Close Brothers Asset Management

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Close Select Fixed Income Fund

Monthly fund manager update

OCTOBER 2020

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Investment Director

FUND PERFORMANCE

The Close Select Fixed Income Fund returned +0.6% in October, and is up +0.6% year-to-date (YTD). In comparison, the IA Sterling Strategic Bond sector returned +0.2% in October, and is up +3.1% YTD.

Fund performance in the first 4-months of H2 2020 is therefore +3.4%, while the IA Sterling Strategic bond sector returned +2.2%.

MACRO BACKDROP

The backward-looking macro-economic data has followed a broadly similar Covid-19-related trend across all 3 major markets over the past 6 months. We believe this is likely to change in Q4 2020 however, as the UK and major European economies enter new broad-based lockdowns. The US approach to containing coronavirus on the other hand remains highly uncertain. The big question remains whether the economic harm triggered by the Q4 2020 national lockdowns in the UK and Europe avoids longer term economic damage.

In the UK, forward-looking data points weakened for the second consecutive month, with October composite Purchasing Managers' Index (PMI) survey data falling to 52.9 versus 56.5 in September. Nevertheless, the current reading remains in expansionary territory and is considerably stronger than April's record low of 13.8. The GDP bounce-back that started in May 2020 has also continued to slow, with August 2020 GDP growing just 2.1% month-on-month (MoM) – and this is before the announcement of a second national lockdown which starts on the 5th November. Consensus forecasts have yet to fully catch-up and reflect the impact of a second lockdown, but overall 2020 GDP growth is forecast to be -10%; inflation is expected to remain below 2% until 2023; and unemployment is projected to peak at c. 7.5% in Q4 2020. However, we believe forecasts are at risk of downgrades over the next 4 weeks.

In the US, forward-looking data improved, with October composite PMI data of 55.5 (September 2020 was 54.3). Q3 2020 annualised GDP growth followed the same improving trend, growing 33.1% quarter-on-quarter (QoQ), albeit from a very weak -31.4% in Q2 2020. Consensus forecasts continue to indicate modest growth in Q4 2020, and an overall GDP contraction of -4.0% in 2020. Inflation is forecast to remain below 2% until 2023; and US unemployment data is expected to improve steadily from the August unemployment figure of 8.4%.

In the Eurozone, forward-looking data is weaker than the UK and US given earlier lockdowns across Eurozone countries – with October composite PMI data a weak 49.4 (versus 50.4 in September). While Q3 2020 QoQ GDP growth was +12.7% (reversing the -11.8% fall in Q2 2020), consensus forecasts indicate +1% QoQ growth in Q4 2020; inflation below 1.3% until 2023; and unemployment continuing to rise to 9.4% in Q1 2021.

PORTFOLIO ACTIVITY

Turning to portfolio activity, October was a relatively quiet month as we cautiously and selectively deployed 5% of our cash reserves. Our deep dive credit research continues apace, and over the month we added to Caixa Bank Perpetual bond (rating = BB / yield = 6.5%); Jupiter 2025 (BBB- / 5.9%); Perenti 2025 (BB / 5.7%); Pension Insurance Corp 2032 (BBB+ / 3.6%); and Pershing Square 2030 (BBB+ / 3.3%).

Given current valuations, which we consider to be slightly rich to fair value, we will continue to deploy cash very cautiously and selectively – targeting only those bonds with exceptional risk-reward characteristics.

On the portfolio construction side, cash levels are at 11% (versus 16% in September); duration is 3.3 years; and yield to expected call is 3.4% (yield to maturity = 3.7%, 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+, and the unrated portion of the fund is just 16%.

OUTLOOK AND STRATEGY

The general market weakness in March and strong rally from April - August led to a clear valuation distinction between Sovereign, Investment Grade, and High Yield bonds. However, all sub-asset classes now appear rich or fair value:

- **Sovereign bond yields** remain at (or near) record lows across the US, UK and Eurozone given volatile macro data; Central Bank intervention; and Covid-19 concerns;
- **Sterling Investment Grade** bonds are slightly rich versus all historical timeframes, with sterling 'BBB' credit

spreads at 185bps, versus their 5yr average of 188bps; 10yr average of 220bps; and 20yr average of 217bps.

- **Sterling High Yield** spreads are fair value versus history given current spread of 549bps (5yr average = 497bps; 10yr average = 521bps; 20yr average = 602bps).

In an effort to preserve capital and deliver a good level of monthly income, we continue to seek out the best risk:reward ideas across the Investment Grade, Unrated and High Yield bond sectors.

CLOSE SELECT FIXED INCOME FUND PERFORMANCE AS AT 31 OCTOBER 2020

	YTD	2019	2018	2017	2016	2015
Close Select Fixed Income Fund	**0.6%**	**9.4%**	**-2.0%**	**7.4%**	**8.0%**	**1.7%**
IA £ Strategic Bond	3.1%	9.3%	-2.5%	5.3%	7.3%	-0.2%

SOURCE:

FE Analytics 03.11.2020; YTD data as at 31.10.2020; all figures are for the X Acc share class; performance is total return, net of fees with dividends reinvested.

IMPORTANT INFORMATION

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