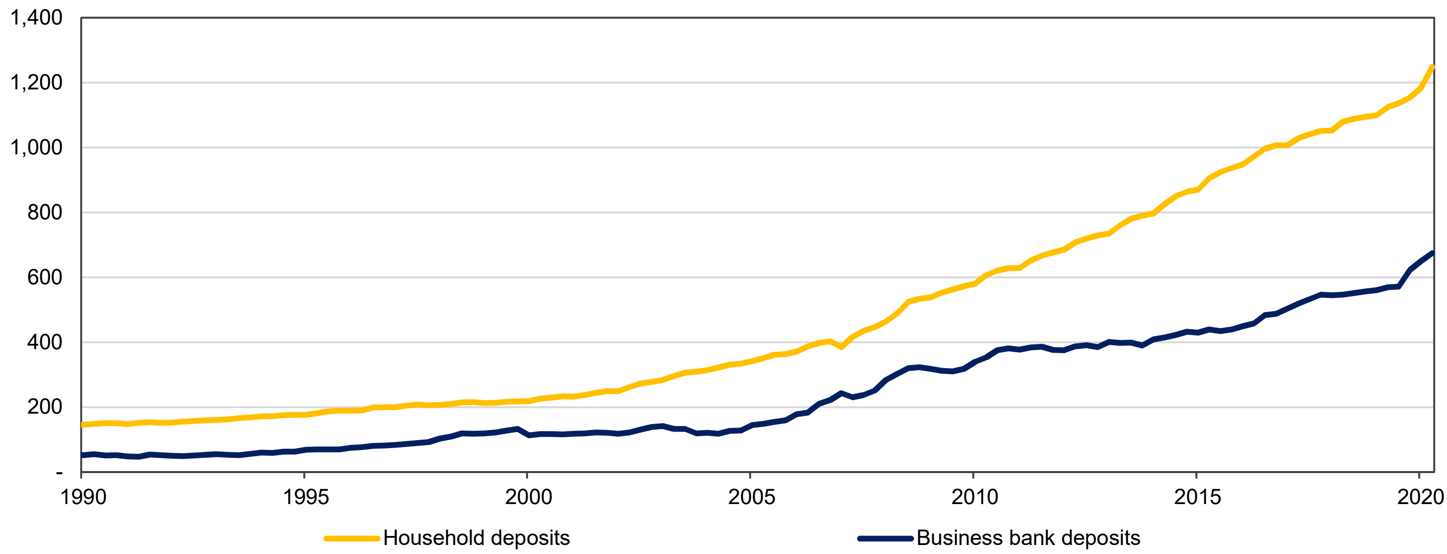
December overnight cash rates (%)



Source: Reserve Bank of Australia, Auscap

We have seen in Australia that household cash balances have also risen to record levels.

Australian Deposits (A$bn)



Source: Reserve Bank of Australia, Auscap

It will be interesting to see whether, over time, investors decide that more of this exposure should switch into other asset classes. Should this be the case the implication for other asset prices could be material. No one knows what the future holds, and by nature we have an aversion to arguments based on relative value, but we think it is worth pondering the impact of the growing money supply on asset prices and the cost of carrying cash in the current environment.

1. ‘M1’ is defined as currency plus bank current deposits from the private non-bank sector; 'M3' is defined as M1 plus all other authorised deposit-taking institution (ADI) deposits from the private non-ADI sector, plus certificates of deposit issued by banks, less ADI deposits held with one another; 'Broad Money' is defined as M3 plus other short-term liquid AFI liabilities held by the private sector, except those held by other AFIs.

Auscap Long Short Australian Equities Fund

Fund Performance*

Period	Auscap	All Ords
December 2020	5.0%	1.8%
Financial Year To Date	51.1%	15.7%
Since Inception	228.2%	116.1%
Annualised Returns	15.8%	10.0%

Fund Exposures

December 2020 Average	% NAV	Positions
Gross Long	132.0%	53
Gross Short	8.3%	2
Gross Total	140.3%	55
Net / Beta Adjusted Net	123.7%	147.0%

Portfolio Commentary

The Fund returned 5.0% net of fees during December 2020. This compares with the All Ordinaries Accumulation Index return of 1.8%. Average gross capital employed by the Fund was 132.0% long and 8.3% short. Average net exposure over the month was 123.7%. Over the month the Fund had on average 53 long positions and 2 short positions. The Fund's biggest exposures over the month were spread across the consumer discretionary, real estate, financials, materials and communication services sectors.

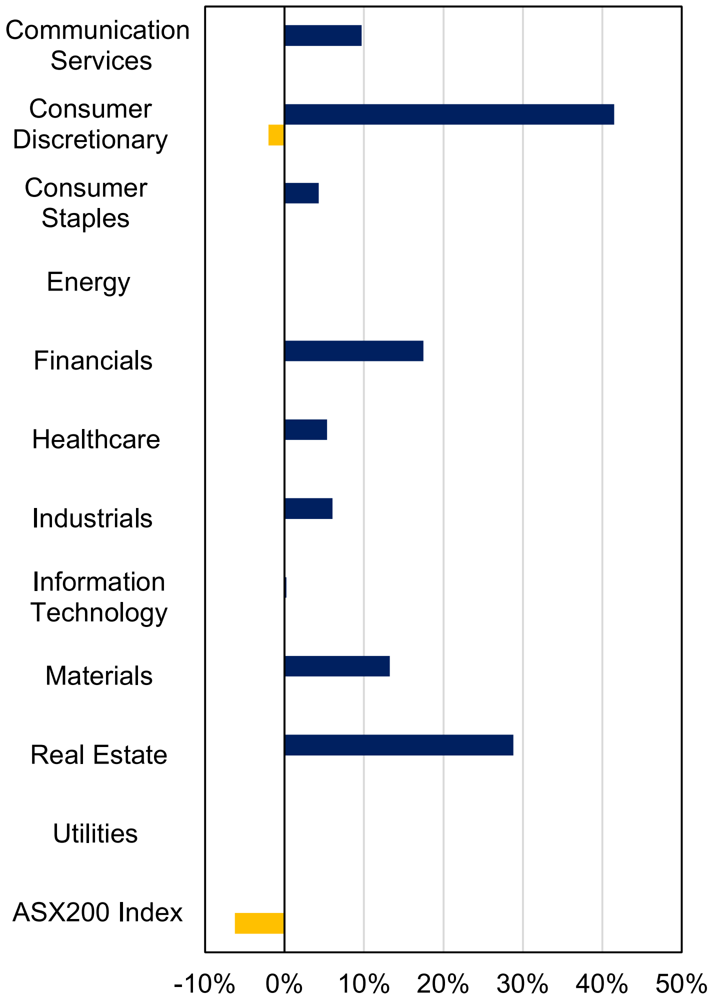
Top 10 Investments^

Aventus Group	Nick Scali
Eagers Automotive	NZME
GDI Property Group	Super Retail Group
Mineral Resources	Unibail-Rodamco-Westfield
Motorcycle Holdings	Virgin Money UK PLC

Fund Calendar Year Returns*

CY13	51.9%	CY17	17.1%
CY14	23.2%	CY18	(18.5)%
CY15	36.0%	CY19	18.1%
CY16	2.2%	CY20	10.6%

Sector Exposure - December 2020



** Performance figures are calculated for the lead series net of all fees and expenses assuming the reinvestment of all distributions. Note, as at 1 January 2021, the Series Class was consolidated into the Monthly Class. Past performance is not a reliable indicator of future performance.*
^ Top 10 long investments in alphabetical order as at 31 December 2020.

Newsletter – January 2021

Auscap Asset Management

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