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Andrew Metcalf
Investment Director

Close Select Fixed Income Fund

Monthly fund manager update

June 2019

Performance

Close Select Fixed Income Fund returned 0.83% in June, and 5.07% YTD. In comparison, the IA Sterling Strategic Bond sector returned 1.55% in June, and 6.27% YTD. The key driver of the underperformance in June was the strong 'risk on' tone during the month, which saw the IA Sterling High Yield sector up +2.07%. Many of our strategic bond peers are heavily invested in the highly volatile High Yield space, while we remain very conservatively positioned versus the strategic bond sector (i.e. low duration and strong, BBB+ average credit rating).

Macro backdrop

On the UK macro side, data remained volatile and politics continued to be the main driver of fixed income markets. The two contenders to be the next UK Prime Minister emerged (Boris Johnson and Jeremy Hunt) – with both raising the risk of the UK leaving the EU in October 2019 with 'no-deal'. Regarding data, GDP growth (for April) fell by -0.4% month-on-month following a busy month of stockpiling ahead of the potential 'no deal' Brexit in March 2019. Unemployment remained stable at 3.8%; inflation fell slightly to 2.0% (from 2.1%, which itself was boosted by Easter-related spending); while PMI data was stable month-on-month at 50.9 – with manufacturing continuing to weaken as a result of global trade tensions, while consumer spending kept the services component in positive territory.

In the US, macro data remained relatively strong. The 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 decreased slightly to +1.8% (from +2.0). Unemployment remained stable at a very strong 3.6% and average employee earnings fell slightly to a still strong +3.1%. PMI survey data was the weakest for about 4 years, reflecting ongoing concerns around President Trump's increasingly aggressive trade policies, which are causing manufacturing weakness across the world.

In the Eurozone, data improved on the previous month, but remains weak. GDP growth for 12-months ending in Q1 2019 was confirmed at 1.2%; inflation fell to 1.2% and unemployment improved to 7.6%. PMI survey data also staged a small improvement, with manufacturing remaining very weak, but more than offset by a stronger services sector. Given ongoing trade tensions and political volatility in the UK (Brexit) and US (Iran, China, immigration rhetoric), the Eurozone now has the strongest PMI survey data of our three core markets.

Portfolio activity

Turning to portfolio activity, there were two major developments in June. Firstly, our holdings in Nationwide Building Society and Helical Bar Plc, which represented c.7% of the portfolio, matured as expected. The team had prepared for the successful 'roll off', and proceeds were reinvested into the Centrica 2021 Hybrid bond and a series of Barclays 2019, 2023 and 2024 bonds. And secondly, we took advantage of volatility in Trafigura bonds to increase our portfolio weighting in Trafigura to c. 4.9%. Following the publication of a research note from a short-seller of Trafigura's bonds (which claimed the company was overvaluing a specific asset), we spent two days with Trafigura's senior management in Geneva. We do not believe the short-seller's claims are material for debtholders given the assets under scrutiny represent less than 1% of Trafigura's USD 54bn of current assets,

and we added to the short duration 2020 bond at a yield of 7.5%.

On the portfolio construction side, duration was increased slightly to 3.5 years (0.6 years of which is a single Gilt holding), while the yield on the fund reduced to 3.9% as a result of strong positive returns over the period. We continue to believe that the combination of short duration and a c. 4% yield de-risks the fund from any future volatility.

Outlook and strategy

The first half of 2019 saw bond markets deliver the strongest 6-monthly return since the financial crisis in 2008, and returns were paradoxically strong across all segments, with both long-dated gilts (the ultimate 'risk-off' instrument) and High Yield (a 'risk-on' instrument) both delivering returns of c. 8%. We do not expect this 'Goldilocks' environment to continue. Indeed, sovereign bond yields are trading at, or near, historic lows, and we also believe that spreads are trading slightly rich to fair value (sterling BBB credit spreads are now 184bps, versus a 5yr average of 184bps; 10yr average of 232bps; and 20yr average of 217bps). 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. We maintain our focus on stock selection reinforced by in-depth credit research, and continue to favour shorter duration corporate bonds.

Close Select Fixed Income Fund discrete performance as at 30 June 2019

	YTD	2018	2017	2016	2015	2014
Close Select Fixed Income Fund	5.1%	-2.0%	7.4%	8.0%	1.7%	9.0%
IA £ Strategic Bond	6.3%	-2.5%	5.3%	7.3%	-0.2%	6.1%
IA £ Corporate Bond	6.3%	-2.2%	5.1%	9.1%	-0.3%	9.8%
IA £ High Yield	7.5%	-3.2%	6.1%	10.1%	-0.7%	1.3%

Source: FE Analytics 05.07.2019; all are X Acc share classes; performance is total returns, net of fees with dividends reinvested.