Close Brothers Asset Management

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Close Sustainable Balanced Portfolio Fund

Monthly fund manager update

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RIITTA HUJANEN
Managing Director

RICHARD STROUD
Investment Manager

MONTH IN FOCUS

The Close Sustainable Balanced Portfolio Fund fell -1.8% in February, taking the return since inception (02/11/2020) to the end of the February to 2.1%. The Fund lagged the Investment Association Mixed Investment 40-85% Shares sector over the month, which was up+0.2%. However, as noted previously, the Fund is still very much in its infancy and the work continues to manage the new inflows into the strategy. We continue to see a very positive trend in terms of inflows, so thank you all once again for your support thus far.

THOUGHTS ON INFLATION & RATES

We think inflationary pressures are likely to be transitory and, at present, expectations are not for a sustained rise in inflation. Our analysis points to several reasons for this. Firstly, monetary stimulus has mostly been confined to financial assets rather than the real economy. Secondly, there is ample capacity in the labour market, with US unemployment at 6.8% at year-end, and the UK at 5.1% (it is worth noting that furloughed workers are counted as unemployed in the US but not in the UK). Inflationary pressures did not emerge in a meaningful way when US unemployment was as low as 3.6% in 2019 (a level considered to be close to 'full employment') when, in theory, labour costs would rise to reflect surplus demand for workers. Looking at inflation expectations through to the third quarter of 2022, CPI inflation is expected to return to the near 2% range following a brief spike in the first half of 2021 given the base effect compared to a year earlier. This, in our view, does not imply the need for significant activity in the Fund. We have instead been using inflows to top up existing positions in more cyclical names, such as Sandvik, UBS, Partners Group, 3i and Anglo American. We have also switched out of our gold position and into copper within the Fund's alternatives allocation, as we outline further below.

TRADING ACTIVITY

Buys

Freshpet (MSCI ESG rating 'A'):

- The company offers natural, preservative-free food for dogs in the US, making it a direct play on the 'humanisation' of pets.
- Freshpet commands an approximately 75% share of the fresh pet food category in the US, which itself is only 1% of the US pet food market. Therefore, we believe the stock offers an attractive combination of high share and low market penetration, suggesting the potential for continued strong growth. The company has grown its top-line at 20%+ since 2018.
- The company hit full sales capacity during the pandemic despite disruption to distribution. The full year 2020 results saw Freshpet increase its 2025 guidance to 11m US homes penetrated (from 8m) and sales of USD1.25bn (from USD1.0bn). An acceleration of growth is therefore expected at over 30%.
- Freshpet's closest peer, Blue Buffalo, was sold to General Mills in 2018 for a price to sales multiple of c.8x. Arguably this provides a floor to Freshpet's valuation which, if assuming the 2025 sales target is realised, would achieve a market capitalisation of c.USD10bn vs today at USD6bn.
- Freshpet carries an MSCI ESG rating of 'A', with 'opportunities in nutrition & health', 'product safety & quality' and 'raw material sourcing' contributing positively to the score. Freshpet's production facilities (or 'kitchens') operate using 100% wind energy and are landfill-free.

WisomTree Copper ETC:

- Copper's market dynamics look set to be supportive for prices over the next couple of years with recovering demand and constrained supply.
- 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, with the raw material often leading broader pricing trends.
- Copper demand is likely to increase with further electrification treads. The copper content in battery electric vehicles is 4-10x greater than internal combustion engine vehicles.

Sells

Vestas (MSCI ESG rating 'AAA'):

- The onshore wind market is set to peak in 2020-21, with the decline from 2022 being led by the US. This is set to

have a sizeable impact on Vestas given its high market share of the US market.
- In contrast, offshore wind is set to become the highest-growing end-market in the capital goods space. Vestas does not have a strong presence in the offshore market, with no competitive product due until 2025, and even this is yet to be unveiled (the company have said they are holding back details for commercial reasons).
- Hence, offshore will get worse before it gets better for Vestas and arguably the company's targets for 2025 are overly ambitious. For example, on margins, Vestas is assuming a ramp up from break-even in offshore in 2024 to in-line with group margins only a year later.
- These challenges are manifested in consensus estimates, which are estimating essentially zero revenue growth from 2021-2024, with only a 3.5% total increase in revenue over the three-year period, before the offshore product comes to market in 2025.

Royal Mint Physical Gold ETC:
- The environment of rising bond yields is not the most favourable for holding non-yielding assets such as gold, as the opportunity cost of holding such assets increases as yields rise.
- Gold can provide some protection in the event of hyper-inflation but this outcome seems rather unlikely / distant as noted above.