Close Brothers
Asset Management

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Close Select Fixed Income Fund

Monthly fund manager update

MARCH 2020

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FUND PERFORMANCE

The Close Select Fixed Income Fund returned -9.2% in March, and -8.4% YTD. In comparison, the IA Sterling Strategic Bond sector returned -7.6% in March, and -6.4% YTD.

March was an extraordinary month for all asset classes – characterised by wild bouts of volatility and market pricing dislocations not witnessed since the financial crisis in 2008.

The Close Select Fixed Income Fund has emerged from this volatility in a very strong position given its:

- Yield to expected call = 6.8% (a record high)
- Duration = 2.2 years (a record low)
- Average rating = A-
- Cash level = 13.3%

This commentary will be different to the usual monthly update format, as the team have been very active throughout March – and we want to highlight exactly what the fund offers today.

MACRO BACKDROP

Global macro data published in March – but relating to data points in January and February 2020 – is of limited value given that it does not yet reflect the impact of COVID-19 on the global economy.

Of more value are the actions of central banks and governments, which have been remarkable – both in terms of size and speed of implementation. In just three weeks, the value of stimulus packages put forward has far eclipsed the multi-year response of central banks and governments after the 2008 financial crisis.

In the UK

- The Bank of England cut rates to 0.10% (from 0.75%); increased the quantitative easing target to GBP 645bn (from GBP 445bn); and launched a series of cheap funding lines to ensure banks boost lending to SMEs.
- The UK government also acted decisively, announcing that they will pay 80% of salaries for workers affected by the crisis; providing GBP 330bn of guarantees to businesses suffering from COVID-19; extra funding for public services; and a range of safeguards for households affected by the virus.

In the US

- The Federal Reserve cut rates to 0–0.25% (from 1.50 – 1.75%); increased quantitative easing by USD 700bn (with a commitment to do more as required); announced intentions to buy investment grade corporate bonds; and provided cheap funding lines to banks.
- The US government passed a c. USD 2.2 trillion stimulus package which will involve c. USD 250bn of cash being sent directly to households; c. USD 500bn of extra unemployment insurance; and USD 1.4 trillion of lending and grants to business and government programmes.

In the EU

- The ECB initially increased the quantitative easing target by EUR 120bn (to EUR 360bn); before announcing additional plans to buy an extra EUR 750bn of assets just one week later.
- Individual Eurozone governments also announced sizeable fiscal stimuli, including c. EUR 750bn of funding and guarantees in Germany and EUR 345bn in France.

PORTFOLIO ACTIVITY

Turning to portfolio activity, there are several key themes to highlight.

1. **We have been nimble and active:** As highlighted in the mid-month update on 19th March, we have been buying super-short duration bonds at previously unthinkable yields. This opportunity has arisen as many funds – including ETFs – have suffered redemptions and were forced sellers of bonds. We used our high cash balances to capitalise on these opportunities. A few examples:

- We have bought an International Personal Finance bond maturing in 38 days at a yield of **44%**. The bond has already been refinanced and liquidity is available to repay the bond.
- We have bought a William Hill bond maturing in 9 weeks at yields of up to **13%.** Bond refinancing is already covered by c. GBP 760m of cash on balance sheet.
- We have bought Paragon Group 2020 bonds (8.5 months to maturity) at a yield of **17%.**
- We have added to our holdings in Trafigura 2022 and 2023 bonds – bonds which are yielding **12% - 25%.**

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Trafigura thrives on low oil prices and volatility, and is likely to be a beneficiary of the oil price war.

- We have added to a series of strong investment grade bonds (UBS; Phoenix Group; BHP Group) maturing between 2021 and 2025 at yields of over **6%.**
- We have sold the only bond with any direct COVID-19 risks attached (Saga Group), and those bonds at risk of being downgraded to High Yield (Daily Mail Group).

2. **We are maintaining relatively high cash levels:** Given ongoing market volatility, we plan on maintaining a c. 10% cash position for the foreseeable future. This will allow us to respond quickly to emerging opportunities. Given c. 17% of the fund will also mature within the next three months, the fund has a strong liquidity profile and plenty of firepower to invest as new opportunities arise.

3. **We have optimised the portfolio**: As of 1st April 2020, the fund is in excellent shape. The yield has never been higher (6.8%); duration has never been lower (2.2 years); and credit quality (for the rated portion of the portfolio) and liquidity are both very strong. We believe the fund is well-placed to generate strong risk-adjusted returns going forward.

OUTLOOK AND STRATEGY

For the first time in several years, bonds are cheap. We believe this could be a once in a generation buying opportunity.

Regular readers of our monthly updates will recall that we have considered bond markets to be “rich”, “expensive” or “relatively expensive” for almost three years. The indiscriminate sell-off in March however has fundamentally changed the landscape. Following the sharp selloff, BBB spreads have widened to 311 versus the 20yr average of 217. BB spreads have also collapsed to c. 640 versus 20yr average of 432. Bonds appear cheap on every timeframe.

We remain focused on risk-adjusted returns, and believe that optimal returns can be generated in short duration, high quality corporate bonds. Short duration bonds will naturally ‘pull to par’ as they approach maturity – even if markets remain volatile. Our investment methodology is also based on the risks associated with the alternative approaches. Indeed, high yield bonds are likely to be negatively impacted by rising default rates, while Gilt yields are near-zero, meaning risk-free bonds offer plenty of volatility, but no income or certainty of positive returns.

CLOSE SELECT FIXED INCOME FUND PERFORMANCE AS AT 31 MARCH 2020

	YTD	2019	2018	2017	2016	2015
Close Select Fixed Income Fund	**-8.4%**	**9.37%**	**-1.96%**	**7.36%**	**7.97%**	**1.68%**
IA £ Strategic Bond	-6.4%	9.26%	-2.49%	5.31%	7.33%	-0.19%

SOURCE:

FE Analytics 02.04.2020; YTD data as at 31.03.2020; all figures are for the X Acc share class; performance is total return, net of fees with dividends reinvested.