

Close Select Fixed Income Fund

Monthly fund manager update

OCTOBER 2019



ANDREW METCALF
Investment Director

FUND PERFORMANCE

The Close Select Fixed Income Fund returned +0.88% in October, bringing the year-to-date return to 7.37%. In comparison, the IA Sterling Strategic Bond sector returned +0.01% in October, and 8.45% YTD. Despite strong performance in October, 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, politics continued to be the main driver of fixed income markets, as the Brexit deadline was extended to 31st January 2020 and an election was confirmed for 12th December 2019. Of equal importance for fixed income markets was the fact that Parliament effectively agreed to support Prime Minister Johnson's new Brexit deal – significantly reducing the potential for a 'no deal' Brexit.

Regarding data, the backward-looking numbers are volatile and weak. GDP growth for August was -0.1%, albeit July's growth was revised up to +0.4% (resulting in +0.3% growth for the 3-months to August 2019). Unemployment rose slightly to 3.9% (from 3.8%); and inflation remained stable at 1.7%. Forward-looking data points also weakened, and again remain volatile and closely linked to Brexit headlines. Indeed, composite PMI data weakened to 49.3 in September (versus a previous reading of 50.2), and all three sectors (services, manufacturing and construction) are showing signs of stress.

In the US, macro data also remained volatile – albeit generally better than the market expected. Q3 2019, annualised GDP growth was +1.9% (versus +2.0% in Q2 2019 and +3.1% in Q1 2019); inflation was stable at 1.7%; unemployment improved to 3.5% (from 3.7%); and average employee earnings growth fell slightly to +3.0%. Composite PMI survey data also improved slightly to 51.2, with manufacturing and services sectors both benefitting from improved sentiment as the market believed a US-China trade deal was edging closer.

In the eurozone, data was generally weaker versus the previous month. GDP growth for the 12-months ending in Q3 2019 was +1.1% (versus +1.2% in Q2 2019); the inflation estimate for October decreased to 0.7%; and unemployment weakened to 7.5% (from 7.4%). Composite PMI survey data was slightly stronger however (at 51.8) with a still very weak

manufacturing sector offset by a slightly stronger services sector.

PORTFOLIO ACTIVITY

Turning to portfolio activity, October was another very busy and productive month for the fund.

Firstly, Burford – a 4.6% portfolio holding – received an inaugural 'Ba3' (Positive Outlook) credit rating on 30th October 2019 from Moody's, and a 'BB-(Stable Outlook)' from S&P on 1st November. Both ratings are in-line with our internal assessment of a BB rating, and we take particular comfort that Moody's highlighted Burford's "*strong capital position to buffer earnings volatility*", and that "*by maintaining high cash balances, employing low leverage and laddering debt maturities, Burford maintains a strong liquidity profile*". We anticipated a potential inaugural credit rating as a major positive catalyst for our Burford holding, and expect the rating to attract more investors to the Burford credit story, given its bonds will enter the major high yield indices over the coming months.

Secondly, our decision to participate in a series of attractively-priced, new issue bonds in September 2019 continued to generate outsized returns – with our new holdings in Rothesay Life; Nationwide Building Society; and Barclays (representing 5.5% of the portfolio) delivering total returns of between 6% and 7.5% over just 6-weeks.

On the portfolio construction side, duration reduced slightly to 3.8 years (0.6 years of which is a single Gilt holding), while the yield on the fund is 4.0% (following strong performance in October). We continue to believe that the combination of short duration and a 4%+ yield de-risks the fund from future volatility.

OUTLOOK AND STRATEGY

Bond markets performed strongly over the first 8-months of the year, but the 'Goldilocks' environment came unstuck in September and October as the IA Sterling Strategic Bond sector posted anaemic returns (of c. 0.17%) and the IA Sterling Corporate Bond sector posted negative total returns. Indeed, sovereign bond yields remain near historic lows, while we also believe that spreads are trading slightly rich-to-fair value (sterling BBB credit spreads are now 177bps, versus their 5yr average of 184bps; 10yr average of 226bps;

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 PERFORMANCE AS AT 31 OCTOBER 2019

	YTD	2018	2017	2016	2015	2014
Close Select Fixed Income Fund	7.37%	-1.96%	7.36%	7.97%	1.68%	9.03%
IA £ Strategic Bond	8.45%	-2.49%	5.31%	7.33%	-0.19%	6.09%
IA £ Corporate Bond	9.37%	-2.22%	5.06%	9.08%	-0.27%	9.83%
IA £ High Yield	8.94%	-3.23%	6.05%	10.09%	-0.66%	1.25%

SOURCE :

FE Analytics 05.11.2019; YTD data as at 31.10.2019; all figures are for the X Acc share class; performance is total return, net of fees with dividends reinvested.

IMPORTANT INFORMATION

This document is only intended for use by UK investment professionals and should not be distributed to or relied upon by retail clients. The value of investments will go up and down and clients may get back less money than they invested. Past performance is not a reliable indicator of future returns. The information contained in this document is believed to be correct but cannot be guaranteed. Opinions constitute our judgment as at the date shown and are subject to change without notice. This document is not intended as an offer or solicitation to buy or sell securities, nor does it constitute a personal recommendation.

Close Brothers Asset Management is a trading name of Close Asset Management Limited (Registered number: 01644127) and Close Asset Management (UK) Limited (Registered number: 02998803). Both companies are part of Close Brothers Group plc, are registered in England and Wales and are authorised and regulated by the Financial Conduct Authority. Registered office: 10 Crown Place, London EC2A 4FT. VAT registration number: 245 5013 86. CBAM5425