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Close Bond Income Portfolio Fund

Monthly fund manager update

May 2019

Performance

The Close Bond Income Fund returned +0.6% in May 2019, and 4.2% YTD. In comparison, the IA sterling corporate bond sector returned +0.8% in May and 4.9% YTD.

Macro backdrop

In May, macroeconomic data once again took a backseat to geopolitics. In the UK, Theresa May resigned as Prime Minister following a miserable performance in the European parliamentary elections for her ruling Conservative Party; and in the US, President Trump expanded the scope of his trade war rhetoric to a host of new countries. The net result was a general 'risk-off' tone across major markets and significant flows into 'risk-free' government bonds – with 10 year government bonds now yielding sub-1% in the UK; sub 2.2% in the US; and a record-low negative -0.21% in Germany.

On the UK macro side, data remained volatile and difficult to evaluate given ongoing political uncertainty. Q1 2019 quarter-on-quarter GDP growth was +0.5% (versus +0.2% in Q4 2018), though the improved data was likely stoked by stockpiling ahead of the potential 'no deal' Brexit on 31st March 2019. Stronger economic growth also led to a fall in the unemployment rate to 3.8% (from 3.9%), while inflation also ticked-up to 2.1% - though chiefly caused by rising energy prices and an Easter-holidays related surge in air fares. PMI survey data remained weak, reflecting ongoing global trade concerns, and underscoring concerns amongst investors that the stronger Q1 2019 data was an aberration – with stockpiling masking a general slowdown in the wider UK economy.

In the US, macro data remained relatively strong. Q1 2019 Annualised GDP growth was revised down slightly to +3.1% (though still a significant improvement on the Q4 2018 reading of +2.2%); inflation increased slightly to +2.0% (versus March 2019 figure of +1.9%); unemployment reduced to 3.6%; and average employee earnings remained stable at a still strong +3.2%. PMI survey data was generally weaker however – reflecting ongoing concerns around President Trump's increasingly aggressive trade policies.

In the Eurozone, data was broadly stable versus the previous month, though remains weak. Q1 2019 GDP growth improved to +0.4% (versus Q4 2018 reading of +0.2%); inflation increased to 1.7% (versus March 2019 figure of 1.4%); and unemployment improved to 7.7%. PMI survey data remained weak however – with the manufacturing sector especially weak as a (likely) result of global trade tensions.

Portfolio activity

The average rating on the portfolio was maintained at 'A', and 48% of fund holdings are in AAA to A- rated bonds. The fund now offers a yield of 3.0% and duration of 5.6 years (2.8 years of which is attributed to our 7.5% holding in long duration UK Gilts. We believe the very strong credit quality of the fund further de-risks it from future volatility.

Outlook and strategy

While the first 4-months of 2019 saw corporate bonds reverse all of the losses accumulated Q4 2018 – May was a slightly different story. Indeed, corporate bonds still

delivered positive returns, but these were driven by falling Gilt yields rather than tightening corporate bond spreads. Despite the fact that corporate bond valuations cheapened in May, we still believe that spreads are trading slightly rich to fair value (sterling BBB credit spreads are now 201bps, versus 5yr average of 183bps; 10yr average of 235bps; and 20yr average of 216bps). In

order to ensure capital preservation and deliver a high level of monthly income, we continue to seek out the best risk:reward ideas across investment grade, unrated and high yield bond sectors while always maintaining our minimum of 80% Investment Grade risk. We maintain our focus on stock selection reinforced by in-depth credit research, and continue to favour shorter duration corporate bonds in GBP and USD.

Close Bond Income Portfolio Fund discrete performance as at 31 May 2019

	YTD	2018	2017	2016	2015	2014
Close Bond Income Portfolio Fund	4.2%	-2.7%	7.6%	7.2%	1.0%	7.6%
IA £ Corporate Bond	4.9%	-2.2%	5.1%	9.0%	-0.3%	9.8%
IA £ Strategic Bond	4.7%	-2.5%	5.3%	7.3%	-0.2%	6.1%
IA £ High Yield	5.7%	-3.2%	6.1%	10.1%	-0.7%	1.3%

Source: FE Analytics 31.05.2019; all are X Acc share classes; performance is total returns, net of fees with dividends reinvested.

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