Naming and taming the bear

From leverage to liquidity

Jos North
Investment Director

Jasmine Yeo
Investment Manager

80 Victoria Street London SW1E 5JL +44 (0)20 7963 8100 ruffer.co.uk

A limited liability partnership, registered in England with registered number OC305288. This financial promotion is issued by Ruffer LLP which is authorised and regulated by the Financial Conduct Authority © Ruffer LLP 2022 For private circulation only. The views expressed in this document are not intended as an offer or solicitation for the purchase or sale of any investment or financial instrument. The information contained in the document is fact based and does not constitute investment advice or a personal recommendation, and should not be used as the basis for any investment decision. References to specific securities should not be construed as a recommendation to buy or sell these securities.

OCTOBER 2022

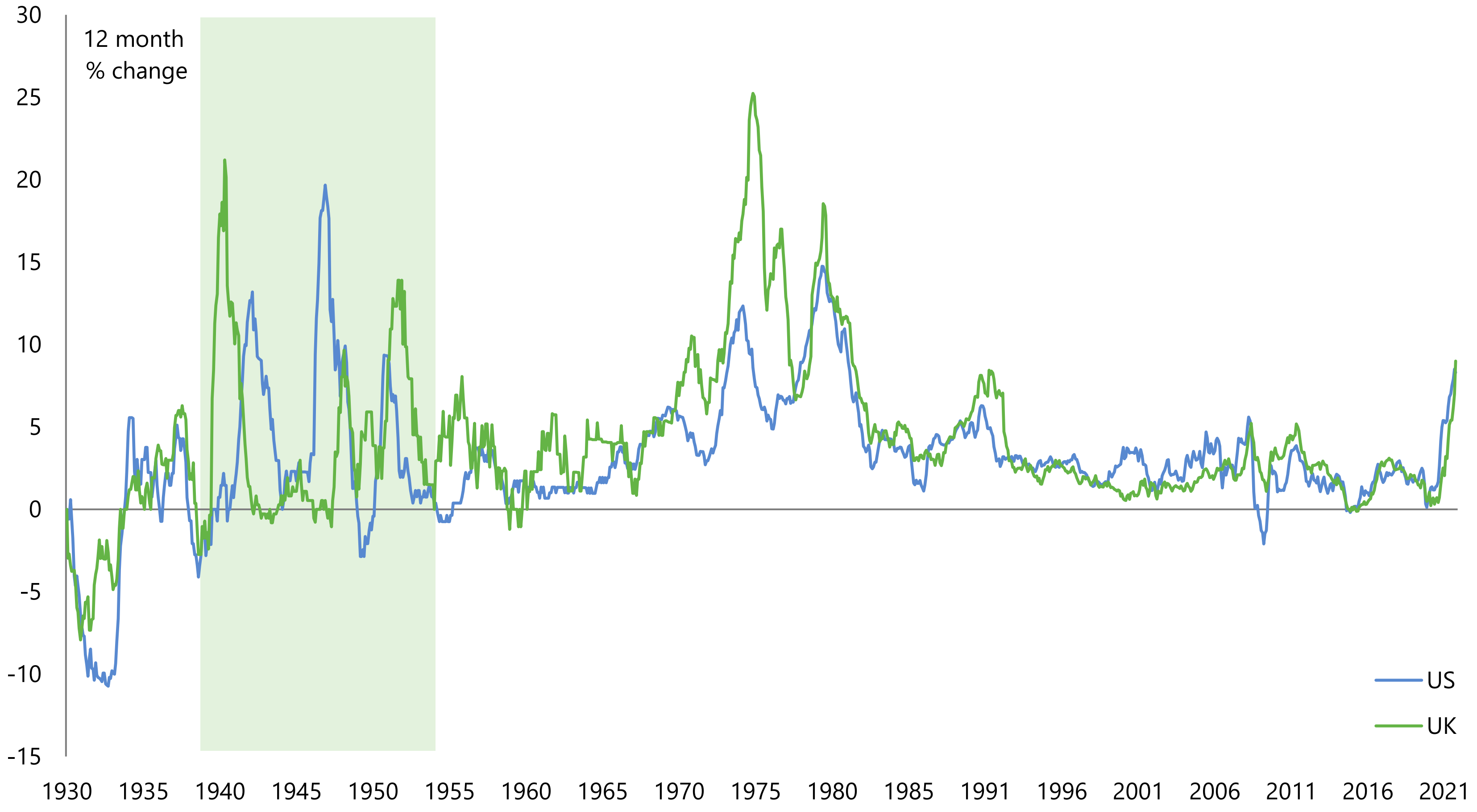
Agenda

- Welcome
- Where are we now?
- What works in a bear market
- How are we positioned?
- Q&A

Where are we now?

A new regime, echoing the past

VOLATILE AND ELEVATED INFLATION



Source: Bank of England, ASR Ltd/ Refinitiv. Date to March 2022

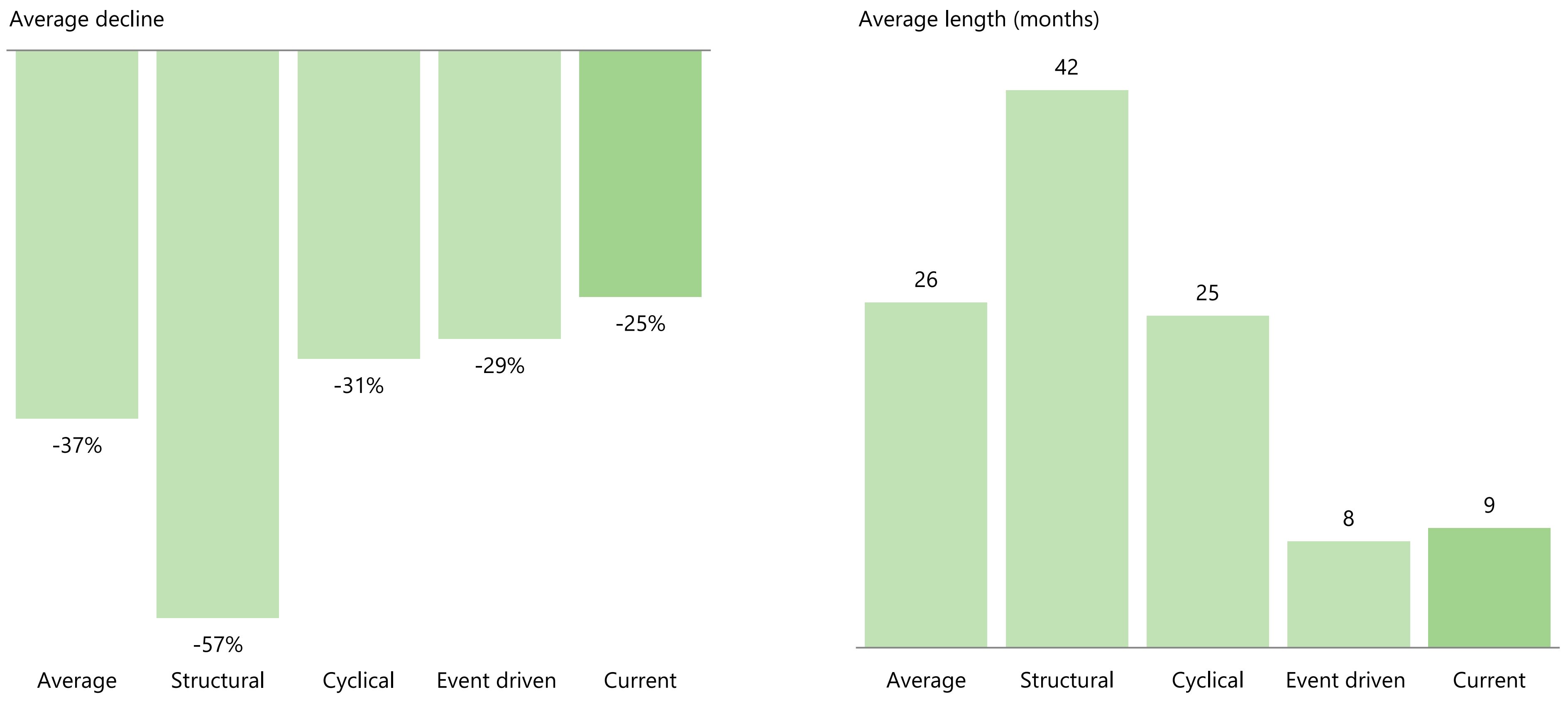
Central banks are fighting an inflation problem they underestimated

We’ve seen a repricing of risky assets. Now we face a possible liquidation of risky assets

Liquidity is the new leverage post the GFC

Naming the bear

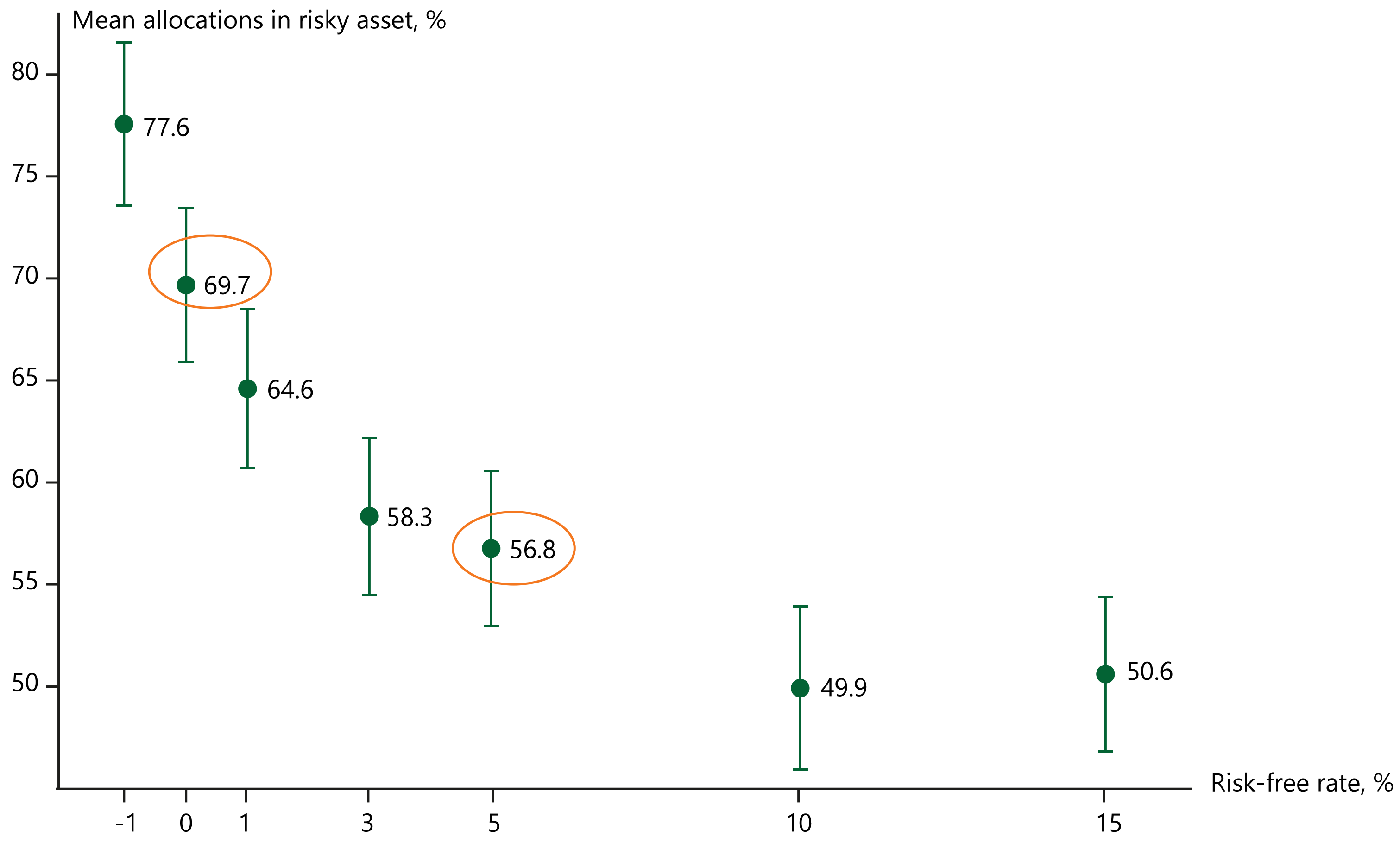
US BEAR MARKETS AND RECOVERIES SINCE THE 1800S



Source: Goldman Sachs Global Investment Research

The unwind of post GFC behaviour

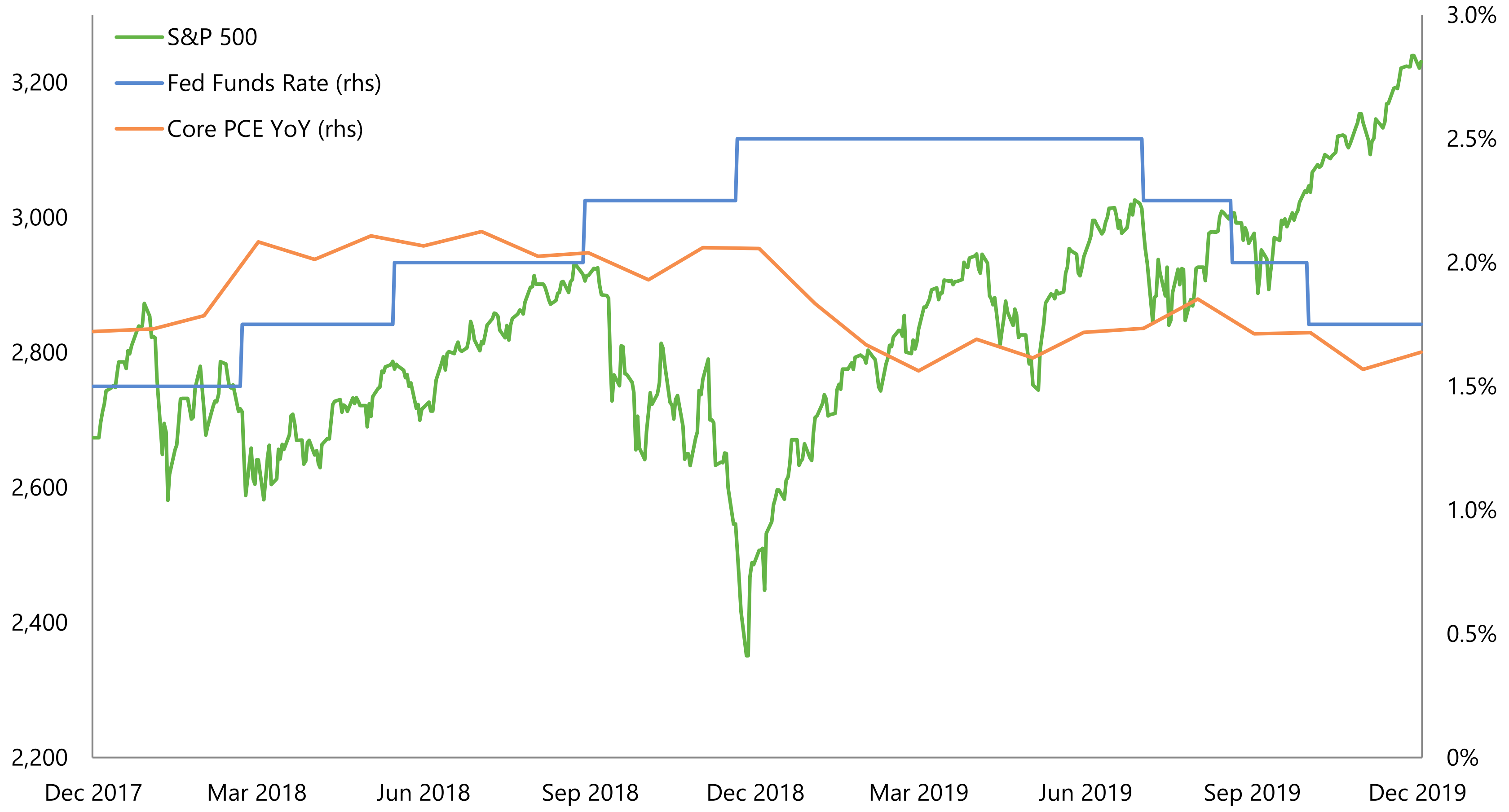
LOWER RATES DRIVE HIGHER ALLOCATIONS TO RISKY ASSETS



Source: Ma and Zijlstra (2018), A new take on low interest rates and risk taking

We got close in 2018

THE S&P VS THE FED FUNDS RATE VS CORE PCE INFLATION



Source: Bloomberg, Federal Reserve

Spot the difference?

THE S&P VS THE FED FUNDS RATE VS CORE PCE INFLATION

Source: Bloomberg, Federal Reserve

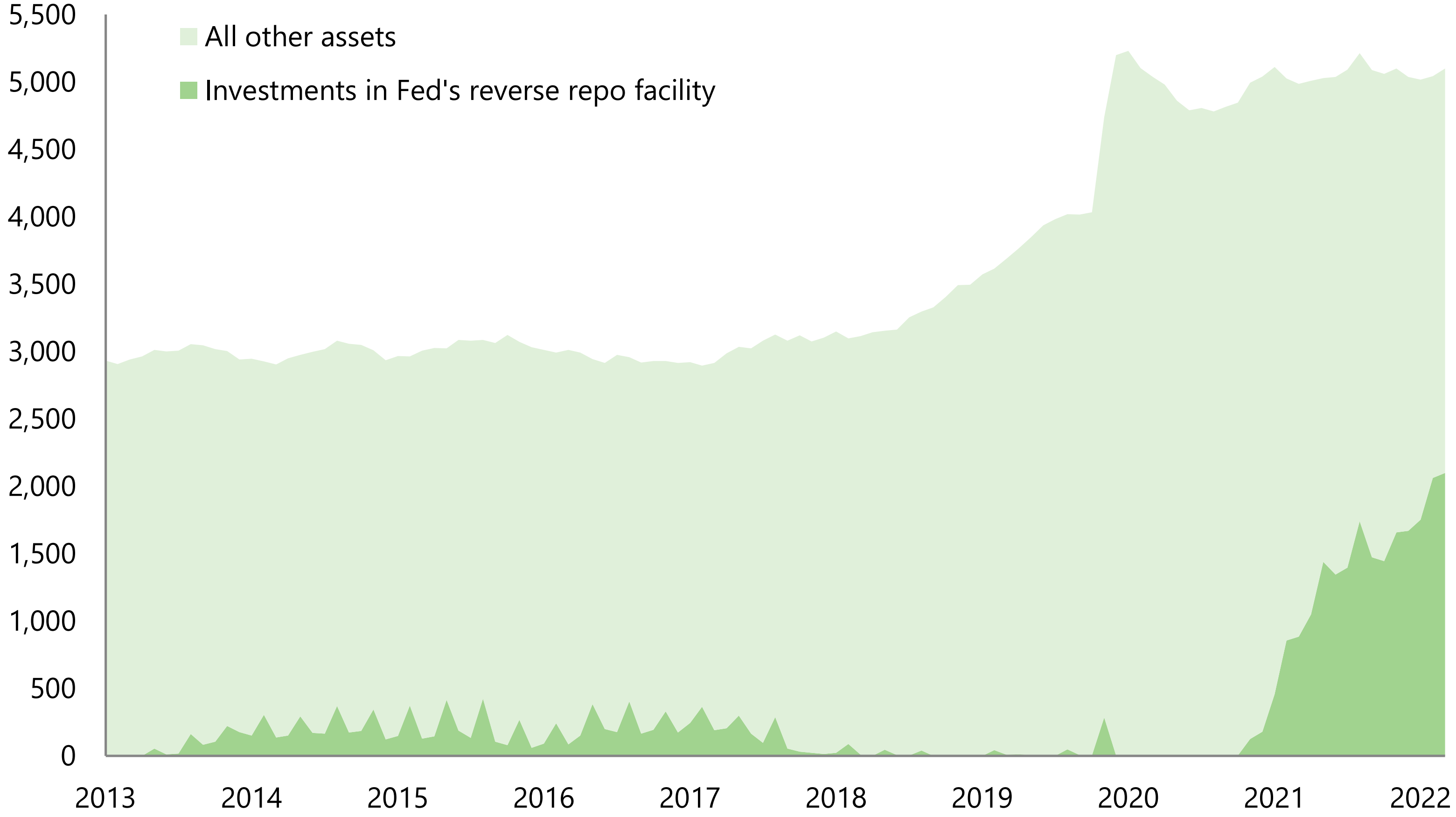
The Fed’s Reverse Repo Program (RRP), its interaction with central bank reserves and the level of interest rates

The inflating nominal economy’s need for more of the commercial banks’ aggregate balance sheet

The reluctance of commercial banks to expand their balance sheets because of regulatory pressure

Fed’s monetary mechanics: the RRP facility

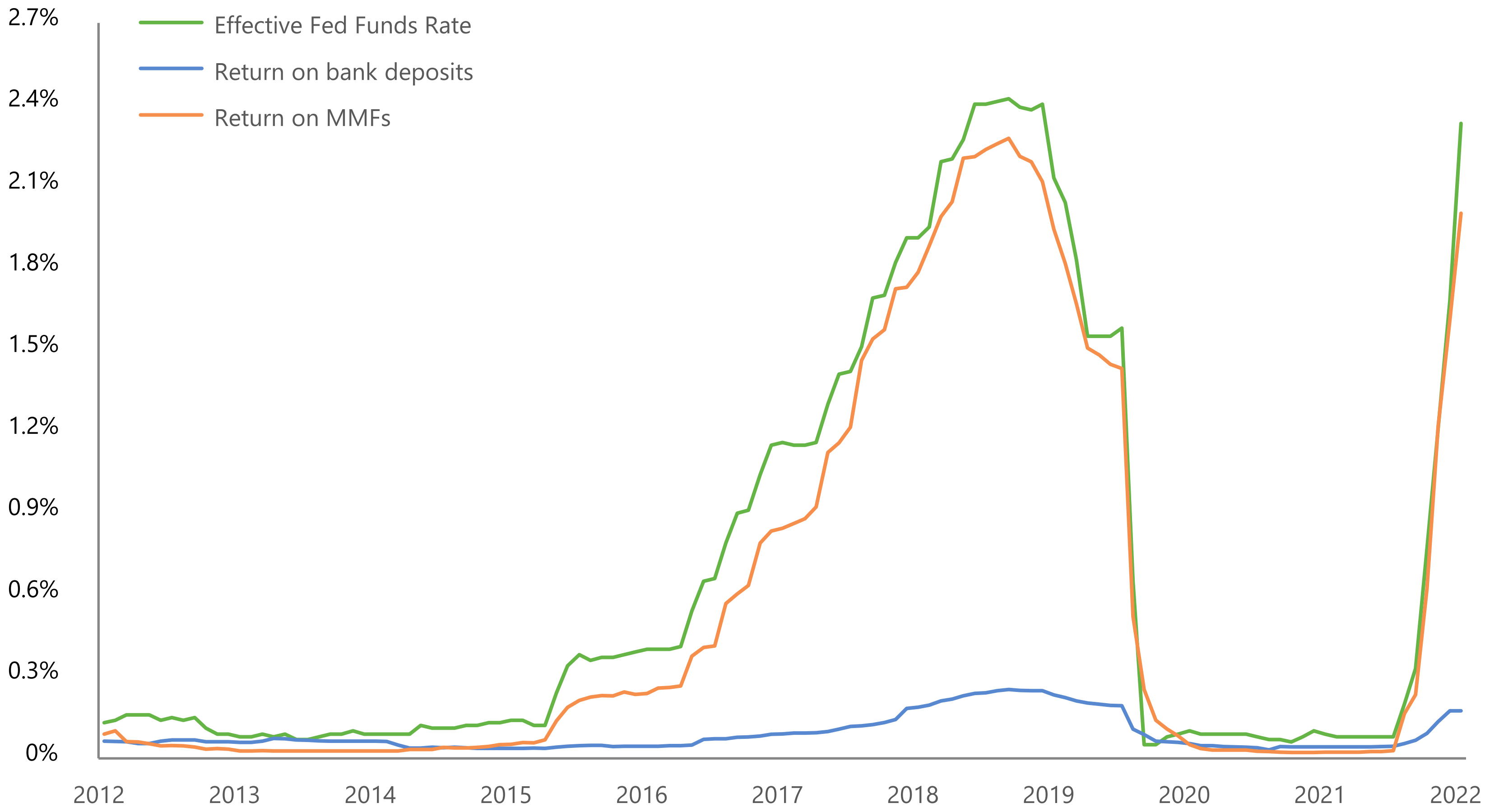
TOTAL MONEY MARKET FUND ASSETS AND ALLOCATION TO FED’S RRP, $BN



Source: US Securities and Exchange Commission (SEC)

Banks are not passing on higher interest rates

RETURN OFFERED BY MONEY MARKET FUNDS VERSUS BANK DEPOSITS, %



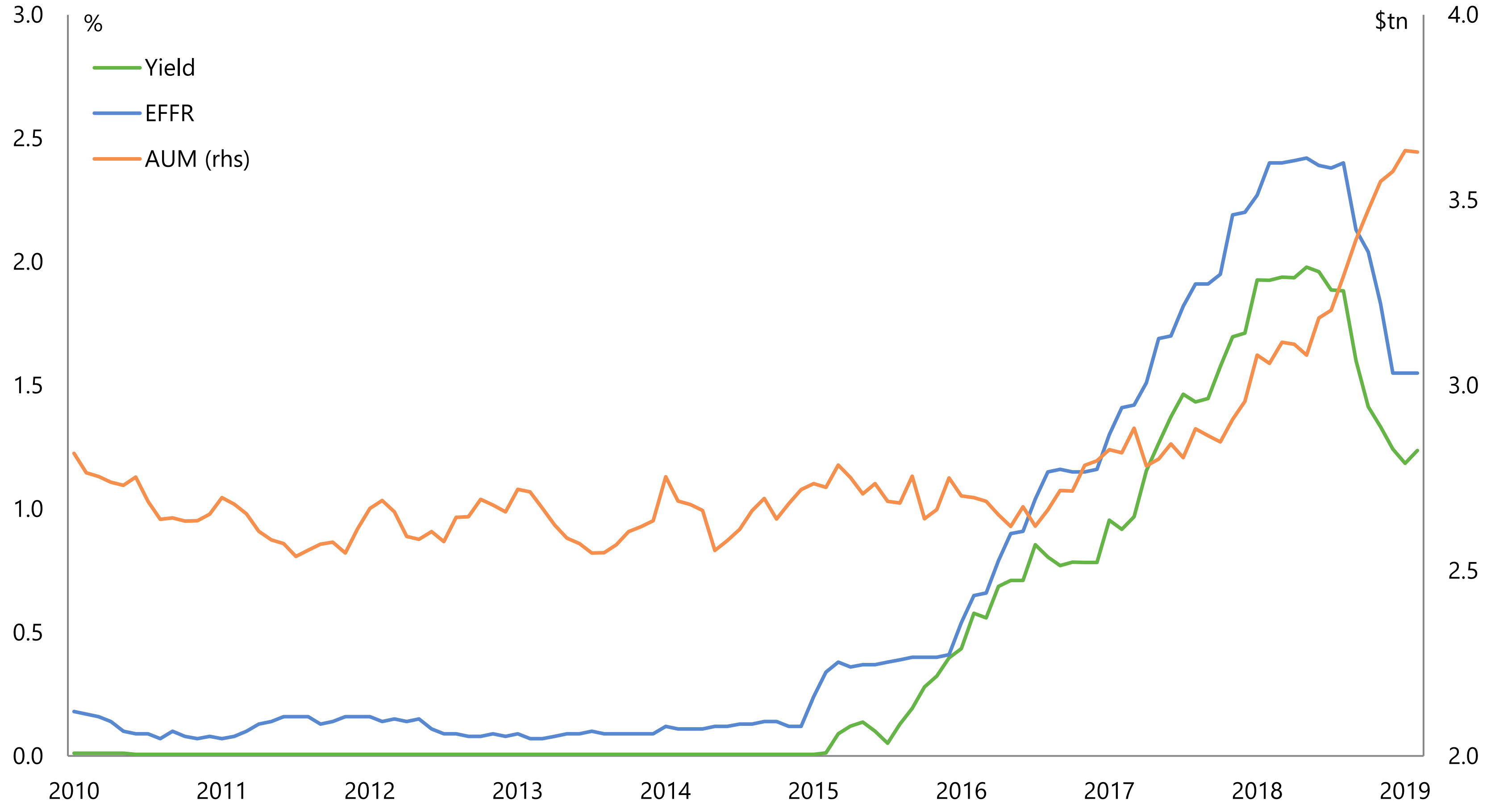
Source: Investment Company Institute

“John Bull can stand many things but he cannot stand two per cent.”

Walter Bagehot

Interest rate level that gets depositors excited

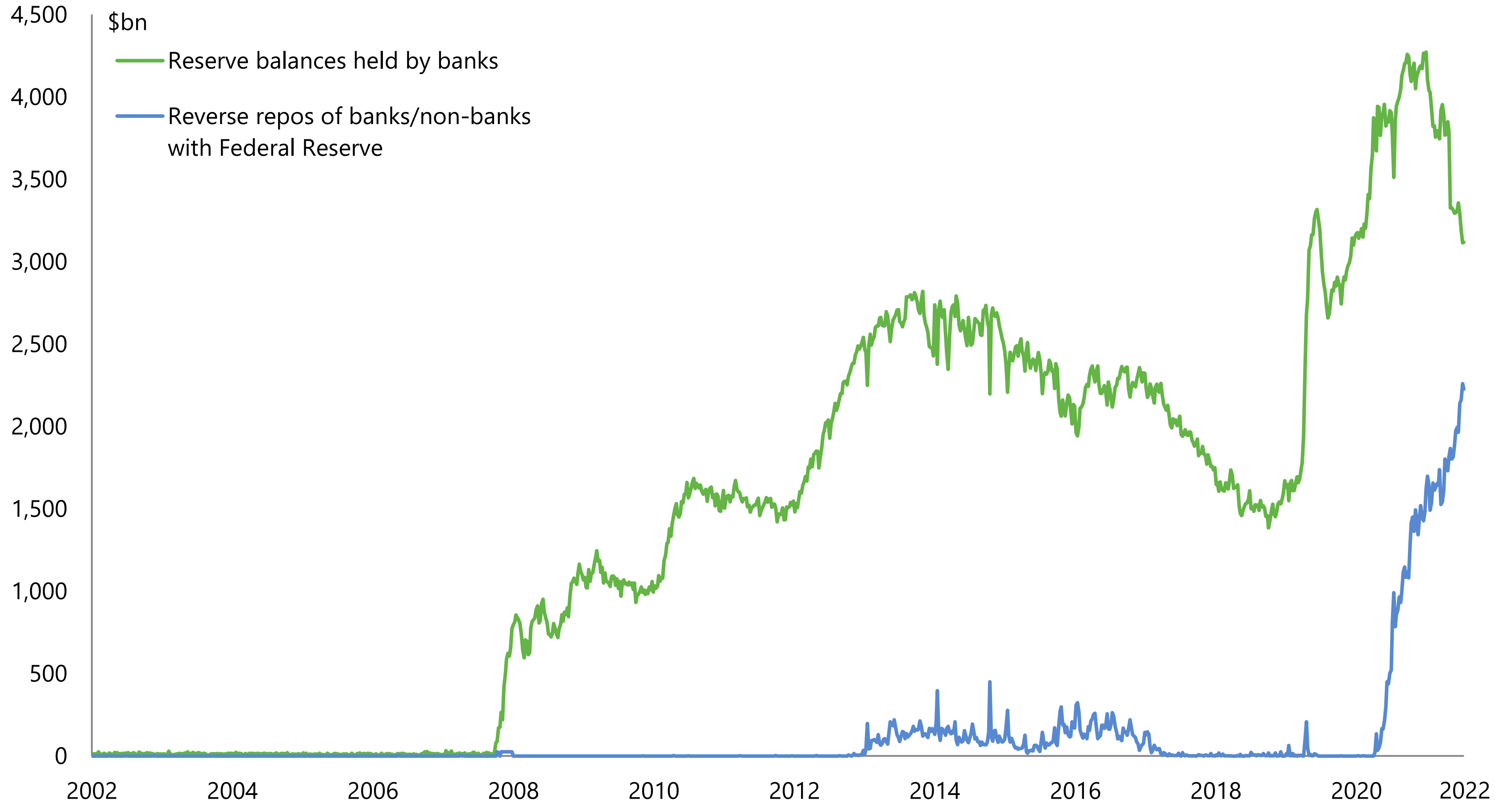
IN 2018, 2.5% WAS THE LEVEL THAT TRIGGERED GROWTH IN MONEY MARKET FUND AUM



Source: Bloomberg, Federal Reserve, Investment Company Institute

The trigger for hidden tightening

RESERVE BALANCES AT/REVERSE REPOS WITH THE US FEDERAL RESERVE, $BN



Source: US Federal Reserve, data to June 2022

Interest rate hikes drive a non-linear deallocation to risk assets

Cash moves from commercial bank deposits to money market funds

Bank reserves are drained as the RRP grows

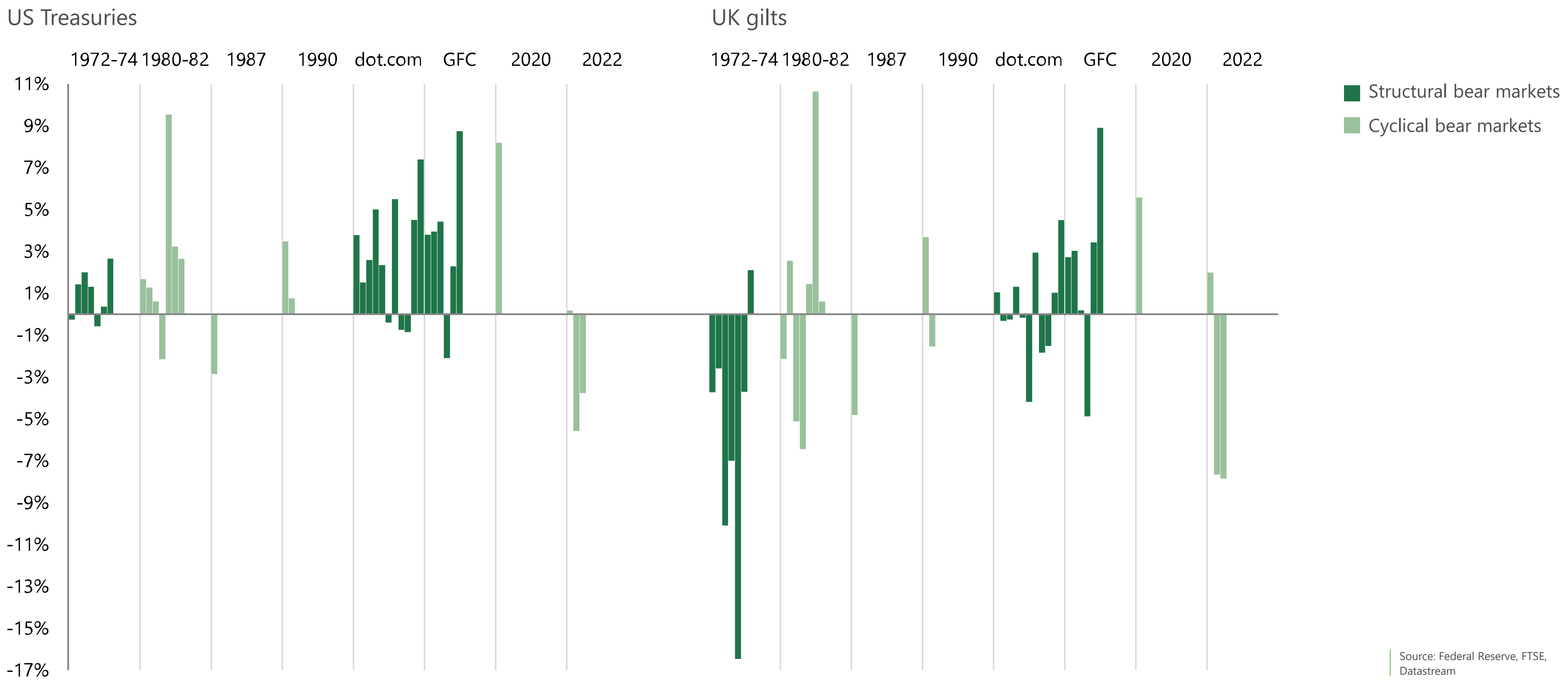
Result is hidden tightening that risks a disorderly sell off in asset markets

Bank balance sheets can’t flex to absorb this

What works in a bear market

Nominal duration

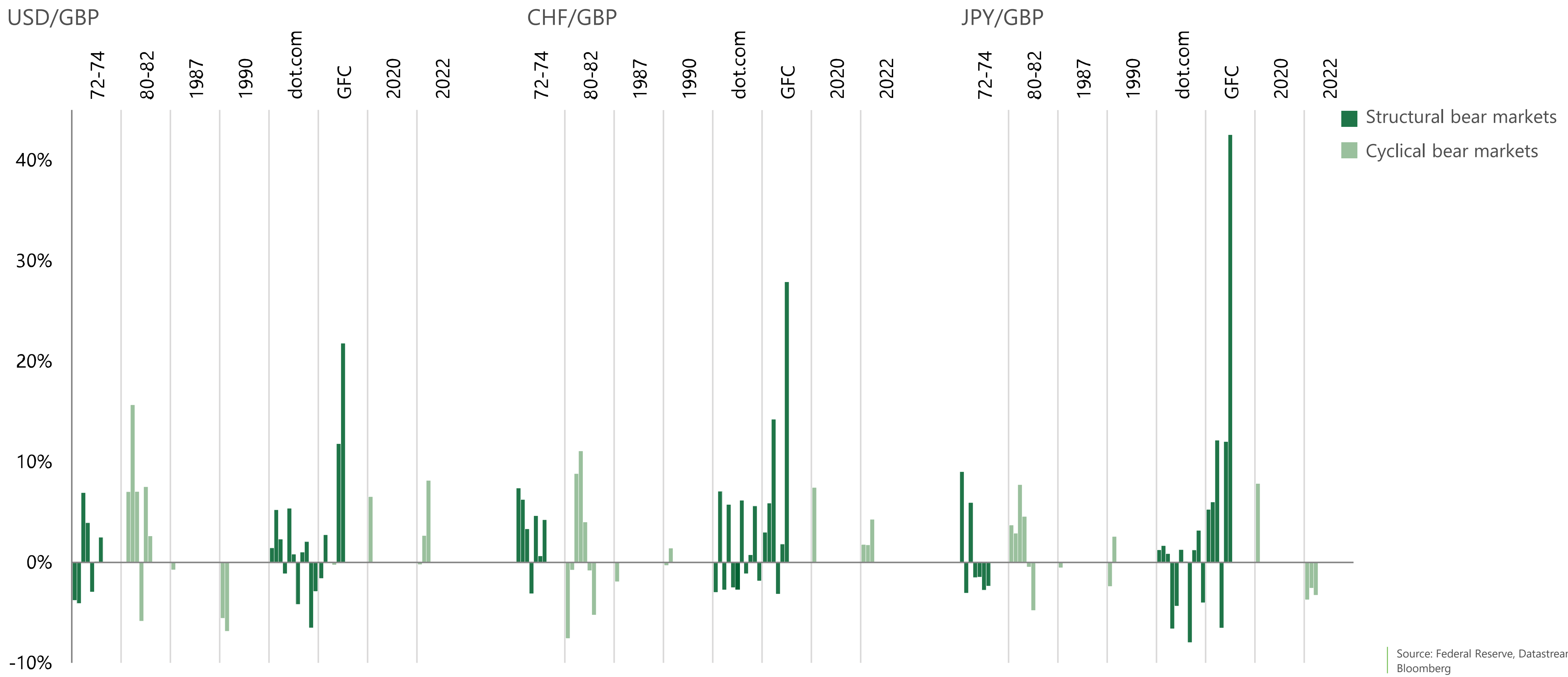
QUARTERLY PERFORMANCE OF TREASURIES AND GILTS DURING BEAR MARKETS



Source: Federal Reserve, FTSE, Datastream

Currencies

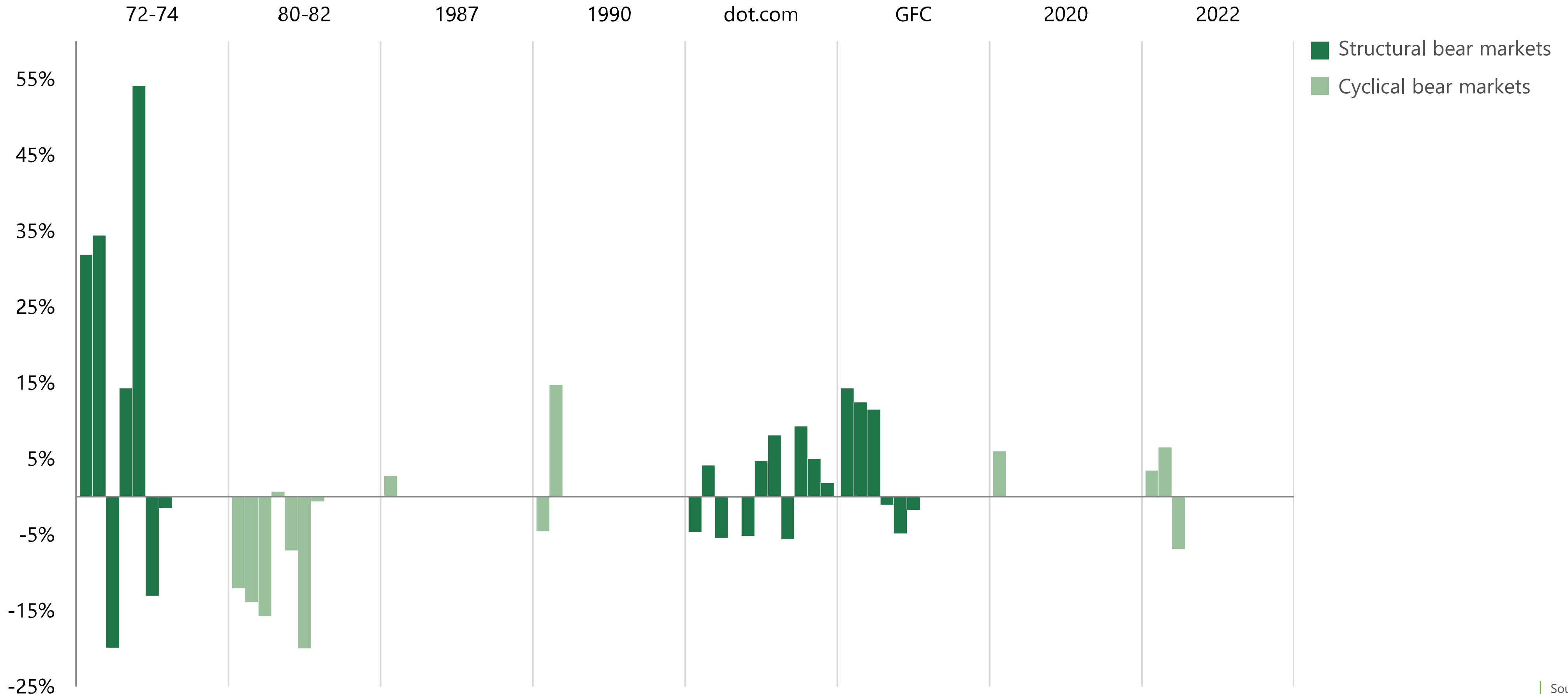
QUARTERLY PERFORMANCE OF VARIOUS CURRENCIES VERSUS STERLING DURING BEAR MARKETS



Source: Federal Reserve, Datastream, Bloomberg

Gold

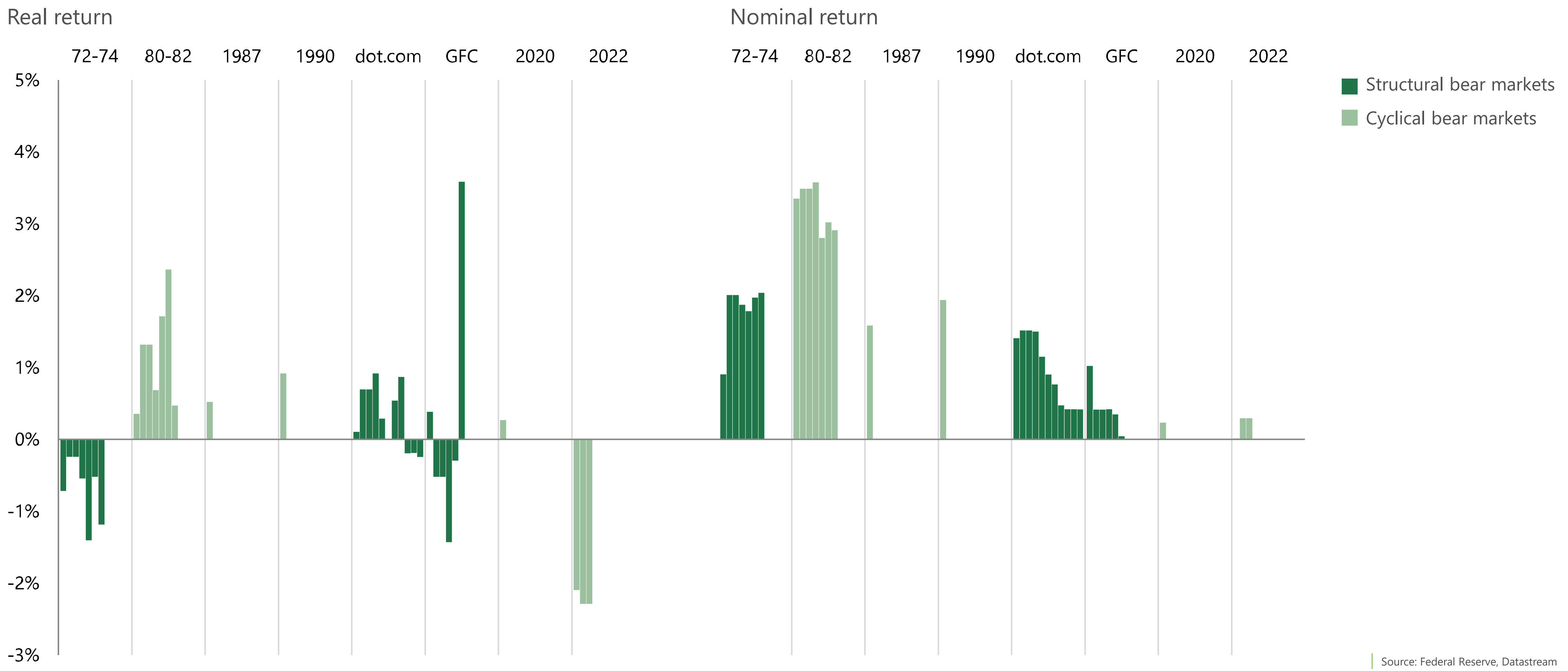
QUARTERLY PERFORMANCE OF GOLD BULLION DURING BEAR MARKETS



Source: ICE Benchmark Administration Ltd, Datastream

Cash – real versus nominal returns

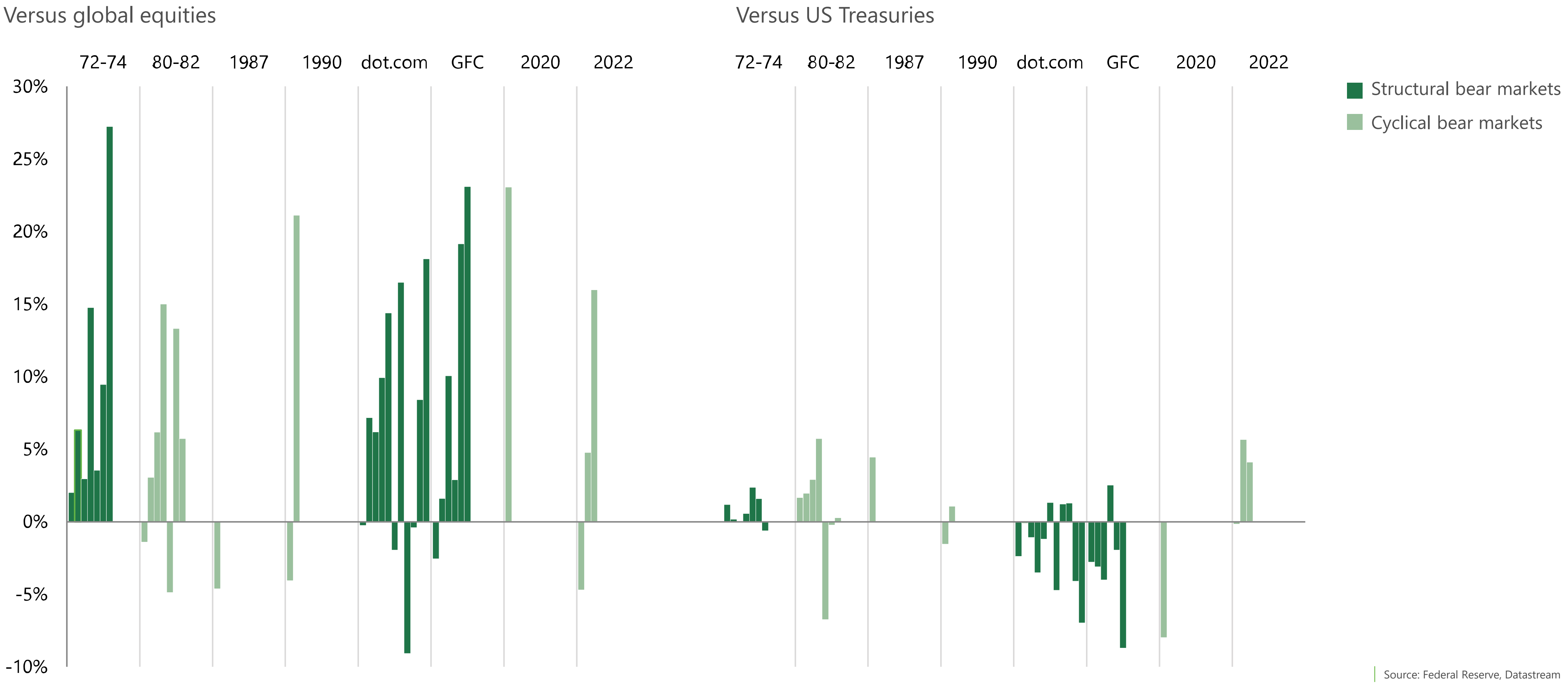
US 3M T-BILLS



Source: Federal Reserve, Datastream

Cash – returns versus bonds and equities

US 3M T-BILLS

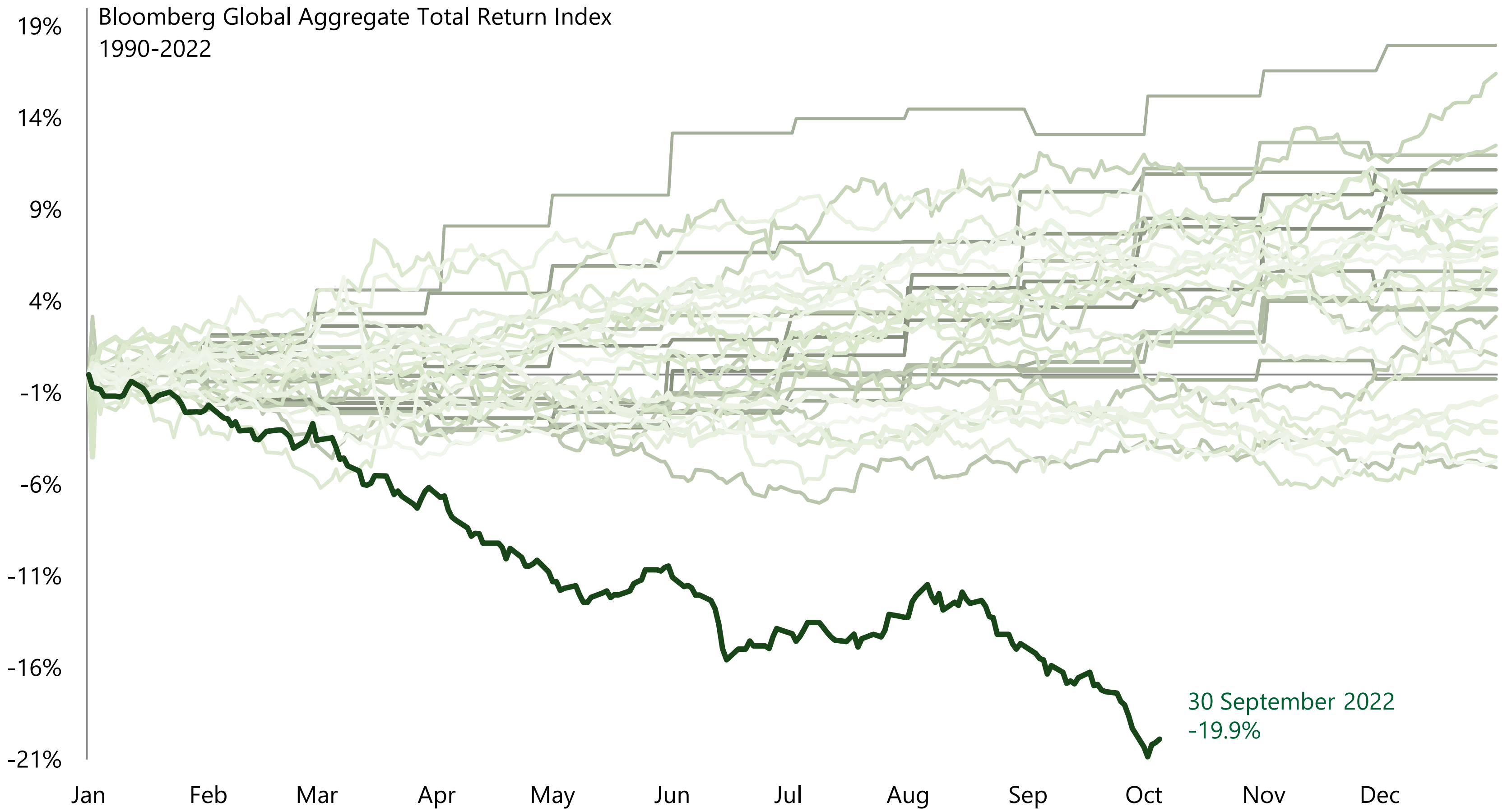


Source: Federal Reserve, Datastream

How are we positioned?

So much for ‘safe haven’

FIXED INCOME ENDURES ITS WORST START TO A YEAR. REMIND ME WHY YOU OWN CONVENTIONAL BONDS?

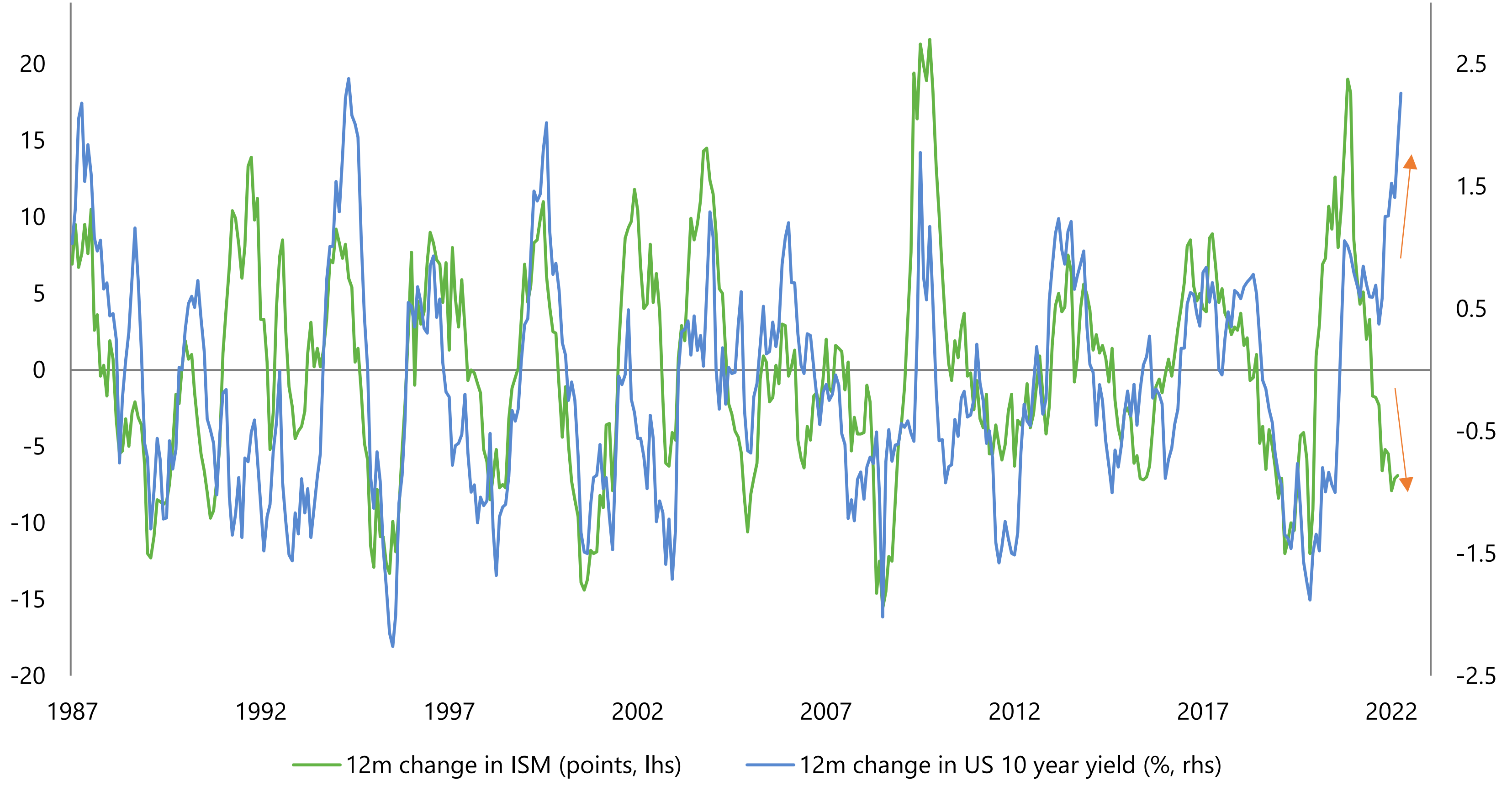


S&P 500 Down Years	S&P 500 TR (Stocks)	Bloomberg Barclays US Agg Index TR (Bonds)
1977	-7.2%	3.0%
1981	-4.9%	6.2%
1990	-3.2%	9.0%
2000	-9.1%	11.6%
2001	-11.9%	8.4%
2002	-22.1%	10.3%
2008	-37.0%	5.2%
2018	-4.4%	0.0%
2022 YTD	-23.9%	-19.9%

Source: Bloomberg, Bianco Research

When will US bond yields reflect slowing growth?

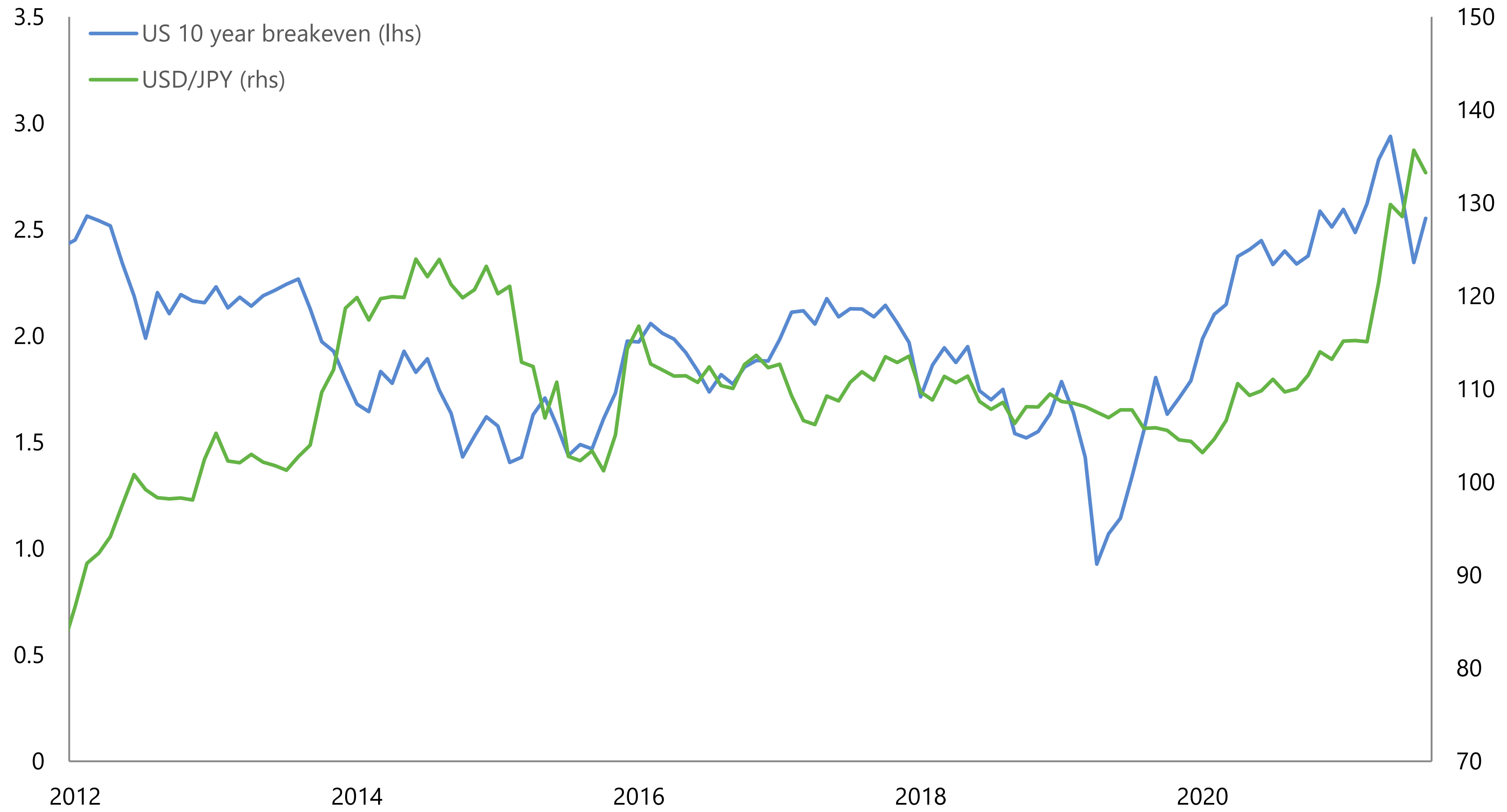
INFLATION MEANS THAT BOND YIELDS ARE RISING EVEN AS ECONOMIC ACTIVITY FALLS



Source: Minack Advisors, FactSet, Ruffer Analysis

The yen should perform as US inflation slows

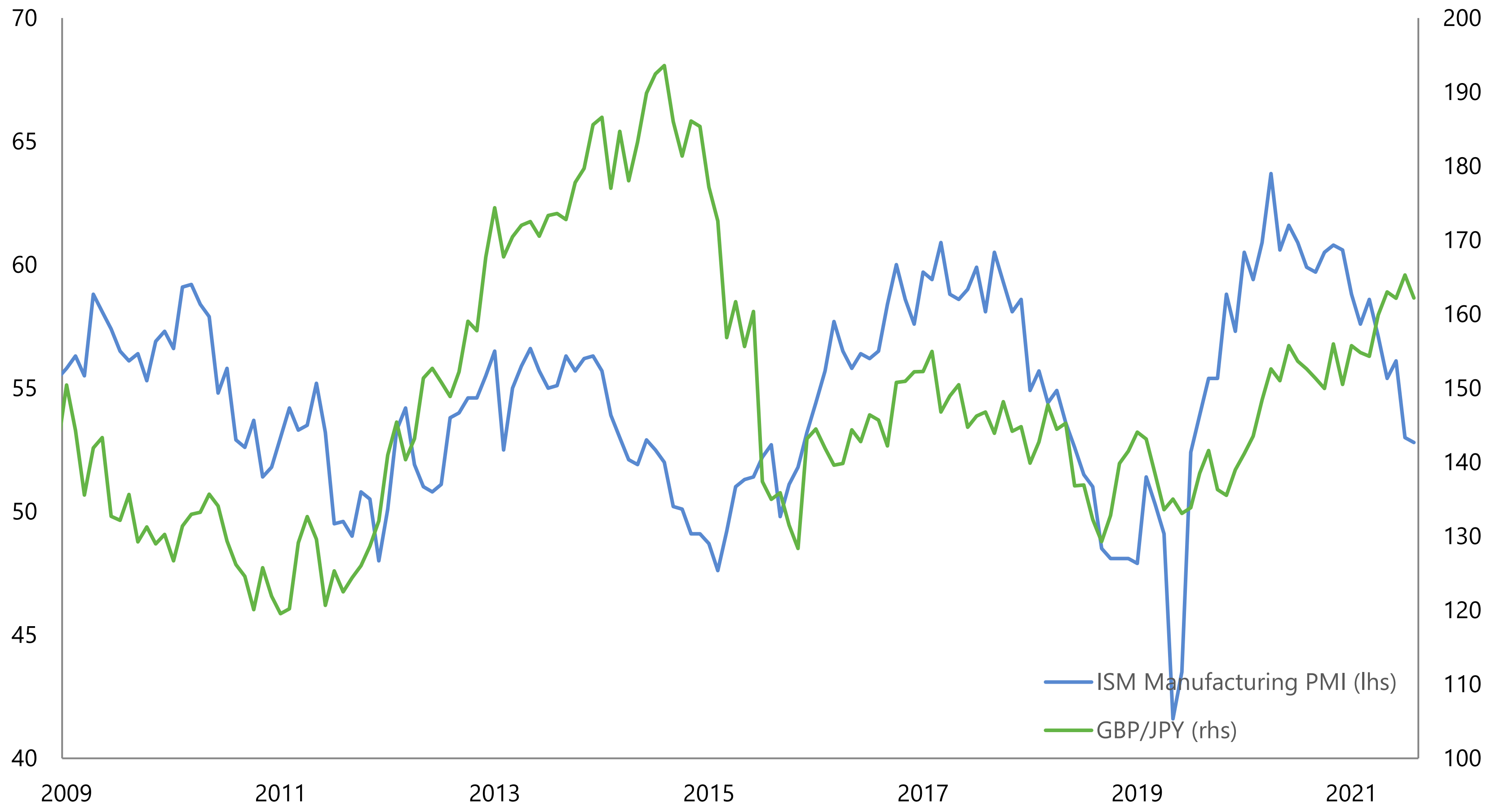
THE YEN IS IGNORING FALLING INFLATION EXPECTATIONS



Source: Federal Reserve, Bloomberg

The yen should perform as global growth slows

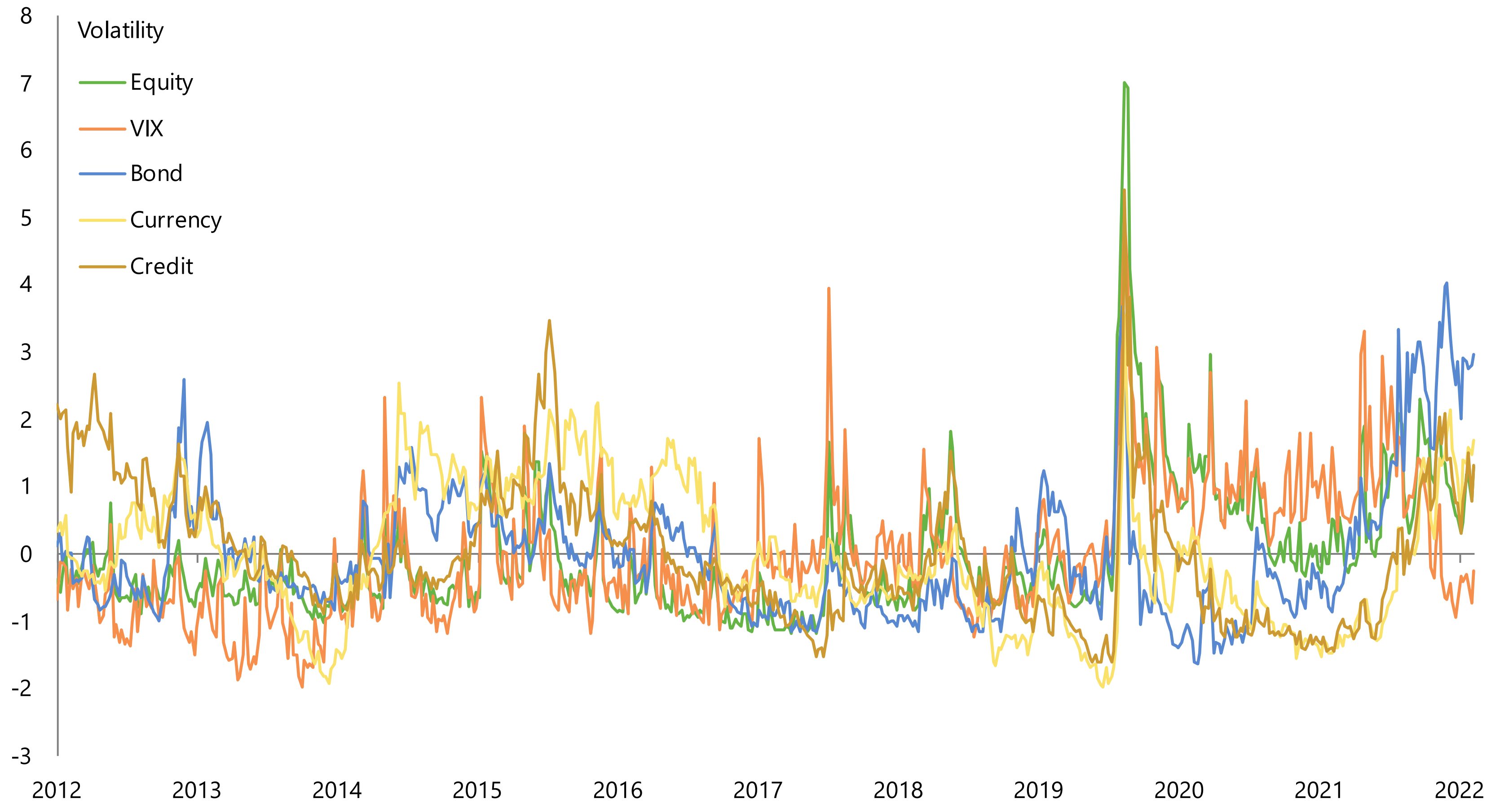
THE YEN AGAINST STERLING HAS BEEN PARTICULARLY SENSITIVE TO GROWTH CONCERNS



Source: Federal Reserve, Bloomberg

The cost of protection is higher

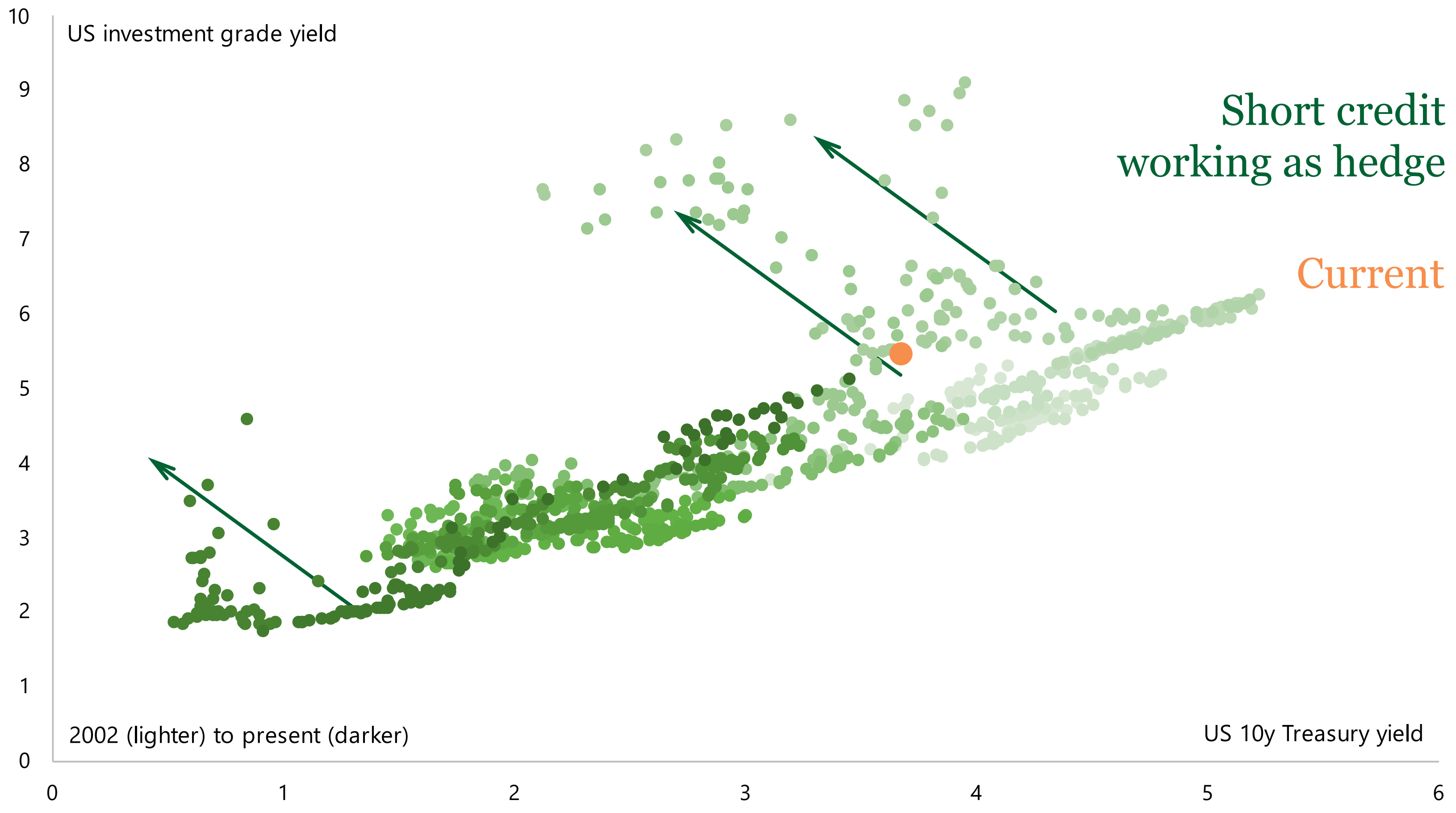
WHICH REQUIRES INVESTORS TO BE SELECTIVE AND DYNAMIC



Source: Bloomberg

Credit provides asymmetry in a further sell-off

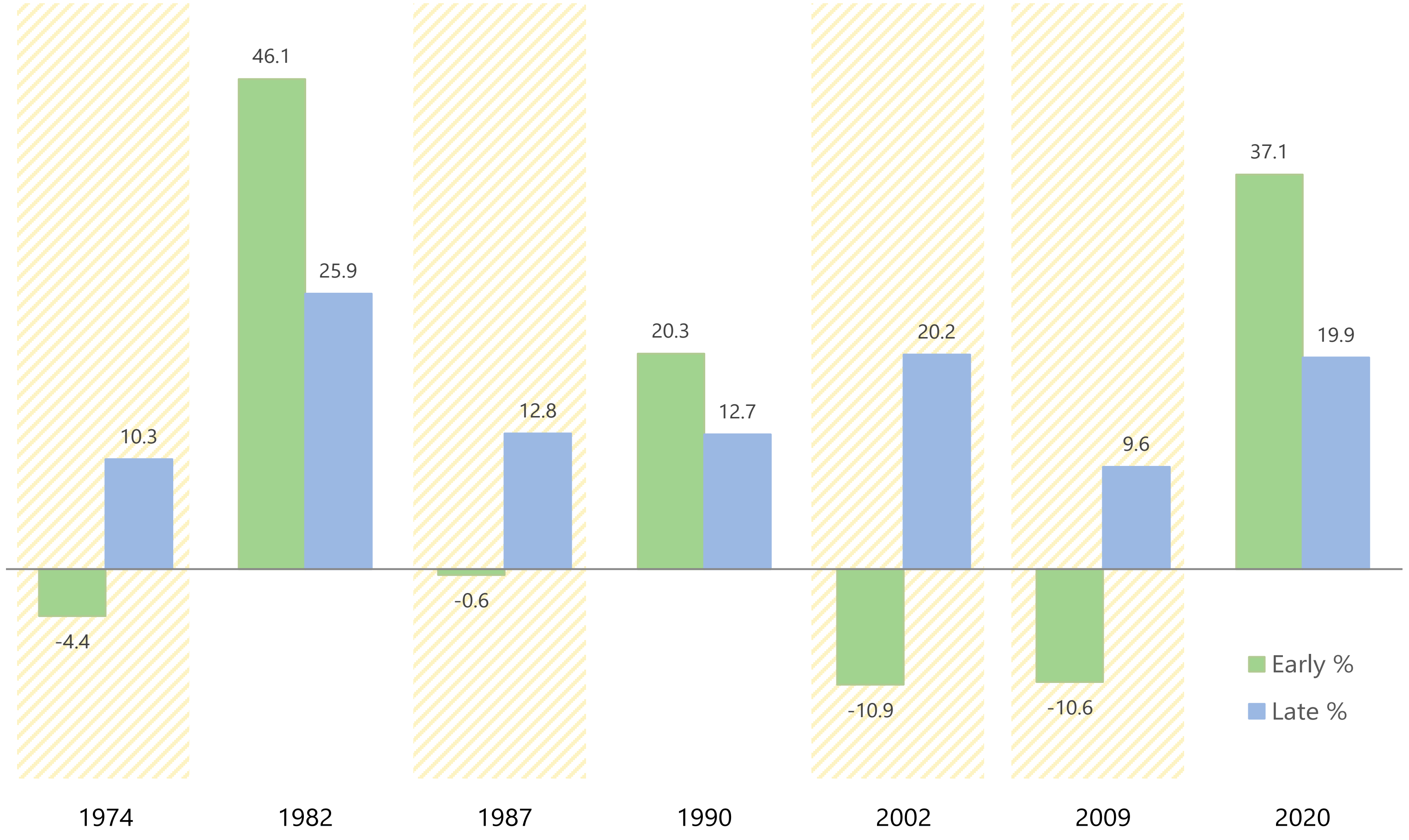
US INVESTMENT GRADE CREDIT VERSUS US TEN YEAR TREASURIES



Source: Bloomberg

You don't need to pick the bottom

TOTAL RETURNS SIX MONTHS BEFORE BEAR MARKET TROUGH TO 12 MONTHS AFTER



Source: Richard Bernstein Advisors LLC. "Early" assumes S&P 500 total returns for the full 18 month period. "Late" assumes 3 month Treasury bill returns as a proxy for returns on cash for 12 months, and then S&P 500 total returns for the final 6 months. Shaded areas denote periods where returns were better for the "Late" approach.

Ruffer LLP

80 Victoria Street London SW1E 5JL +44 (0)20 7963 8100

A limited liability partnership, registered in England with registered number OC305288. Ruffer LLP is authorised and regulated by the Financial Conduct Authority in the UK and is registered as an investment adviser with the US Securities and Exchange Commission (SEC). Registration with the SEC does not imply a certain level of skill or training. Ruffer LLP © 2022. For private circulation only. The views expressed in this document are not intended as an offer or solicitation for the purchase or sale of any investment or financial instrument. The information contained in the document is fact based and does not constitute investment advice or a personal recommendation, and should not be used as the basis for any investment decision. References to specific securities should not be construed as a recommendation to buy or sell these securities.

RUFFER.CO.UK