Close Select Fixed Income Fund

Monthly fund manager update

JANUARY 2022

FUND PERFORMANCE

The Close Select Fixed Income Fund fell -0.85% in January. In comparison, the Investment Association Sterling Strategic Bond sector fell -1.59%.

MACRO BACKDROP

News flow in January 2021 was dominated by Central Banks' hawkishness regarding rate hikes and Quantitative Tightening (QT). Despite this, inflation expectations keep on rising, and it remains to be seen whether CB actions can curb supply-driven inflation, and not just economic growth (which has already been dropping for months). Our base case is for rate hikes and QT to push rates higher, but this could be derailed if economic growth is disturbed and a risk-off mood infects fixed income markets.

In the UK, January Composite Purchasing Managers Index (PMI) data remained flat at 53.4 (from a December reading of 53.6) despite Manufacturing PMI dropping to 56.9 (-1.0 Month-on-Month). The 2022 GDP consensus forecast was again downgraded from 4.8% to 4.5%, but the upward trend in rates continues as 2022 inflation forecasts keep on rising (Jan-22 was 4.7%, Dec-21 was 4.0%, Nov-21 was 3.6%, Oct-21 was 3.4% and Sep-21 was 2.6%).

In the US, January Composite PMI dropped markedly to 50.8 (-6.2 MoM), with Manufacturing PMI dropping to 55.0 (-2.7 MoM) and Services PMI weakening to 50.9 (-6.7 MoM). The 2022 GDP forecast dropped to 3.8% but is expected to drop further, and 2022 inflation expectations were once again revised upwards (Jan-22 was 4.8%, Dec-21 was 4.4%, Nov-21 was 3.7%, Oct-21 was 3.6% and Sep-21 was 3.0%). We expect the upward trend in rates to continue.

Data in the Eurozone was the most benign for rates. January Composite PMI weakened to 52.4 (-0.9 MoM), with Manufacturing PMI up to 59.0 (+1.0 MoM) and Services PMI down to 51.2 (-1.9 MoM). 2022 GDP expectations dropped to 4.0% (-0.2 MoM). 2022 inflation expectations strengthened to 3.1% from 2.4%, but unlike the UK and the US, forecasts for 2023 remain comfortably below the ECB's 2% target at 1.6%.

PORTFOLIO ACTIVITY

We took some profits on the Lancashire 2041 bond (double digit returns in a falling market) and added to the Abrdn Perpetual bond at a yield of 5%.

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

On the portfolio construction side, cash levels are at 12.7%; duration is 3.1 years; and yield to expected call is 3.0% (the Yield to Maturity is 3.6%, 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 5% of the Fund is unrated.

OUTLOOK AND STRATEGY

All Fixed Income sub-asset classes continue to 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 150bps, versus their 5yr average of 171bps; 10yr average of 202bps; and 20yr average of 215bps.
- Sterling High Yield spreads are rich versus history, with 'BB' spreads at 290bps (versus their 5yr average of 317bps; 10yr average of 360bps; and 20yr average of 435bps).

In an effort to preserve capital and deliver a high level of monthly income, we continue to seek 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 Brothers Asset Management