Close Brothers Asset Management

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Close Sustainable Bond Portfolio Fund

Monthly fund manager update

FEBRUARY 2022

FUND PERFORMANCE

The Sustainable Bond Fund returned -2.9% in February, and -5.2% year to date (YTD). In comparison, the Investment Association Sterling Corporate Bond sector returned -2.5% in February, and -4.8% YTD.

The 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 Sustainable Bond fund has outperformed the sector 86% of the time in 'Down' markets, and 88% of the time when the sector is down by -25bps or more (since February 2014).

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 markets.

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 Jan-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 Jan-22, and +4.8% in Dec-21), inflation forecasts remain stubbornly elevated. Indeed, end of year 2022 CPI inflation is now forecast to reach +4.5%. In September 2021 – just 5 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 Jan-22) as omicron fears faded. 2022 consensus GDP growth forecasts declined slightly to +3.7% (from +3.8% in Jan-22, and +3.9% in Dec-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 Jan-22); consensus 2022 GDP growth forecasts remained stable at +4.0%; and end of year 2022 inflation expectations remain above-target at +2.6% (from +1.7% in Sep-21). 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 48% of fund holdings are in AAA to A- rated bonds. The fund offers a yield of 3.4% and duration of 5.8 years. We believe the very strong credit quality of the fund helps de-risks the fund from potential future volatility.

OUTLOOK AND STRATEGY

All Fixed Income sub-asset classes appear slightly rich:

- **Sovereign bond yields** have been volatile over the last 8 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 the 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 sustainable investment grade sectors. We maintain our focus on stock selection reinforced by in-depth credit research.