Close Brothers Asset Management

Close Select Fixed Income Fund

Monthly fund manager update

NOVEMBER 2020

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Investment Director

FUND PERFORMANCE

The Close Select Fixed Income Fund returned +2.6% in November, bringing the year-to-date (YTD) return to +3.2%. In comparison, the IA Sterling Strategic Bond sector returned +2.4% in November, and has returned +5.6% YTD.

Fund performance over the 5-months of H2 2020 to the end of November is therefore +6.0%, while the IA Sterling Strategic Bond sector has returned +4.6% over the same period.

MACRO BACKDROP

Newsflow in November was dominated by the positive COVID-19 vaccine data releases from three clinical trials, as well as the US election outcome and increasingly positive newsflow emanating from the Brexit discussions between UK and EU. As such, both backward- and forward-looking macro data is balancing the negative short-term impact from ongoing lockdowns and social restrictions, with the 6-to-12 month positive outlooks that a vaccine rollout has created.

In the UK, forward-looking data points weakened for the third consecutive month, with October composite Purchasing Managers' Index (PMI) data falling to 47.4 (versus 52.1 in October) – largely attributable to the various November lockdown measures which hurt sentiment. The GDP bounce-back which started in May 2020 has also continued to slow, with September 2020 GDP growing just 1.1% month-on-month (MoM). Consensus forecasts were downgraded following the November lockdown measures – with Q4 2020 GDP growth forecast to be -2.0%, and overall 2020 GDP growth downgraded to -12% (from -10%). Inflation is expected to remain below 2% until 2023; and unemployment is expected to peak at c. 7.3% in Q3 2021.

In the US, forward-looking data was strong, with November composite PMI data of 57.9 (versus 56.3 in October), meaning the reading has improved for the sixth time in seven months. Despite ongoing public health concerns in the US related to COVID-19, consensus forecasts continue to improve – with overall 2020 GDP growth upgraded to -3.6% (from -4.0%). Inflation is forecast to remain below 2% until 2023; and US unemployment data is expected to continue to improve from the October unemployment figure of 6.9%.

In the Eurozone, forward-looking data is weaker than the UK and US given earlier lockdowns across Eurozone countries – with November composite PMI data a weak 45.1 (versus 50.0 in October). While Q3 2020 quarter-on-quarter (QoQ) GDP growth was +12.6% (reversing the -11.8% fall in Q2 2020), consensus forecasts indicate a -1.9% QoQ fall in Q4 2020. Inflation is expected to remain below 1.2% until 2023; and unemployment is forecast to continue to rise to 9.3% in Q2 2021.

PORTFOLIO ACTIVITY

Turning to portfolio activity, there were three key developments during November:

Inaugural rating for Louis Dreyfus

Firstly, the largest holding in the fund (a 3.97% position in the Louis Dreyfus 2023 bond) received an inaugural rating from S&P of BBB- (Investment Grade). As a result, the Louis Dreyfus bond was up +5pts in a matter of days. The rating is exactly in-line with our internal rating, and is yet another example of our in-depth research process at work. We expect further upside in December as the Louis Dreyfus bonds enter corporate bond indices and index-tracking funds emerge as buyers.

Added beta ahead of "good news November"

Readers of our September and October commentaries will recall that we highlighted the potential for three key positive catalysts in November (positive vaccine news; a clear outcome to the US election, and positive Brexit newsflow). As such, we added to several bonds in the early part of November, including: Pershing Square 2030 (BBB+ / yield = 3.25%); QBE Insurance 2022 (BBB / 2.6%); Commerzbank 2031 (BB+ / 6.2%); Travis Perkins 2026 (BBB- / 3.75%); Societe Generale Perp (BB+ / 5.4%); and IPF 2025 (BB- / 10.6%).

Reduced long duration credit exposure at end of month

Following the positive vaccine data in early November and the strong rally in mid-November, we took advantage of our ability to be highly nimble and reduced exposure to longer duration bonds which had performed extremely well - but were suddenly trading at fair value. As such, cash holdings increased at the end of the month.

On the portfolio construction side, cash levels are at 15% (versus 8% intra-month); duration is 3.2 years; and yield-to-expected call is 2.9% (Yield to Maturity = 3.4%, 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 has fallen to just 11% (following Louis Dreyfus moving from unrated to Investment Grade in November).

OUTLOOK AND STRATEGY

The broad market weakness in March has been followed by a strong rally between April and November. While the rally led to a clear valuation distinction between Sovereign, Investment Grade, and High Yield bonds in the summer, all sub-asset classes now appear relatively rich:

- **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 rich versus all historical timeframes, with sterling 'BBB' credit spreads at 151bps, versus their 5yr average of 184bps; 10yr average of 225bps; and 20yr average of 217bps.
- **Sterling High Yield** spreads are slightly rich versus history given the current spread of 459bps (5yr average = 452bps; 10yr average = 516bps; 20yr average = 601bps).

In an attempt to preserve capital and deliver 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 30 NOVEMBER 2020

	YTD	2019	2018	2017	2016	2015
Close Select Fixed Income Fund	**3.2%**	**9.4%**	**-2.0%**	**7.4%**	**8.0%**	**1.7%**
IA £ Strategic Bond	5.6%	9.3%	-2.5%	5.3%	7.3%	-0.2%

SOURCE:

FE Analytics 02.12.2020; YTD data as at 30.11.2020; all figures are for the X Acc share class; performance is total return, net of fees with dividends reinvested.