Close Brothers Asset Management

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Close Portfolio Funds

Monthly fund manager update

FEBRUARY 2022

GILES PARKINSON
Managing Director

STRATEGY OVERVIEW

The Close Portfolio Funds seek to achieve resilient returns over the long term through an equity-led approach to investing in a multi-asset context. Our strategy of acquiring companies we consider 'cheap durables' – direct interests in predictable and sustainable businesses purchased at attractive cash-based valuations – is complimented by allocations across fixed income and alternatives as appropriate.

MONTHLY PERFORMANCE

Each fund delivered negative returns in February and performed roughly in-line with their respective Investment Association peer groups (in brackets): Conservative fell -1.5% (-1.7%), Balanced -1.9% (-1.6%) and Growth -2.1% (-1.7%).

Since inception the Funds have increased by an annualised 4.9% (4.8%), 6.6% (6.5%), 7.8% (6.6%) across Conservative, Balanced and Growth respectively.

MONTH IN REVIEW

UK Bonds broadly fell -1.6% in February as markets continued to price for higher interest rates and credit spreads rose from very low levels. Our positioning in cash and other short-dated Gilt securities, with limited exposure to corporate bonds, protected on a relative basis. However, the month was dominated by the Russian invasion of Ukraine. Following on from a weak January, global stock markets (MSCI World Index) declined a further -2.5% in February in sterling terms. Our equities performed broadly in line with markets over the month. The top three contributors were Oriental Land, Costco, and Booz Allen; the most significant detractors were Accenture, Air Products (discussed further below) and Trane Technologies.

FEBRUARY THOUGHTS: AN EXOGENOUS SHOCK

Last month we described how the economic backdrop was characterised by a cyclical slowdown but that central banks were nevertheless committed to raising interest rates in order to curtail the present rate of inflation. Consequently we positioned cautiously, with a low allocation to corporate bonds and reduced equity exposure from 2021 levels. And within equities, biasing the portfolio towards companies with resilient toplines, or exposure to secular growth trends which would fare relatively better than businesses with economically cyclical revenues.

Then, towards the end of February, Russia invaded Ukraine. Since the two countries constitute a small proportion of global GDP the first order economic impacts are minor (within the portfolio the biggest single exposure is Visa, with just 5% of revenues from the region). However, the second order consequences are profound. Russia is a substantial commodity exporter, particularly of oil and gas. Despite their substantial energy dependence, and confounding our expectations, European countries have instead offered support to Ukraine. Moreover, Western multinationals have withdrawn from Russia *en masse*; overnight Russia has become a pariah state approaching a level more commonly associated with Iran or North Korea. Regardless of whatever settlement is reached over Ukraine it is difficult to see this reverting as long as Putin remains in power. Commodity prices have spiked consequently due to the near-term supply disruption and questions around the longer-lasting impact of sanctions on future export capacity. At the time of writing the prices of a host of commodities especially food (wheat, corn and soybeans) and energy (crude oil and natural gas) have all jumped over 20% so far this year. This will hit consumption and, as such, constitutes an exogenous shock which has the potential to tip the cyclical slowdown into recession.

During February we further reduced exposure to equity-like risk. Within equities, we sold industrial gas supplier Air Products which is negatively exposed to higher-for-longer European gas prices, and shortly after month end purchased a small position in Canadian oilsands producers. Overall fund holdings continue to be biased towards businesses with strong franchises, sound balance sheets, and relatively economically insensitive revenues. Our expectation is that markets should reward these types of businesses in time.

LOOKING AHEAD

With substantial holdings in cash and short-term Gilts we are looking for opportunities to become more constructive on the lower valuations for equities and corporate bonds. In particular we are watching for the Federal Reserve to become less 'hawkish' with respect to interest rate increases, while we are also following the unfolding business cycle to see whether it stabilises and turns upwards. Conversely, should a recession be confirmed we would reduce equities further and look to buy longer-duration Gilts in order to protect portfolios. Elsewhere, a regime change in Russia would have the potential to reverse the commodity outlook.

As a long-term strategy with low turnover we fully expect and recommend that unitholders judge our performance over a period of five years or more.