Close Brothers Asset Management

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Close Sustainable Bond Portfolio Fund

Monthly fund manager update

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FUND PERFORMANCE

The Close Sustainable Bond Fund returned -0.33% in October, bringing its year-to-date (YTD) return to -1.32%. In comparison, the IA Sterling Corporate Bond sector returned +0.02% in October and has returned -1.98% YTD.

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 86% of the time in ‘down’ markets, and 91% of the time when the sector has been down by -25bps or more (since February 2014).

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

MACRO BACKDROP

News flow in October was dominated by global supply-chain disruptions, expected central bank actions, and the continued re-opening of economies across the developed world. As such, forward-looking data is balancing the positive impact from reduced restrictions, against the potential threat that supply-demand imbalances – and central bank actions – could pose to the global economic recovery. Current year Gross Domestic Product (GDP) growth forecasts in the UK, US and the Eurozone are +7%, +5.7%, and +5%, respectively.

In the UK, the October composite Purchasing Managers’ Index (PMI) rose to 56.8 (September = 54.9), after a strong rebound in Services (October = 58; September = 55.4) and a robust reading for Manufacturing (October = 57.7; September = 57.1). The GDP consensus forecast for 2021 was upgraded from 6.8% to 7%. Inflation is forecast to reach 4.1% in Q4 2021; and unemployment is now expected to peak at 5% in Q4 2021.

In the US, forward-looking data remained solid – with the October composite PMI rising to 57.3 (September = 55). Inflation is now expected to reach 5.4% in Q4 2021 before progressively falling to 2.9% by Q3 2022. Unemployment is forecast to fall from the September figure of 4.8% to 4% by Q3 2022.

In the Eurozone, the October composite PMI continued to normalise after a strong re-opening boost earlier in the year. The composite PMI stood at 54.3 (September = 56.2), falling for the second consecutive month: Manufacturing was stable at 58.5, while Services softened to 54.7 (September = 56.4). The GDP consensus forecast for 2021 was upgraded to 5% from 4.7%. The October Consumer Prices Index (CPI) of 4.1% came in above expectations and inflation is now expected to reach 3.6% in Q4 2021, before falling back below the ECB’s 2% target. Unemployment is expected to remain stable at 7.5%.

PORTFOLIO CHARACTERISTICS

The average credit rating of the portfolio remained strong at ‘A-’, with 52% of the Fund’s holdings in AAA to A- rated bonds.

The Fund now offers a yield of 2.1% and carries a duration of 6.3 years. We believe the very strong credit quality of the Fund helps to de-risk and protect it from any future volatility.

OUTLOOK AND STRATEGY

All Fixed Income sub-asset classes now appear rich:

- **Sovereign bond yields** remain low across the US, UK, and Eurozone.
- **Sterling Investment Grade** bonds are rich versus all historical timeframes, with sterling ‘BBB’ credit spreads at 128bps, versus their 5yr average of 174bps; 10yr average of 210bps; and 20yr average of 216bps.

- **Sterling High Yield** spreads are rich versus history, with ‘BB’ spreads at 257bps (5yr average of 321bps; 10yr average of 374bps; 20yr average of 438bps).

In an effort to attempt to preserve capital and deliver a good 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.