

Close Select Fixed Income Fund

Monthly fund manager update

DECEMBER 2020



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FUND PERFORMANCE

The Close Select Fixed Income Fund returned +1.13% in December and +4.33% in 2020. In comparison, the IA Sterling Strategic Bond sector returned +0.95% in December and +6.55% in 2020.

Fund performance in the second half of 2020 was therefore +7.4%, while the IA Sterling Strategic bond sector returned +5.6%.

MACRO BACKDROP

Newsflow in December was dominated by: 1) COVID-19 (the vaccine rollout is successfully underway in many countries, but public health statistics continue to deteriorate); and 2) geopolitics (the UK and EU agreed a trade deal, while President Trump continued to attack the veracity of US election result). As such, forward-looking macro data is balancing the negative short-term impact from ongoing lockdowns and social restrictions, against the 6- to 12-month positive outlook that a vaccine rollout has created.

In the UK, forward-looking data points were mixed as positive Brexit discussions, a national vaccine rollout and pre-Brexit stockpiling countered concerns over additional lockdowns. As a result, December composite Purchasing Managers' Index (PMI) data improved to 50.7 (from 49.0 in November), though we expect this data point to remain volatile as fresh lockdown announcements and the unwinding of pre-Brexit stockpiling (i.e. fewer manufacturing orders in Q1 2021) take effect. Consensus GDP forecasts were downgraded yet again following the announcement of additional lockdown measures in December – with Q4 2020 GDP growth forecast now at -2.4%, and overall 2020 GDP growth downgraded to -12.1% (from -10% in October). Inflation is expected to remain below 2% until 2023; and unemployment is expected to peak at c. 7% in Q2 2021.

In the US, forward-looking data remained strong, with a December composite PMI reading of 55.7 (albeit weaker than the November return of 58.6). Despite ongoing public health concerns in the US related to COVID-19, consensus GDP forecasts continue to improve, with overall 2020 GDP growth upgraded again to -3.5% (from -4.0% in October and -3.6% in November). The positive growth forecasts have translated

into expectations of inflation rising to 2.0% at the end of 2021 – while unemployment is expected to continue to improve from the November figure of 6.7%.

In the Eurozone, December composite PMI data improved to 49.8 (versus 45.3 in November), but consensus GDP growth forecasts for Q4 2020 was simultaneously downgraded to -2.2% (from -1.9% in November) as additional lockdown measures were implemented across much of the Eurozone. Inflation is expected to remain below 1.2% until 2023; and unemployment is expected to peak at c. 9% in Q2 2021.

PORTFOLIO ACTIVITY

There were two key developments for the fund in December 2020:

Firstly, we cautiously added to several existing issuers, including Beazley 2026 (BBB+ / yield = 4.1%); Rothesay 2028 (BBB- / yield = 4.6%); Pension Insurance Corp 2029 (BBB- / yield = 4.6%); and Glanbia 2021 (unrated; yield = 3.5%).

Secondly, our Travis Perkins 2021 bond, which we bought in March 2020 at a yield of c. 6.2%, was redeemed early by the company. This proved to be a very successful investment given: 1) the company received an investment grade credit rating in November 2020; and 2) the bond was redeemed at a yield of 0.40%, representing a 10-month return of c. 10%.

On the portfolio construction side, cash levels are at c.10%; duration is 3.4 years; and yield-to-expected-call is 2.8% (the Yield to Maturity is 3.4%, but we believe the lower figure is a more accurate measure of yield). The average credit rating on the rated portion of the portfolio is BBB+, while the unrated portion of the fund is now c.11%. (In 2020, c.10% of our unrated exposure received an inaugural credit rating, while another c.10% of unrated bonds successfully matured).

OUTLOOK AND STRATEGY

All fixed income 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 144bps, versus their 5yr average of 186bps; 10yr average of 219bps; and 20yr average of 217bps.
- **Sterling High Yield** spreads are slightly rich versus history given their current spread of 463bps (5yr average

= 498bps; 10yr average = 519bps; 20yr average = 599bps).

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 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 DECEMBER 2020

	YTD	2019	2018	2017	2016	2015
Close Select Fixed Income Fund	4.3%	9.4%	-2.0%	7.4%	8.0%	1.7%
IA £ Strategic Bond	6.6%	9.3%	-2.5%	5.3%	7.3%	-0.2%

SOURCE:

FE Analytics 04.01.2021; YTD data as at 31.12.2020; 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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