Close Brothers
Asset Management

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Close Select Fixed Income Fund

Monthly fund manager update

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FUND PERFORMANCE

Close Select Fixed Income Fund returned +1.07% in July and has returned +4.23% YTD. In comparison, the IA Sterling Strategic Bond sector returned +0.61% in July and +1.18% YTD respectively.

This positive month for the Fund follows its strong outperformance in the first half of 2021 during which it returned +3.1%, compared to +0.6% for the IA Sterling Strategic bond sector.

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 cases of Covid-19. 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

While most fixed income sub-asset classes appear richly priced, we continued to selectively buy bonds with attractive risk/reward characteristics.

As an example, we took a starter position in Ocado 2024 bonds at a yield to maturity of 3.6%.

Elsewhere, we continued to sell or reduce positions in bonds that have performed well. We sold the Sainsbury convertible bonds after they rallied heavily when the convertible option became 'in-the-money', driving its yield down to -167% and posting equity-like returns.

In general, we remain convinced that our strategy, focussed on taking relatively concentrated positions in core bonds at attractive valuations, is appropriate in the current market environment.

On the portfolio construction side, cash levels are at 12%; duration is 3.4 years; and the yield to expected call is 2.5% (the yield to maturity is 3.0%, but we believe the lower figure is a more accurate measure of yield). The average rating on the rated portion of the portfolio is BBB+, and 6% of the Fund is unrated.

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.