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# Close Bond Income Portfolio Fund

## Monthly fund manager update

July 2019

### Performance

The Close Bond Income Portfolio Fund returned +1.02% in July 2019, and 6.33% YTD. In comparison, the IA Sterling Corporate Bond sector returned +1.53% in July and 7.97% YTD. We remain very conservatively positioned versus the sector (i.e. higher credit quality and lower duration).

### Macro backdrop

On the UK macro side, politics continued to be the main driver of fixed income markets. Boris Johnson was elected as the new leader of the Conservative Party – and thus emerged as the new UK Prime Minister – raising the risk of the UK leaving the EU in October 2019 with ‘no-deal’. Following Johnson’s appointment, sterling and the UK 10 year Gilt yield both hit June 2016 lows as investors took fright at the new Prime Minister’s hardline rhetoric. Regarding data, the backward-looking numbers are relatively robust - GDP growth (for the 3-months to May 2019) was +0.3%; unemployment remained stable at 3.8%; and inflation remained stable at 2.0%. However, forward-looking data points are weakening: PMI data weakened to 49.7 (below 50 means the economy is likely shrinking) – with the manufacturing and construction sectors especially weak.

In the US, macro data remained relatively robust albeit on a weakening trend. Q2 2019 annualised GDP growth was +2.1% (versus +3.1% in Q1 ‘19, and +2.2% in Q4 ‘18); inflation decreased to +1.6% (from +1.8%); unemployment increased slightly to (a still very strong) 3.7%; and average employee earnings were stable at +3.1%. PMI survey data improved marginally MoM, but remains near 4 year lows – largely reflecting ongoing

concerns around President Trump’s increasingly aggressive trade policies – which are causing manufacturing weakness across the world. The weakening outlook prompted the Federal Reserve to cut the policy rate by 25bps, to 2.00% - 2.25%, and also end the Quantitative Tightening programme (i.e. balance sheet reduction) two months earlier than planned.

In the Eurozone, data was generally weaker versus the previous month. GDP growth for 12-months ending in Q2 2019 was confirmed at 1.1% (versus 1.2% in Q1 19); inflation increased slightly to 1.3%; and unemployment improved to 7.5%. PMI survey data weakened however – with manufacturing remaining very weak – partially offset by a stronger Services sector.

### Portfolio activity

The average rating on the portfolio was maintained at ‘A’, and 49% of fund holdings are in AAA to A- rated bonds. The fund now offers a yield of 2.6% and duration of 5.1 years (2.2 years of which is attributed to our 6.1% holding in long duration UK Gilts). We believe the very strong credit quality of the fund further de-risks the fund from any future volatility.

### Outlook and strategy

The first seven-months of 2019 saw bond markets deliver the strongest 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 176bps, versus 5yr average of 184bps; 10yr average of 230bps; 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 Bond Income Portfolio Fund discrete performance as at 31 July 2019

	YTD	2018	2017	2016	2015	2014
<b>Close Bond Income Portfolio Fund</b>	<b>6.3%</b>	<b>-2.7%</b>	<b>7.6%</b>	<b>7.2%</b>	<b>1.0%</b>	<b>7.6%</b>
IA £ Corporate Bond	8.0%	-2.2%	5.1%	9.0%	-0.3%	9.8%
IA £ Strategic Bond	7.3%	-2.5%	5.3%	7.3%	-0.2%	6.1%
IA £ High Yield	8.4%	-3.2%	6.1%	10.1%	-0.7%	1.3%

Source: FE Analytics 02.08.2019; all are X Acc share classes; performance is total returns, net of fees with dividends reinvested.

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