Close Sustainable Bond Portfolio Fund

Monthly fund manager update

JANUARY 2022

FUND PERFORMANCE

The Close Sustainable Bond Fund returned -2.3% in January. In comparison, the Investment Association Sterling Corporate Bond sector returned -2.4% over the same period.

The Close Sustainable Bond fund is focused on risk-adjusted returns and has historically operated with lower duration than the corporate bond sector. As a result, the fund has outperformed the sector 89% of the time in 'down' markets, and 92% of the time when the sector is down by -25bps or more (since February 2014).

The Sustainable Bond fund currently maintains an average credit rating of A-.

MACRO BACKDROP

News flow in January was dominated by Central Bank hawkishness regarding rate hikes and quantitative tightening. Across all three major markets, GDP growth forecasts weakened, inflation forecasts increased, and Purchasing Managers' Index (PMI) data was slightly weaker.

In the UK, January Composite PMI data remained flat at 53.4 (December 2021 was 53.6), despite Manufacturing PMIs falling to 56.9. While the consensus 2022 GDP growth forecast was again downgraded to +4.5% (from +4.8%), inflation forecasts continued to rise. Indeed, end of year 2022 Consumer Price Index (CPI) inflation is now forecast to reach +4.7%. In September 2021 – just 4 months ago - the 2022 inflation forecast was just +2.6%.

In the US, January Composite PMI data weakened significantly to 50.8 (December 2021 was 57.0), with Manufacturing PMIs falling to 55.0 and Services PMIs weakening to 50.9. Consensus 2022 GDP growth forecasts also declined to +3.8% (from +3.9% in December 2021), and end of year 2022 inflation expectations were once again revised upwards to +4.8% (from +3.0% in September 2021).

Macroeconomic data in the Eurozone followed a similar trend to the UK and US, but was generally more benign. January Composite PMI data weakened to 52.4 (December 2021 was 53.4); consensus 2022 GDP growth forecasts reduced to +4.0% (from +4.2% in December 2021); and end of year 2022 inflation expectations increased to +3.2% (September 2021 was +1.7%). Despite rising inflation expectations, forecasts for 2023 remain comfortably below the ECB's 2% inflation target – unlike the UK and US.

PORTFOLIO CHARACTERISTICS

The average credit rating on the portfolio remained strong at 'A-' and 49% of fund holdings are in AAA to A- rated bonds.

The fund offers a yield of 3.44% and duration of 5.9 years. We believe the very strong credit quality of the fund helps de-risk it from potential future volatility.

OUTLOOK AND STRATEGY

All Fixed Income sub-asset classes continue to appear rich:

- **Sovereign bond yields** have risen significantly over the last 4 weeks, but remain rich across the UK, US and Eurozone.
- **Sterling Investment Grade** bonds are rich to slightly rich versus all historical timeframes, with sterling 'BBB' credit spreads at 166bps, versus their 5yr average of 170bps; 10yr average of 200bps; and 20yr average of 215bps.
- **Sterling High Yield** spreads are rich to slightly rich versus history, with 'BB' spreads at 301bps (versus the 5yr average of 317bps; 10yr average of 357bps and 20yr average of 434bps).

In an effort to preserve capital and deliver a good level of monthly income, we continue to seek out the best risk / reward ideas across sustainable investment grade sectors. We maintain our focus on stock selection reinforced by in-depth credit research.