Close Brothers Asset Management

Close Portfolio Funds

Monthly fund manager update

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MONTH IN REVIEW

The Close Portfolio Funds all delivered modest positive returns in February after a lacklustre January. The Conservative Fund returned +0.43%, Balanced added +0.68% and Growth +0.63%. Their relevant IA Sectors returned -0.06%, +0.24% and +0.61% respectively (see below for year-to-date returns).

REFLECTION 1: ARE WE IN A BUBBLE (YET)?

After years of strong returns in almost all asset classes, this is a valid question. Recent aggressive fiscal stimulus and loose monetary policy mean that money is cheap and there is plenty of it around. This would be an ideal environment for bubble formation, even if it were not a good reason. Offsetting the slowdown triggered by the pandemic may have unintended consequences as liquidity percolates through the global economy. A bubble might plausibly be one.

Now that vaccination programmes are progressing and economies are expected to rebound strongly this year as social restrictions are removed, it raises other questions as far as investors are concerned: have markets come too far too quickly? What happens next? If markets are in a bubble, what would burst it?

My view is that there are specific areas which are potentially are too ‘bubbly’. Bitcoin and similar ‘impossible-to-value’ speculative instruments do raise red flags. Likewise, companies or sectors with unrealistically high future growth expectations can be prone to excessive valuations. We will only know with time whether those lofty promises will be fulfilled.

So what happens next? Much depends on the trajectory that discount rates, which inform our theoretical valuation metrics, will take. This, in turn, depends largely on Central Banks and Government policies. Thankfully, for Fund Managers this is observable and quantifiable to some extent. It is not always clearly predictable, of course, but not completely unpredictable, either.

Our response to the situation is to do what we always do: seek asset classes and individual securities which look attractively valued at this point in time. Equities, in general, still appear grounded by fundamentals in light of the expected improvement in corporate profits. There are still a number of companies which constitute genuine, established growth, businesses and innovative disruptors. Of course one has to be selective and we know that there is no such thing as an entirely ‘safe investment’. But, we use tried and tested quantitative valuation tools to help us identify undervalued opportunities while avoiding overvalued areas of the market.

The conclusion: rather than chasing bubbles, inflated by unrealistic and speculative returns, it is best to focus on long-term global multi-asset investing. We will very much be keeping our feet firmly on the ground with optimistic, yet realistic, expectations about the future. A realistic approach and outlook with regards to what is achievable will become increasingly important given the prevailing backdrop for markets and economies. Therefore, careful allocation of capital will be evermore important for the wellbeing of client portfolios, the wellbeing of future generations (through ethical factors influencing investment decisions), and our own peace of mind as Fund Managers too. This is what the “Year of Charity” - the Funds’ theme for 2021 - is all about.

REFLECTION 2: ON DIVERSIFIERS, SAFE HAVENS AND COMMODOTIES

The recent environment of rising bond yields is not very attractive for non-yielding assets such as gold. If higher yields become available again, that makes non-yielding options look relatively poor in comparison. On the other hand, gold can provide some protection from hyper-inflation, but that outcome seems rather unlikely (or at best distant) at the moment. During equity bear markets, gold usually works as a safe haven. However, a major equity market correction is not our main scenario, either.

While it can be justifiable to hold gold in the portfolio as a diversifier, the above reasoning indicates that this kind of diversification is not required for the time being. In my opinion, gold should not be a ‘permanent fixture’ in the Funds, but rather an investment like any other. It is a diversification tool which works well in certain conditions and less well in others. Therefore, after a few prosperous years as gold investors, we took the decision to sell holdings in gold ETFs as well as our holding in Kirkland Lake Gold, a Canadian gold mining company.

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Within commodities, the Funds remain invested in platinum and silver through ETFs. These two precious metals have a wider industrial use and their prices have reacted well to the emerging economic rebound. In addition, we initiated a small holding in an even more economically sensitive commodity in February: copper.

Copper's market dynamics look set to be supportive for prices over the next couple of years with recovering demand and constrained supply. The base case scenario is that the copper market will swing to a deficit, although delays to stimulus and a further hit to consumer confidence could result in another surplus year. Exchange inventories are at multi-year lows, implying that restocking is needed given the likely pace of the rebound. The copper price has historically been used as a macro-trade on inflation expectations and emerging market strength given China's large share of consumption of the raw material, which often leads to broader pricing trends.

TRADING ACTIVITY

This aside, there was no major trading activity in the Funds in February. We have been pleased to see over 80% of our investee companies meet or beat their consensus earnings expectations in the recent round of corporate announcements. The companies that we back are delivering solid results and continue to provide positive outlooks. There is spring in the air and hope in our steps.

CLOSE PORTFOLIO FUNDS DISCRETE PERFORMANCE AS AT 28 FEBRUARY 2021

	YTD	2020	2019	2018	2017	2016
Close Conservative Portfolio Fund	**0.3%**	**3.0%**	**12.5%**	**-2.7%**	**9.0%**	**5.4%**
IA 20-60	-0.4%	3.5%	11.8%	-5.1%	7.2%	10.3%
Close Balanced Portfolio Fund	**0.5%**	**2.4%**	**17.1%**	**-2.9%**	**11.8%**	**6.3%**
IA 40-85	0%	5.3%	15.8%	-6.1%	10.0%	12.9%
Close Growth Portfolio Fund	**0.3%**	**5.4%**	**21.9%**	**-3.4%**	**12.5%**	**6.8%**
IA Flexible Investment	0.5%	6.7%	15.7%	-6.7%	11.2%	13.8%

SOURCE:
FE Analytics 03.03.2021; 2021 (YTD) data as at 28.02.2021; fund performance is total return net of fees with dividends reinvested for X Acc share class.