Close Brothers
Asset Management

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Close Select Fixed Income Fund

Monthly fund manager update

NOVEMBER 2019

ANDREW METCALF
Investment Director

FUND PERFORMANCE

The Close Select Fixed Income Fund returned +1.08% in November, and 8.53% year-to-date (YTD). In comparison, the IA Sterling Strategic Bond sector returned +0.25% in November, and 8.73% YTD.

Our conservative positioning versus the Strategic Bond Sector (i.e. low duration & strong 'BBB+' average credit rating) has generated strong returns over the past 3 months - and we remain conservatively positioned heading into December 2019.

MACRO BACKDROP

Politics continued to be the main driver of fixed income markets as the country approaches the general election on 12th December. UK Bond markets continued to reflect the opinion polls' expectations of a Conservative Party majority – with Gilts underperforming (less demand for 'risk-off' assets), and corporate bonds outperforming (less political risk and upbeat expectations of growth under a Conservative Government).

Backward-looking data remains relatively weak. Month-on-month GDP growth for September was -0.1%, leading to Q3 2019 growth of +0.3%. Unemployment fell slightly to 3.8%; and inflation declined to +1.5% (from 1.7%). Forward-looking data points also weakened, with composite PMI data declining to 48.5 in November (from 50.0 in October), with all 3 sectors (Services, Manufacturing and Construction) 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 revised up to +2.1% (from the original estimate of +1.9%, and versus +2.0% in Q2 '19 and +3.1% in Q1 '19); inflation increased slightly to +1.8%; unemployment increased slightly to 3.6% (from 3.5%); and average employee earnings growth was stable at +3.0%. Composite PMI survey data also improved slightly to 51.9, 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 broadly stable versus the previous month. GDP growth for the 12-months ending in Q3 2019 was +1.2% (versus +1.2% in Q2 '19); the inflation estimate for October increased to +1.0%; and unemployment was stable at 7.5%. Composite PMI survey data was slightly weaker however (at 50.3) – with Manufacturing remaining very weak – partially offset by a slightly stronger Services sector.

PORTFOLIO ACTIVITY

Turning to portfolio activity, November was another very productive month for the fund. Firstly, our UK-focused holdings (such as Barclays, Nationwide and PHP) continued to outperform as the perceived 'no deal' Brexit risk declined further and polls for the General Election increasingly pointed to a Conservative Party majority (at the time of writing)

Secondly, Burford (a 4.6% portfolio holding) continued to perform strongly given the company received an inaugural 'Ba3' (Positive Outlook) credit rating on 30th October from Moody's, and a 'BB-' (Stable Outlook) from S&P on 1st November. Burford bonds are up between +3% to +5% in November (and +12% to + 14% over past 3 months).

And thirdly, our active and nimble approach to portfolio management again generated outsized returns in November. Medical Properties Trust – an international Healthcare REIT - issued two inaugural sterling bonds. After meeting the company and conducting our research, we bought a 3.6% portfolio position in the new 2027 bond. Investor demand for the new bonds was very strong and just 24 hours after issue they appreciated to our fair value target. We quickly sold our entire £7.5m holding for a 1.6% profit. To put that 24 hour return into context, an investor would need to hold a 10 year Gilt for 2 years to generate the same return.

On the portfolio construction side, we reduced duration slightly to 3.7 years (0.6 years of which is a single Gilt holding), while holding the yield on the fund at 4.1%. We continue to believe that the combination of short duration and a 4% + yield should de-risk the fund from future volatility.

OUTLOOK AND STRATEGY

Bond markets performed strongly over the first 8-months of 2019, but the 'Goldilocks' environment has come unstuck over the last 3 months (September to November); markets have posted anaemic returns at best. Sovereign bond yields remain near historic lows; while we believe that spreads are trading slightly rich-to-fair value (sterling 'BBB' credit spreads

are now 174bps, versus their 5yr average of 184bps; 10yr average of 225bps; 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 30 NOVEMBER 2019

	YTD	2018	2017	2016	2015	2014
Close Select Fixed Income Fund	**8.53%**	**-1.96%**	**7.36%**	**7.97%**	**1.68%**	**9.03%**
IA £ Strategic Bond	8.73%	-2.49%	5.31%	7.33%	-0.19%	6.09%
IA £ Corporate Bond	9.54%	-2.22%	5.06%	9.08%	-0.27%	9.83%
IA £ High Yield	9.69%	-3.23%	6.05%	10.09%	-0.66%	1.25%

SOURCE:

FE Analytics 03.12.2019; YTD data as at 30.11.2019; all figures are for the X Acc share class; performance is total return, net of fees with dividends reinvested.