Close Brothers Asset Management

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Close Tactical Select Passive Funds

Monthly fund manager update

DECEMBER 2019

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Investment Manager

MONTH AND YEAR IN REVIEW

Overall, the Close Tactical Select Passive (TSP) range enjoyed a strong year in 2019. The Conservative and Growth strategies outperformed their respective IA peer groups, while the Balanced strategy was only fractionally adrift of its sector.

Equities posted another month of positive returns in December, rounding off a strong year which saw the majority of developed and emerging market indices return more than +15% in local currency terms. The best performing investment across the TSP range for 2019 was the iShares Nasdaq 100 ETF, which provided holders with a +33.6% return in sterling terms. Elsewhere, UK mid-cap outperformed large-cap, which the TSP range was able to capture through the HSBC FTSE 250 index fund. This fund returned +4.8% in December and +29.5% in 2019 – making it another of the best performing TSP investments.

Sterling fixed income was mostly negative in December. However, in 2019, UK corporate bonds delivered roughly two-thirds of the returns of UK equities (+11.4% versus +16.4% respectively). Over the course of the year, long duration bonds outperformed short duration, both in gilts and corporates. The worst performing fixed income investment was the Lyxor FTSE Actuaries UK 0-5 Year Gilts ETF – but this was still in positive territory, up +1.0%.

Alternatives were also mostly positive in December, with Global REITS being the only drag on performance as they were held back by sterling strength. As expected, our range of alternatives delivered widely varying returns in sterling terms over the year: the JPM Managed Futures ETF was the worst performer, yet still positive at +4.2%; while our best performing holding in this space was the iShares UK Property ETF, which was up +29.4%.

GENERAL POSITIONING

December was ultimately positive for risk assets, as a decisive Conservative victory in the General Election and progress in the US-China trade dispute helped to alleviate some short-term uncertainty. Anticipating this, we increased equities to overweight and pared back our overweight to alternatives heading into 2020.

Within fixed income, we remain overweight corporate versus government bonds and prefer short duration to long. Elsewhere, within alternatives, we are still overweight commodities (primarily gold), while underweight property/REIT investments.

ARTICLE: THE ETF IS DEAD! LONG LIVE THE ETF!

In recent years, we have all become used to retail going big, whether 'bricks' or 'clicks': out of town shopping centres, massive malls and on-line conglomerates which sell us whatever we want whenever we want it. Big, instant and cheap might sum it up. This trend has to some extent also pervaded the investment management industry, with fund supermarkets and multi-trillion dollar asset managers soaking up investors' cash in a highly competitive market. However, critical mass is not always easy to achieve in investments, or sustainable even at such scale. Occasionally closures result.

The proliferation of Exchange Traded Products (ETPs)[1], like ETFs, since the Global Financial Crisis is one manifestation of quick and cheap retail, as ever greater flows have been attracted to passive investments over the last decade. Yet, whilst this is broadly acknowledged as an almost irreversible trend, ETP closures have not caused such a stir to date.

OVER AND OUT

According to data analyst and provider Bloomberg, there were over 1,000 ETP closures globally in 2018.[2] Among last year's casualties were:

- UBS MSCI World Select Factor Mix ETF closed in November citing low levels of AUM as a key reason.[3]
- 13 X-trackers ETFs from German asset manager DWS closed in October as a result of "persistently low levels of investor demand and fund sizes that have consistently remained below the Minimum Fund Size".[4]

In the majority of cases, after de-lisiting and liquidation, cash was returned to investors in accordance with termination agreements, so investors did not usually suffer a monetary loss. However, moribund ETPs tend to have wide spreads and thin volumes, meaning they may become relatively expensive to trade. The removal of some ETPs from the market is arguably a good thing for investors. But at very least, closures can be a headache as they prompt more research to identify a replacement ETP, taking time and incurring costs.

True, there may have been tell-tale "closing down" signs with parallels in general retail; low AUM (poor footfall and sales),

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poor product placement (not filling a gap in the market) and a saturated playing field (too many competitors and low barriers to entry). But these signals are only informative if anticipated and understood in time.

In much the same way that failing businesses may close, so too might languishing ETPs. This is a Darwinian tale of the survival of the fittest and in part attests to the health of the ETP market. As with the High Street, the unrelenting downward pressure on fees offers little solace to the ETP minnow in a winner-takes-all market. Many products are not viable at the margin when perhaps £100m might be considered the lower bound of a fund's AUM – especially if they carry an OCF of less than 0.1% p.a. The lower the fees, the higher the AUM threshold of survival. If you're stacking 'em high and selling 'em cheap, you have to shift a huge volume just to cover costs.

At Close Brothers Asset Management, we aim to avoid these pitfalls in our Close Tactical Select Passive range by following a stringent due diligence process to partner with asset managers offering ETPs, and a strict methodology in choosing the right ETP to express our tactical asset allocation. Understanding not just an ETP's absolute levels of AUM, but more importantly the market trends and investors' appetite for the said product, are key.

The wider point is this: *cheapest* may mean biggest but cannot always, if ever, be synonymous with *best*. Quality has an intrinsic value of which cost is but one dimension. As the ETP market grows and matures, we must rightly continue to be discerning to ensure that only the best ETPs survive. Even if no absolute financial loss results from an ETP's liquidation, the headache of replacing it bears a cost which, in the ETP providers' world of fractional gains and vanishing headline fees, can chip away at performance at the portfolio level.

[1]ETP: Exchanged Traded Products (includes ETF, Exchange Traded Funds, ETC, Exchanged Traded Commodities, ETN, Exchange Traded Note).
[2]Bloomberg Opinion: "1,000 Dead ETFs is Cause for Celebration", 29th November 2019.
[3]FT Adviser, 30 September 2019.
[4]DWS Q&A Factsheet, October 2019.

CLOSE TACTICAL SELECT PASSIVE FUNDS DISCRETE PERFORMANCE AS AT 31 DECEMBER 2019

	2019	2018	2017	2016	2015	2014
Close TSP Conservative Fund	**12.1%**	**-4.2%**	**6.5%**	**14.3%**	**1.9%**	**8.2%**
IA £ 20-60% Equity	11.8%	-5.1%	7.2%	10.3%	1.2%	4.9%
Close TSP Balanced Fund	**15.3%**	**-5.3%**	**9.1%**	**17.6%**	**2.5%**	**7.3%**
IA £ 40-85% Equity	15.8%	-6.1%	10.0%	12.9%	2.7%	4.9%
Close TSP Growth Fund	**17.7%**	**-5.5%**	**11.8%**	**16.4%**	**1.8%**	**7.0%**
IA £ Flexible Investment	15.7%	-6.7%	11.2%	13.8%	2.0%	4.9%

SOURCE:
FE Analytics 06.01.2020. 2019 full year data as at 31.12.2019; all are X Acc share classes; performance is total returns, net of fees with dividends reinvested.