

Close Select Fixed Income Fund

Monthly fund manager update

APRIL 2022

FUND PERFORMANCE

The Close Select Fixed Income Fund returned -1.2% in April, bringing the year-to-date (YTD) return to -4.7%. In comparison, the Investment Association (IA) Sterling Strategic Bond sector returned -1.9% in April, and has fallen -6.0% YTD. The Fund has therefore outperformed the IA sector by +1.3% in the first 4-months of 2022.

MACRO BACKDROP

Newsflow in April was again dominated by the Russia-Ukraine crisis, in addition to headlines about global inflation and Central Bank rhetoric (especially in the US). Indeed, the US Federal Reserve (Fed) signalled that Quantitative Tightening will likely start in summer 2022, at a pace of c. USD 95bn per month (unwinding the c. USD 9trn of debt on the Fed's balance sheet).

In the UK, April Composite Purchasing Managers' Index (PMI) data weakened slightly versus March, but still remained at a relatively strong 57.6 (March was 60.9). The slightly weaker PMI data also translated into another downgrade to the consensus 2022 GDP growth forecast to +3.8% (from +4.0% in March, and +4.5% in January). Inflation forecasts remain stubbornly elevated, with end of year 2022 Consumer Prices Index (CPI) inflation now forecast to reach +7.1% (after peaking at c. 8.1% in Q2 2022). In September 2021 – just 7 months ago - the 2022 inflation forecast was as low as +2.6%.

In the US, April Composite PMI data weakened to 55.1 (March was 57.7), while 2022 consensus GDP growth forecasts declined to +3.2% (March was +3.5%). The growth downgrade was caused by a shock data point which highlighted that US GDP contracted at an annualised rate of -1.4% quarter-on-quarter in Q1 2022 – albeit this decline was largely driven by inventory un-winding and reduced public sector spending, rather than material changes to household consumption (which remained strong). US inflation forecasts for the end of 2022 rose to 5.7% - a significant increase on the +4.5% forecast in March.

In the Eurozone, April Composite PMI data actually strengthened to 55.8 (March was 54.9), while consensus 2022 GDP growth forecasts declined to +2.8% (March was +3.2%). End of year 2022 inflation expectations increased significantly to 5.9% (February was +2.6% / March was 5.1%) given ongoing concerns over Russian gas supplies.

PORTFOLIO ACTIVITY

In April, the fund again took advantage of negative market sentiment – especially in EUR credit - and invested in 3 new positions and topped up an existing holding, all at very attractive valuations. Firstly, we increased our holding (to 3.3%) in the Abridn 2026-PERP subordinated bond (GBP) at a yield of 6.0% (rated BBB). Secondly, we bought a 3.2% position in the EDP 2027 Hybrid bond (EUR) at a yield of c. 6.6% (rated BB+). Thirdly, we increased our position (to 2.6%) in the AT&T 2025 Hybrid bond (EUR) at a yield of 6.8% (rated BB+ / BBB-). And finally, we bought a 2.5% position in the Pershing Square 2027 senior bond (EUR) at a yield of 6.2%. These cheap valuations in EUR-denominated credit - irrespective of whether the underlying Issuer has material exposure to European markets – provides a very attractive entry point for the fund given we fully hedge all FX exposure.

Purchases were funded from excess cash, as well as the sale of our Commerzbank 2031, and Jerrold 2027 bonds.

On the portfolio construction side, cash levels are 4%; duration is 3.1 years; and the yield to expected call is 5.1% (yield to maturity is 5.6%, but we believe the lower figure is a more accurate measure of yield). The average credit rating on the fund is BBB, with the unrated portion of the fund at just 5.7%.

OUTLOOK AND STRATEGY

All Fixed Income sub-asset classes appear slightly rich:

- **Sovereign bond yields** have been volatile over the last four weeks, and remain rich across the UK, US and Eurozone.
- **Sterling Investment Grade** bonds are slightly rich versus historical timeframes, with sterling 'BBB' credit spreads at 194bps, versus their 5yr average of 170bps; 10yr average of 195bps; and 20yr average of 215bps.
- **Sterling High Yield** spreads are fair value versus history, with 'BB' spreads at 389bps versus their 5yr average of 318bps; 10yr average of 350bps; and 20yr average of 432bps).

IMPORTANT INFORMATION

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