Quarterly Commentary
Miralta SICAV Sequoia
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MiraltaBank
Advanced Banking

THE NEW POLITICAL ECONOMY

Since October 2022, where global liquidity hit record lows, we have again witnessed the speed and intensity with which currency devaluation returns to the scene. This phenomenon has been evident after every significant episode of stress experienced in the last 18 months, including the Budget Crisis in the UK, the Regional Banking Crisis in the US, the Real Estate Crisis in China and a second Budget Crisis in the US, In each of these situations we have seen how Central Banks and Treasuries have intervened, injecting liquidity into economies which, despite being over-indebted and lacking dynamism, have shown a remarkable recovery in most financial assets, thanks to this improvement in global liquidity. Gold and Bitcoin, which have once again demonstrated their capacity as hedges against monetary inflation, have been particularly noteworthy in this context.

In the United States, the symbiosis between Treasury Secretary Janet Yellen and Federal Reserve Chairman Jerome Powell has offered temporary relief to the country's worrisome fiscal situation. The adjustment in Yellen's debt issuance and financing strategy (bills vs. bonds) has acted as a disguised curve control, easing pressure on long maturities and significantly loosening financial conditions. This has caught Powell unawares, who, much to his regret, has had to ease his rhetoric as the November elections approach. In any case, and despite the time gained, excessive government indebtedness in terms of GDP and an unsustainable fiscal situation make concepts such as financial repression and fiscal dominance more relevant today than ever, once again highlighting the worrying lack of independence of central banks.

As we have argued since the first measures taken in the pandemic, which were later ratified in June 2021 with the G7 Carbis Bay communiqué, we have witnessed the largest state intervention in all areas of the economy since World War II. And once again we have also witnessed the abysmal difference in the ability, both in terms of magnitude and agility, between the United States and Europe to implement measures, thus widening the gap in productivity and economic growth between the two regions.

The situation in Europe is particularly alarming. To the persistent political paralysis, aggravated since the European Debt Crisis of 2012, we must now add the loss of competitiveness and productivity of an economy lacking in innovation and demographic dynamism, suffocated by excessive regulatory pressure and tax burden, with a weak energy and resource position, and where ideology is prioritized over the economic needs of its companies. This inevitably, and despite those who would have us believe that sustainability is not at odds with competitiveness, has triggered the flight of companies to the other side of the Atlantic, in the heat of greater incentives, more succulent valuations and more competitive energy prices.

In addition to the aforementioned challenges, there is the credit crunch resulting from rate hikes and the tightening of credit standards. This scenario is further complicated by the loss of independence of the European Central Bank, which has taken on the fight against climate change and sustainability as its own, which will make it more difficult for certain sectors and companies that are not in line with the regulator's expectations to access credit and financing, thereby slowing economic growth, job creation and technological innovation.

In this new politicized economy, where government spending accounts for 49.25% of GDP, and in the absence of regulators to encourage innovation and a regulatory framework conducive to the development of a competitive economy, our strategy must focus on identifying those sectors and companies to which the flow of credit and capital will be facilitated, putting valuations in perspective and thus avoiding falling into the so-called "value traps".

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PERFORMANCE

The fund returned +0.42% in the A class at the end of the first quarter, versus a Bloomberg Barclays Global Aggregate of -2.07%.

As we warned at the end of last year, 2024 was going to be a down year. The market has blurred 100 bps of downside, following the overly aggressive expectations that investors were counting on after the rallies of November and December. In terms of performance, the best performing strategies in the portfolio were European Financials Cocos and older vintage Spanish RMBS. Also adding significant returns, albeit to a lesser extent, were convertibles, senior debt of financial institutions and investment in domestic real estate. On the negative side, debt linked to currency hedges and emerging AAA zero coupons are the strategies that have detracted the most from the fund's performance.

POSITIONING AND OUTLOOK

During the quarter, we continued to maintain an agile positioning in terms of duration management, taking advantage of corrections in European long maturities to take profits on hedges and gradually increase duration, which we have set at 4.75 years. In dollar terms, we have maintained a slightly long bias, around 6%, which has enabled us to cushion some of the poor performance of the long maturities.

In terms of names, we have added Intesa and Nokia credit in the long maturities of the US curve at 7.5% and 7% respectively, which represents a pick-up of around 175bps of yield vs. euro issues, once the currency risk has been mitigated. We have also added convertible debt from Zalando and Coinbase, and for the first time in months we have added an HY issuer due to the deterioration suffered by Eutelsat after the results presentation, with yields above 10%. In terms of sales, we took profit on part of the long European curve longs we held in our portfolio, selling names such as Hungary, Jab Holdings or Blackstone. We also took profit on the Vallourec and Volkswagen positions because of the poor value they offered.

We continue to believe that it will be a year of less and more. Where the deflationary process should continue to unfold, as real interest rates of 2% and close to their historical average, strangle over-indebted economies. This will hopefully prompt the Federal Reserve to make a move as the November elections approach, after which we should see an easing of tax incentives, which will allow some relief in Treasury financing costs, although it is far from the solution.

At the end of the quarter the portfolio's yield was 5.3%, with a duration of 4.7 years and a cashflow coupon of 2.9%. The weighted average price of the portfolio is 85.9 cents per euro. The dollar exposure is 5.7%.

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