

Close Select Fixed Income Fund

Monthly fund manager update

MARCH 2022

FUND PERFORMANCE

The Close Select Fixed Income Fund returned -1.0% in March, bringing the year-to-date (YTD) return to -3.5%. In comparison, the Investment Association Sterling Strategic Bond sector returned -0.5% in March, and has fallen -4.1% YTD.

MACRO BACKDROP

Newsflow in March was dominated by the Russia-Ukraine crisis and Central Bank action. The Federal Reserve raised US interest rates (to 0.25% – 0.50%) for the first time since December 2018, and complemented the rate hike with hawkish language. The Bank of England raised rates (to 0.75%) for the third time since December 2021. And the European Central Bank (ECB) kept policy rates stable (at -0.50%), although their rhetoric was more hawkish than expected.

In the UK, March Composite Purchasing Managers Index (PMI) data remained strong at 59.7 (Feb-22 was 59.9). Despite the strong PMI data, consensus 2022 GDP growth forecasts were again downgraded, dropping to +4.0% from +4.3% in Feb-22, and +4.5% in Jan-22. Inflation forecasts remain stubbornly elevated, indeed, end of year 2022 Consumer Price Index (CPI) inflation is now forecast to reach +6.2%. In September 2021, just 6 months ago, the 2022 inflation forecast was just +2.6%.

In the US, March Composite PMI data rebounded to 58.5 (Feb-22 was 55.9), albeit 2022 consensus GDP growth forecasts declined to +3.5% (from +3.7% in Feb-22). US inflation forecasts for the end of 2022 rose to 4.5% - a significant increase on the +3.3% forecast in Feb-22.

In the Eurozone, March Composite PMI data weakened slightly to 54.5 (Feb-22 = 55.5), while consensus 2022 GDP growth forecasts also declined, falling to +3.2% from +4.0% in February. End of year 2022 inflation expectations increased significantly to 5.1% (Feb-22 was +2.6%) given concerns over Russian gas supplies.

PORTFOLIO ACTIVITY

March was a positive month for our rating upgrade strategy. Firstly, Paragon Group (4% position in the fund) was upgraded by Fitch. This resulted in our 2026 bond moving to BBB- (Investment Grade), from BB+ (High Yield). Secondly, Holcim – a new purchase in the fund in February 2022 – was upgraded

by S&P. Again, this resulted in the 2024 Hybrid bond moving to BBB- (Investment Grade), from BB+ (High Yield).

Also in March, the fund took advantage of negative market sentiment and used excess cash to invest in four holdings. Firstly, we increased our holding (to 2.5%) in the Abrdn 2026-PERP subordinated bond at a yield of 6.1% (rated BBB). Secondly, we bought a 2.6% position in the Nationwide 2025-PERP at an average yield of c.5.8% (rated BB+ / BBB-). Thirdly, we increased our position (to 2.6%) in the Holcim 2024 Hybrid bond at a yield of 5.1% (rated BBB-). And finally, we increased our holding in the Trafigura 2023 bond at a yield of 6.9%. We now hold a 3.8% position across two Trafigura bonds.

On the portfolio construction side, cash levels are 6%; duration is 3.1 years; and the yield to expected call is 4.4% (Yield to Maturity is 5.0%, but we believe the lower figure is a more accurate measure of yield). The average credit rating on the fund is BBB+, while the unrated portion of the fund is just 5.2%.

OUTLOOK AND STRATEGY

All Fixed Income sub-asset classes appear slightly rich:

- **Sovereign bond yields** have been volatile over the last 4 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 180bps, versus their 5yr average of 170bps; 10yr average of 197bps; and 20yr average of 215bps.
- **Sterling High Yield** spreads are slightly rich versus history, with 'BB' spreads at 339bps (versus 5yr average of 317bps; 10yr average of 353bps; 20yr average of 432bps).

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.

IMPORTANT INFORMATION

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