Close Brothers Asset Management

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Close Sustainable Bond Portfolio Fund

Monthly fund manager update

JULY 2021

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FUND PERFORMANCE

Close Sustainable Bond Portfolio Fund returned +1.11% in July, and +0.17% YTD. In comparison, the IA Sterling Corporate Bond sector returned +1.18% in July and -0.39% YTD respectively.

The Fund is focused on risk-adjusted returns and has historically operated with lower duration than the corporate bond sector. As a result, it has outperformed the sector 87% of the time in 'down' markets, and 90% of the time when the sector is down by 25bps or more on a monthly basis (since February 2014).

As of 31 July 2021, the Fund maintained an average credit rating of A-.

MACRO BACKDROP

The news in July was dominated by the recent rise in Covid-19 cases driven by the Delta variant and the ongoing vaccination rollout. As such, forward-looking data is balancing the positive impact of fewer restrictions against the potential threat new variants might pose to the economic recovery. 2021 GDP growth forecasts in the UK, US and euro zone are currently +6.9%, +6.5%, and +4.6%, respectively.

In the UK, July composite PMI data remained strong at 57.7 (versus 62.2 in June) but declined for the second consecutive month, reflecting concerns about the impact of rising Covid-19 cases. Nonetheless, both Manufacturing PMI (July's reading was 60.4) and Services PMI (June's, 57.8) point to solid growth in the third quarter. The consensus GDP forecast for 2021 was further upgraded from 6.7% to 6.9%, reflecting a stronger-than-expected pickup in activity in Q2-21. Inflation is forecast to reach 2.7% in Q4-this year; and unemployment is now expected to peak at 5.3% in Q4 2021.

In the US, forward-looking data remained strong, after peaking in May, with a July composite PMI reading of 59.7 (versus 63.7 in June). Inflation is now expected to reach 4.6% in Q3 2021 before progressively falling to 3.8% by Q1 2022. Unemployment is forecast to fall from the June figure of 5.9% to 4.9% by Q4 2021.

In the euro zone, July composite PMI data improved for the sixth consecutive month to 60.6 (from 59.5 in June) as Covid-19 vaccination rates improved rapidly across member countries. Manufacturing PMI remained broadly stable at 62.6 while Services PMI rose to 60.4 (from 58.3 in June), as restrictions continued to be eased in several euro zone countries. The consensus GDP forecast for 2021 was upgraded to 4.6% from 4.4%. Inflation is expected to peak at 2.7% in Q4 2021, before falling back below the ECB's 2% target. Unemployment is expected to peak at 8.1% in Q3 2021.

PORTFOLIO ACTIVITY

The average credit rating on the portfolio remained strong at 'A-' and 53% of fund holdings are in 'AAA to A- rated' bonds.

The Fund now has a yield of 1.7% and a duration of 6.4 years. We believe its strong credit quality helps to de-risk it from any future volatility.

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.
- **Sterling Investment Grade** bonds are rich versus all historical timeframes, with sterling 'BBB' credit spreads at 129bps, versus their 5yr average of 176bps; 10yr average of 214bps; and 20yr average of 216bps.
- **Sterling High Yield** spreads are rich versus history, with 'BB' spreads at 263bps (versus a 5yr average of 324bps; 10yr average of 380bps; and 20yr average of 434bps).

In order to attempt to preserve capital and deliver a high level of monthly income, we continue to seek out the best risk:reward ideas across the investment grade, unrated and high yield bond sectors. We maintain our focus on stock selection reinforced by in-depth credit research.

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