



AFFINIUM

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4º Quarter Letter 2021

January 31, 2022

“Nothing is more frequently overlooked than the obvious”.

—Thomas Temple Hoyne

There is nothing more deceptive than an obvious fact”.

—Sir Arthur Conan Doyle

The Difference Between Seeing and Observing

"When I hear you give your reasons, the thing always appears to me to be so ridiculously simple that I could easily do it myself, though at each successive instance of your reasoning, I am baffled until you explain your process. And yet I believe that my eyes are as good as yours."

"Quite so. You see, but you do not observe. The distinction is clear. For example, you have frequently seen the steps which lead up from the hall to this room."

"Frequently."

"How often?"

"Well, some hundreds of times."

"Then how many are there?"

"How many? I don't know."

"Quite so! You have not observed. And yet you have seen. That is just my point. Now, I know that there are seventeen steps, because I have both seen and observed."

A Scandal in Bohemia, Sir Arthur Conan Doyle, 1891.

Dear Fund Investor:

During the 4th quarter the NAV rose +2.58%, with the month of December result +2.48%.

The monthly results since the fund commenced operations on 31 March 2021:

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	2021
NAV	-	-	99.49	101.53	103.73	102.46	103.76	104.36	100.88	102.21	100.98	103.49	
Net Total Return	-	-	-	2.05%	2.17%	-1.23%	1.27%	0.58%	-3.33%	1.32%	-1.21%	2.48%	4.01%
Cumulative	-	-	-	2.05%	4.26%	2.98%	4.29%	4.90%	1.40%	2.73%	1.49%	4.01%	

The first question after a calendar year end is to ask, how did each asset contribute to the portfolio's total return? The answers are to be found within the field of 'Performance Analysis' in particular the techniques of 'Performance Attribution' and more precisely 'Return Contribution Analysis'.

Since we first started working in financial markets in 1995, the use of a simple arithmetic sum of each asset's gross return compared with the portfolio total arithmetic gross return was the only method and therefore the most prevalent. Today, this field has more papers and models than many asset valuation theories. However, we will continue to use the arithmetic sum of individual gross returns as this shows the asset contributions to portfolio gross total return in the simplest and most easily understandable manner.

RETURNS CONTRIBUTIONS*: March 31 2021 - December 31 2021

	Stocks	Real Estate	Gold	Bonds	Portfolio
2021	2.10%	5.53%	-0.75%	-1.02%	5.86%
* Gross Returns (not including "liquidez" or fund expenses)					

Regarding direct fund expenses, we can advance you the following direct expenses and the costs of the purchase and sale of individual securities ("corretaje"):

GASTOS DIRECTOS 2021	
Comision de Gestion	-0.91%
Comision Depositario	-0.09%
Tasas, Auditor, Banca etc.	-0.36%
Ratio Total Gastos	-1.36%
Corretaje Valores	-0.04% (€ 1 484.06)

Notice that the corretaje cost is not included in the Ratio Total de Gastos published by the CNMV.

The estimated average return from Cash/Liquidez including balances held at the custodian bank (depositario) and all the one-day REPO operations in public debt securities during the period was annualized at -0.55%

We also provide the average non-Euro foreign currency exposures during the period 31 March 2021 until 31 December 2021:

NON-EUR FX EXPOSURES 2021/22		
Currency	Amount	% of Fund
USD	\$242 650	6.43%
GBP	£19 200	0.68%

As you can appreciate, the Fund has almost no foreign currency exposure (risk). As such, the Fund does not gain or lose any significant extra return from movements in the USD vs the EUR or the GBP vs the EUR.

These insignificant foreign currency exposures are due to the use of derivatives and reflect the margins deposited in foreign currency as required, which are most of the time a very small proportion of the asset's total notional exposure value.

Therefore, although we invest approximately 92.5% of the Fund in USD denominated securities, we only have 6.43% USD exposure and 0.68% GBP exposure.

Considering that in 2021 the USD increased vs the EUR by +8.34%, we did not gain +7.72% from this USD appreciation against the EUR.

By the same token, if the USD had decreased vs the EUR by the same -8.34%, then we would not have lost -7.72% from such USD depreciation against the EUR.

In December 2021, many of you wrote to us enquiring about the difference between our Fund return and other portfolios or funds you considered to be 'similar'. Due to these enquiries, we published a memo titled –“*El impacto de divisa no-€ en el retorno total de una cartera o fondo: Un activo extra en cartera*”– explaining the principal reason for such a significant difference in our comparative return during 2021.

* * *

Markets

We begin this short section where we ended our last quarterly letter, namely central bank monetary policy and those infamous marketing terminologies of ‘QE’, ‘Operation Twist’, ‘QT’, ‘Balance Sheet Shrinkage’ etc. etc.

As the acute observers among you will be aware, the central bank playbook is again squarely focused on returning monetary policy back to ‘normal’.

Never be manipulated by marketing flare, the Fed has been trying to reduce its vast assets (balance sheet) –today close to \$9 trillion– back to the normal \$1 trillion and to increase base interest rates (Fed Funds Rate) back to a more normal level, since 2014. Why? So that monetary policy will be dependent –as it almost always was before– solely on the Fed Funds Rate. When the economy grew too hot –above moderate inflation– then raise Fed Funds, when the economy was too cold –rising unemployment– then lower Fed Funds.

This return to normal is the current end goal of the Fed and will be for a long time. Because reducing \$9 trillion of assets will need a long period of uninterrupted economic growth, similar to the periods 1991-2000 and again from 2009-2018.

As we mentioned in our 3Q letter, the Fed first tried this exercise from 2015 until 2019 when Fed Funds was raised from 0% to 2.5% and Fed assets were slowly reduced. The Fed Funds rate was lowered from 2.5% to 1.5% in 2019 to see if the economy could tolerate and grow at/above potential and from which interest rates could be raised to a higher ‘terminal rate’ once growth became too hot again. However, the exogenous shock of the Chinese Flu ruined the Fed’s plan.

This caused Fed Funds to fall again to 0% and Fed assets to balloon to double their post 2008 peak of \$4.5 trillion. Hence, we are all the way back to the beginning of the plan again, but with an even bigger \$9 trillion in assets and this time around, higher inflation.

The Fed now needs another long growth cycle to provide an environment in which the assets can be reduced little by little and interest rates can slowly grind higher along with the ups and downs of economic growth and the inevitable cycles.

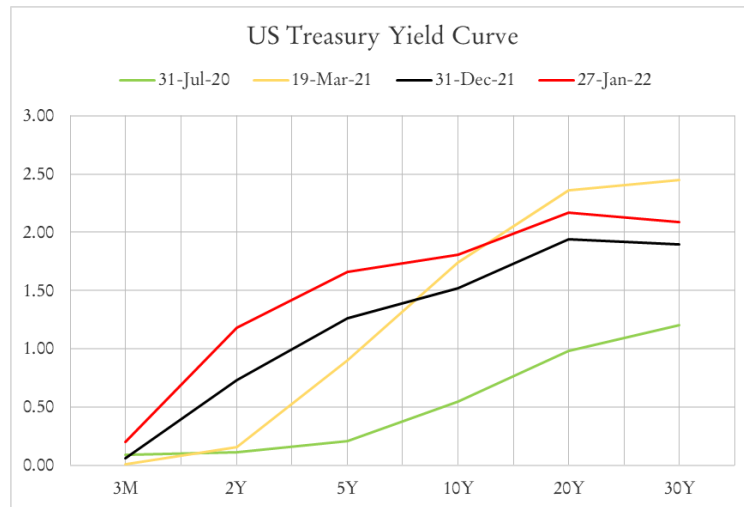
Absent any further exogenous shocks and assuming above potential GDP growth of 3-4%, we would estimate a minimum of 10 years as being ‘a long time’.

During this time there will still be cycles and if inflation is moderate, we can expect the Fed to attempt every central banker’s dream –the ‘Goldilocks Economy’. This is defined as reasonably robust economic growth and low unemployment together with low and stable inflation. The economy would be neither too hot to induce above moderate inflation nor too cold to cause unemployment to rise.

During our first years in financial markets, such a Goldilocks Economy was achieved under the guidance of Mr Alan Greenspan at the Fed. At the time he was characterized as simply a wizard.

As we turn to observe the bond market, we can see that the US Treasury bond yield curve is currently signaling we are close to the end of the current market cycle as the ‘flattening’

has started. After flattening is achieved at all maturities the curve can advance further into what is known as an ‘inversion’ –long term yields lower than short term yields.



–Chart 1–

One can observe the last recent bottom in yields generally was on 31 July 2020 and the peak in long term 20Y and 30Y on 19 March 2021. Since March 2021 both 20Y and 30Y are currently lower, whereas 3M, 2Y and 5Y are much higher, with the 2Y and 5Y especially higher as of 27 January 2022.

Moreover, we have already experienced an inversion at the 20Y to 30Y end of the curve since 31 December 2021. Finally, the 10Y is almost unchanged from 19 March 2021 to today 27 January 2022.

Now, our observations of bond market participants behavior are not a predictive signal rather just an observation. The future is full of possibilities and unimaginable events. Flattening can reverse and/or inversion arrive later or never.

The Fed’s actions from here will much depend on the evolution of economic growth and inflation, but we can be sure that they will at the very least commence removing the immense monetary support provided in response to the Chinese Flu shock.

At the same time, the substantial fiscal support provided by the government has already tailed off and will be negative in 2022. Removing both stimuli simultaneously will undoubtedly take some wind out of the economy’s sails.

Can Mr. Powell navigate policy, avoid too heavy a storm, and return the ship safely back to port?

We will see, but meanwhile –we will observe.

Yours faithfully,

Marcos Perez & Sharash Alexander

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