

Close Select Fixed Income Fund

Fund manager update

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WHY ARE WE WRITING TODAY?

The last time we published a mid-month update was in July 2019 in a piece entitled "Crazy Rich Bond Markets." It is very unusual for us to communicate mid-month, but these are unusual times.

Regular readers of our monthly updates will recall that the fund significantly increased cash levels (to c. 13%) in December 2019 in response to what we perceived were exuberantly high (expensive) valuations across global bond markets. We expected markets to get cheaper, but we certainly did not expect anything of the magnitude we are witnessing today.

WHAT IS GOING ON IN BOND MARKETS?

Close Brothers Asset Management has written separately on the conditions which created the current panic in the markets. Essentially, the global spread of COVID-19 and the resulting shutdown of major economies – compounded by an unfortunately timed 'oil war' between Saudi Arabia and Russia – provide the backdrop.

What many non-fixed income specialists will unlikely be able to see, however, are the ripple effects these factors are having under the surface. Bond markets are behaving irrationally. Redemptions at almost any price are dragging down all valuations, **but also creating opportunities**.

Following the sharp sell-off, BBB spreads have widened to c. 290 bps versus the 20yr average of 217 bps. High yield spreads have also collapsed to c. 890 bps versus the 20yr average of 600bps. Bonds now appear cheap on every timeframe.

WHAT ARE WE DOING?

1. **We are maintaining high cash levels.** We have c. 10% in cash today, and our ultra-short duration positioning means we have another 13% of the portfolio maturing in the next 3 months.
2. **We remain nimble and active** – and are buying super-short duration securities at previously unthinkable yields. The following are a few prominent examples:

- We have bought an International Personal Finance bond maturing in 7 weeks at a yield of **44%**. The bond has already been refinanced and liquidity is available to repay the bond today.
 - We have bought a William Hill bond maturing in 10 weeks at yields of up to **13%**. Bond refinancing is already covered by c. GBP 800m of liquidity.
 - We have bought Paragon 2020 bonds (8.5 months to maturity) at a yield of **17%**.
 - We have added to our holdings in Trafigura 2022 and 2023 bonds – which are yielding between **12% and 25%**. In our opinion, oil price volatility (and lower oil prices) is good for Trafigura which is likely to be a beneficiary of the oil price war.
3. **We have sold our Gilts.** In December 2018, we bought the 2071 Gilt at a price of c. £90. In the last few days, we have sold our holdings at an average price of £141. Our timing has been exceptional – as the 2071 Gilt is now 42 points lower than just 9 days ago. This sale has reduced duration (and therefore risk) significantly.

HOW IS THE FUND POSITIONED TODAY?

On the portfolio construction side, duration has decreased to just 2.5yrs – a record-low – while the yield on the fund is c. 6.8% - a record high. The average rating on the fund is currently BBB+.

As noted, around 10% of the fund is currently held in cash, while a further 13% will mature within 3 months and 21% will mature within 6 months. This is a buyer's market, and we remain extremely nimble and well-positioned to take advantage of current market conditions.

WHAT ABOUT THE NEXT 6-12 MONTHS?

For the first time in several years, bonds are cheap – this could be a once in a generation buying opportunity. Central banks and governments are injecting significant monetary and fiscal stimulus into the global economy in a co-ordinated effort. While we must, of course, monitor the situation carefully, there is every possibility that the current crisis could lead to an aggressive rebound in bond markets in the second half of the year.

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