Close Brothers Asset Management

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Close Select Fixed Income Fund

Monthly fund manager update

FEBRUARY 2022

FUND PERFORMANCE

The Select Fixed Income Fund returned -1.7% in February, and -2.6% year to date (YTD). In comparison, the Investment Association Sterling Strategic Bond sector returned -2.1% in February, and -3.6% YTD.

MACRO BACKDROP

Newsflow in February was initially focused on continued Central Bank hawkishness and the 'stickiness' of inflation across the UK, US and Eurozone. However, the invasion of Ukraine by Russian forces on 24 February has since dominated both headlines and global market sentiment.

As a result of the Russia-Ukraine crisis, government and corporate bonds experienced significant volatility during February – with 'escalation/de-escalation' headlines driving markets. Forecast macro data should be treated with caution during these volatile periods, as short-term negative sentiment can skew long-term data trends.

In the UK, February Composite Purchasing Managers Index (PMI) data rebounded to 60.2 (from 54.2 in January 22) – the highest reading since June 2021 – as Omicron fears faded. While the consensus 2022 GDP growth forecast was again downgraded to +4.3% (from +4.5% in January 2022, and +4.8% in December 21), inflation forecasts remain stubbornly elevated. Indeed, end of year 2022 CPI inflation is now forecast to reach +4.5%. In September 2021 – just five months ago - the 2022 inflation forecast was just +2.6%.

In the US, February Composite PMI data rebounded to 56.0 (from 51.1 in January 22) as Omicron fears faded. 2022 consensus GDP growth forecasts declined slightly to +3.7% (from +3.8% in January 22, and +3.9% in December 21), while US inflation forecasts for the end of 2022 remain above-target at +3.3%, but are much more subdued than in the UK.

Macro data in the Eurozone followed a similar trend to the UK and US, but was generally more benign. January Composite PMI data rebounded to 55.8 (from 52.4 in January 22); consensus 2022 GDP growth forecasts remained stable at +4.0%; and end of year 2022 inflation expectations remain above-target at +2.6% (September 21 reading 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 ACTIVITY

In February, the Fund invested in 3 new holdings: firstly, we added to our existing 1.4% position in the 'BBB-' Jupiter bond, at a yield of 3.8% for 3.2 years of risk. Secondly, we bought a 1.2% position in a short-dated QBE bond maturing in May 2022 at a yield of 2.3% (rated BBB). Thirdly, we bought a 1.5% position in the Holcim Hybrid bond at an attractive yield of 4.8% for just 2.3 years of risk. The Holcim bond is rated BB+ (positive outlook), and we expect the bond to be upgraded to Investment Grade over the next 12-18 months.

On the portfolio construction side, cash levels are 11%; duration is 3.0 years; and the yield to expected call is 3.8% (Yield to Maturity is 4.4%, but we believe the lower figure is a more accurate measure of yield). The average rating on the fund is BBB+, and the unrated portion of the fund is just 5.3%.

OUTLOOK AND STRATEGY

All Fixed Income sub-asset classes appear slightly rich:

- **Sovereign Bond Yields** have been volatile over the last eight weeks, and remain rich across the UK, US and Eurozone.
- **Sterling Investment Grade** bonds are slightly rich versus all historical timeframes, with sterling 'BBB' credit spreads at 186bps, versus their 5yr average of 170bps; 10yr average of 199bps; and 20yr average of 215bps.
- **Sterling High Yield** spreads are slightly rich versus history, with 'BB' spreads at 354bps versus their 5yr average of 316bps; 10yr average of 355bps; and 20yr average of 433bps).

In an effort to preserve capital and deliver a high 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.