Close Brothers Asset Management

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Close Select Fixed Income Fund

Monthly fund manager update

MARCH 2021

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FUND PERFORMANCE

The Close Select Fixed Income Fund returned +0.46% in March – excluding the temporary 'swing price' (see below) and +1.23% YTD. In comparison, the IA Sterling Strategic Bond sector returned -0.12% in March, and -1.23% YTD.

Swing prices occur to protect existing holders when there is an inflow or outflow greater than 1% of the Fund's total value. There was a swing price on the final day of February, artificially impacting performance by -0.75%. The Fund's performance was then artificially boosted by +0.75% on the 1st of March to net off the impact to existing holders.

MACRO BACKDROP

Once again, news flow in March continued to be dominated by the ongoing COVID-19 vaccine rollout, and how quickly major economies can begin to re-open. 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 the vaccine rollout has created. Despite near-term volatility, 2021 GDP growth forecasts in the UK, US and Eurozone are +4.7%, +5.7%, and +4.2%, respectively; the US seeing a significant upward revision since February. .

In the UK, March composite PMI data materially improved to 56.6 (from 49.6 in February), predominantly due to a strong rebound in services PMI (the March reading was 56.8 and February was 49.5). The Q1 2021 GDP consensus forecast was further downgraded to -3.5% while the Q2 2021 GDP forecast was maintained at +4.8%, reflecting a strong expected pick-up in activity as the UK economy progressively re-opens in Q2 2021. Inflation is expected to remain below 2% until 2023; and unemployment is expected to peak at c. 6.1% in Q4 2021.

In the US, forward-looking data remained strong, with March composite PMI data at 59.1 (from 59.5 in February). The 2021 GDP consensus forecast was upgraded from 4.9% to 5.7% as a result of the USD1.9tn stimulus package passed by the US Congress in March. Inflation is expected to reach 2.9% in Q2 2021, and unemployment to continue to improve from the February figure of 6.2%.

In the Eurozone, March composite PMI data also improved to 52.5 (from 48.8 in February), materially exceeding expectations. Manufacturing PMI reached an all-time high of 62.4 as a result of a strong recovery in global trade. Services PMI also increased to 48.8, but remained in contractionary territory as new waves of lockdowns impacted sentiment. The Q2 2021 GDP consensus forecast was downgraded from 2.1% to 2.0% while the Q3 2021 forecast was maintained at 2.0%. Inflation is expected to remain below 1.6% until 2023; and unemployment is expected to peak at c. 8.6% in Q4 2021.

PORTFOLIO ACTIVITY

In March, we selectively added to a series of attractive opportunities in primary and secondary markets.

Firstly, we added to our existing holding of the IPF 2025 bond at a yield of 8.5% following encouraging 2020 results.

Secondly, we decided to participate in the inaugural USD benchmark size bond issue from Lancashire Holdings, who issued a 2041 bond (callable in 2031) at a yield of 5.625%. Whilst the company is new to the fixed income market, we know it well as a result of holding the equity in our multi-asset funds and having met management on multiple occasions.

Thirdly, we decided to tender the Paragon 2026 bond at a yield of 1.25%, replacing it with the new Paragon 2031 issue at an attractive yield of 4.375% in GBP.

As a result, the Fund's yield to expected call has increased to 2.5%. The Fund is well positioned to take advantage of similarly attractive investment opportunities as and when they arise. On the portfolio construction side, cash levels are at 9%; duration is 3.2 years; and yield to expected call is 2.5% (yield-to-maturity is 3.1%, 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+, and the unrated portion accounts for 11% of the Fund.

OUTLOOK AND STRATEGY

All Fixed Income sub-asset classes now appear rich:

- **Sovereign bond yields** remain near record lows across the US, UK, and Eurozone, despite gradually rising since the mini-crisis in 2020.
- **Sterling Investment Grade** bonds are rich versus all historical timeframes, with sterling 'BBB' credit spreads at 138bps, versus their 5yr average of 181bps; 10yr average of 216bps; and 20yr average of 217bps.
- **Sterling High Yield** spreads are rich versus history, with 'BB' spreads at 269bps versus their 5yr average of 331bps; 10yr average of 384bps and 20yr average of 438bps).

In an effort to preserve capital and deliver a high 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 MARCH 2021

	YTD	2020	2019	2018	2017	2016
Close Select Fixed Income Fund	**1.23%**	**4.2%**	**9.4%**	**-2.0%**	**7.4%**	**8.0%**
IA £ Strategic Bond	-1.23%	6.6%	9.3%	-2.5%	5.3%	7.3%

SOURCE:

FE Analytics 06.04.2021; YTD data as at 31.03.2021; all figures are for the X Acc share class; performance is total return, net of fees with dividends reinvested.