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Close Bond Income Portfolio Fund

Monthly fund manager update

September 2019

PERFORMANCE

The Close Bond Income Portfolio Fund returned +0.29% in September 2019, and 7.72% YTD. In comparison, the IA Sterling Corporate Bond sector returned -0.10% in September and 9.60% YTD. We remain very conservatively positioned versus the sector (i.e. higher credit quality and lower duration) – which generally leads to the Bond Income fund outperforming in 'down' markets.

MACRO BACKDROP

On the domestic front, politics continued to be the primary driver of fixed income markets as Prime Minister Johnson continued to oversee a minority government. Over the course of the month, he was ruled to have acted unlawfully when suspending Parliament; became embroiled in a scandal involving payments to a personal friend during his time as Mayor of London;, and increased his 'no deal' rhetoric ahead of the Conservative Party conference. Gilt markets remained volatile on Brexit related headlines.

With regards to specific data points, the backward-looking numbers remain volatile and relatively weak. GDP growth for the 3-months to July was 0%, albeit this beat consensus following a +0.3% month-on-month growth spike in July 2019. Unemployment improved slightly to 3.8% (from 3.9%); and inflation fell to 1.7% (from 2.1%). Forward-looking data points also weakened, but again remain volatile and closely linked to Brexit headlines. Indeed, PMI data weakened to 50.2 in August (versus the previous reading of 50.7), and all three constituent sectors (services, manufacturing and construction) are showing signs of stress.

In the US, macro data also showed signs of weakness. Q2 2019 annualised GDP growth was confirmed at +2.0% (versus +3.1% in Q1 2019, and +2.2% in Q4 2018); inflation fell to 1.7% (from +1.8%); unemployment remained stable at (a still very strong) 3.7%; and average employee earnings remained stable at +3.2%. PMI survey data also weakened to 50.7. Global trade tensions and geopolitical risk remain the key factors behind the weakening data.

In the Eurozone, data was mixed versus the previous month. GDP growth for 12-months ending in Q2 2019 was upgraded to 1.2% (in-line with Q1 2019); the inflation estimate for September decreased to 0.9%; and unemployment improved to 7.4%. PMI survey data was slightly stronger however (at 51.9) – although manufacturing remains very weak – due to a stronger Services sector.

PORTFOLIO ACTIVITY

The average credit rating on the portfolio was maintained at 'A', and 50% of fund holdings are in AAA to A- rated bonds. The fund now offers a yield of 2.6% and duration of 5.4 years (2.7 years of which is attributed to our 7.3% holding in long duration UK Gilts). We believe the very strong credit quality of the fund further de-risks it from any future volatility.

OUTLOOK AND STRATEGY

Bond markets have performed strongly over the first nine-months of 2019, but the 'Goldilocks' environment came unstuck in September 2019, as the IA Sterling Corporate Bond sector posted negative total returns and long duration indices underperformed. 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 192bps, versus a 5yr average of 184bps; 10yr average of 227bps; 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 30 SEPTEMBER 2019

	YTD	2018	2017	2016	2015	2014
Close Bond Income Portfolio Fund	**7.7%**	**-2.7%**	**7.6%**	**7.2%**	**1.0%**	**7.6%**
IA £ Corporate Bond	9.6%	-2.2%	5.1%	9.0%	-0.3%	9.8%
IA £ Strategic Bond	8.5%	-2.5%	5.3%	7.3%	-0.2%	6.1%
IA £ High Yield	9.1%	-3.2%	6.1%	10.1%	-0.7%	1.3%

Source: FE Analytics 03.10.2019.
Performance is total return, net income reinvested after fees, X Acc share class.

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