Close Brothers Asset Management

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Close Select Fixed Income Fund

Monthly fund manager update

JULY 2020

ANDREW METCALF
Investment Director

FUND PERFORMANCE

The Close Select Fixed Income Fund returned +0.62% in July, bringing the year-to-date (YTD) return to -2.13%. In comparison, the IA Sterling Strategic Bond sector returned +1.57% in July and has returned +2.55% YTD. The fund was, however, subject to a technical "swing price" in July. This occurred on the final day of the month and negatively impacted the return figure for the period.

The technical 'swing price' event on 31 July meant that performance data will appear artificially lower (by -0.65%) for the month. This swing price reversed the following business day (Monday 3 August), thereby boosting performance by a corresponding +0.65% which will be evident in the August figures. Swing prices occur when the fund has an inflow / outflow greater than 1%.

MACRO BACKDROP

In the UK, forward-looking data points improved, with July composite PMI data rising to 57.1 (from 47.7 in June. For context, April's record low stood at just 13.8). The backward-looking data is finally reflecting the 'new normal' of materially reduced economic activity, with quarter-on-quarter (QoQ) UK GDP growth falling -19% in May. Consensus forecasts paint an improving picture, but remain bleak given they have yet to factor-in data from June and July. Indeed, GDP growth is forecast to remain negative until at least Q2 2021; inflation is expected to remain below 0.6% for the next 12 months; while unemployment is (optimistically) forecast to increase to c. 8% in Q4 2020.

In the US, forward-looking data also improved, with July composite PMI data rising to 50.0 (versus the April nadir of 27.0). While Q2 2020 QoQ annualised GDP growth was a very weak -32.9%, consensus forecasts continue to indicate a strong rebound in Q3 2020 of +18% (and further positive growth over the next 3 quarters), as well as inflation remaining below 0.8% over the next 12 months. While US unemployment data has positively surprised markets over the past 10 weeks, this data should be treated with caution, as there are significant anomalies within it which we feel have yet to be rectified by US statistical agencies.

In the Eurozone, the data is broadly aligned with the UK and US. June composite PMI data improved to 47.5 (versus 31.9 in May and 13.5 in April), while Q2 2020 QoQ GDP growth was -12.1% (-40% on annualised basis). Consensus forecasts indicate weak but improving data from here – including negative GDP growth until at least Q2 2021); inflation below 0.5% over the next 12 months; and unemployment rising to c.10% until at least Q2 2021.

PORTFOLIO ACTIVITY

Turning to activity, there were two key developments within the fund in July 2020.

Firstly, the fund's unrated exposure decreased significantly as c. 10% of holdings matured – all of which happened to be unrated. Indeed, Balfour Beatty 2020; Shawbrook Bank 2025; and Sainsbury's 2020 bonds were called; tendered or matured. Given sizeable unrated bond maturities over the past 10 weeks, coupled with a myriad of attractive new issues in the rated space, the unrated portion of the fund has reduced to just 17% (versus 35% in January 2020).

Secondly, we reinvested the proceeds from maturing bonds into new and existing ideas – adding to positions in Hikma 2025 (BBB-; Yield = 3.1-3.5%); Barclays 2022 (BBB+; Yield = 3.5%); UBS Perp (BBB; Yield = 5.1%); Raiffeisen Bank Perp (BB+; Yield = 6.0%); and Travis Perkins 2023 (BB+; Yield = 3.7%).

On the portfolio construction side, duration increased slightly to 3.4 years, while the fund's yield to expected call reduced to 3.6% (the Yield to Maturity = 3.9%, but we believe the lower figure is a more accurate measure of yield). The average rating on the rated portion of the portfolio is BBB+. As mentioned above, the unrated portion of the fund has reduced significantly of late, while the fund has c. 10% in cash.

OUTLOOK AND STRATEGY

The general market weakness in March and strong rally in April – July initially led to a valuation distinction between Sovereign; Investment Grade; and High Yield bonds – albeit all sub-asset classes now appear rich or near fair value:

- **Sovereign bond yields** remain at (or near) record lows across the US, UK and Eurozone given weakening macro data; Central Bank intervention; and Covid-19 concerns.

- **Sterling Investment Grade** bonds are priced at fair value versus all historical timeframes, with sterling 'BBB' credit spreads at 200bps, versus their 5yr average of 184bps; 10yr average of 225bps; and 20yr average of 217bps.
- **Sterling High Yield** spreads are slightly cheap versus history given current spread of 661bps (5yr average = 452bps; 10yr average = 516bps; 20yr average = 601bps). High Yield spreads in USD and EUR however – which are significantly larger and more liquid markets - are both trading at fair value versus historical timeframes.

Aiming to preserve capital and generate a good 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.

CLOSE SELECT FIXED INCOME FUND PERFORMANCE AS AT 31 JULY 2020

	YTD	2019	2018	2017	2016	2015
Close Select Fixed Income Fund	**-2.1%**	**9.4%**	**-2.0%**	**7.4%**	**8.0%**	**1.7%**
IA £ Strategic Bond	2.6%	9.3%	-2.5%	5.3%	7.3%	-0.2%

SOURCE:

FE Analytics 04.08.2020; YTD data as at 31.07.2020; all figures are for the X Acc share class; performance is total return, net of fees with dividends reinvested.