Close Select Fixed Income Fund

Monthly fund manager update

MAY 2022

FUND PERFORMANCE

The Close Select Fixed Income Fund returned -0.9% in May, and -5.5% YTD. In comparison, the Investment Association Sterling Strategic Bond sector returned -0.9% in May, and -6.8% YTD.

The Close Select Fixed Income Fund has therefore outperformed the IA sector by +1.3% in the first 5-months of 2022.

MACRO BACKDROP

Newsflow in May was dominated by macro data - with markets volatile on the outlook for the second half of 2022 - and the debate around 'soft-landing' versus recession. Against this backdrop, Central Banks remained active in their bid to tame inflation:

The Federal Reserve raised rates to 1.0% (from 0.50%); clearly signalled 2 more rate hikes in June and July 2022 (of 0.50% each); and confirmed that Quantitative Tightening will start on 1st June 2022, at a pace of c. USD 47.5bn / month (unwinding the USD 9trn of debt on the Fed's balance sheet).

The Bank of England raised rates to 1.0% (from 0.75%); downgraded UK growth forecasts for the second half of the year; and announced that they would confirm more details around potential Quantitative Tightening in August 2022.

The European Central Bank released a policy statement indicating that rate hikes could commence as early as June 2022 – raising rates to 0% (from -0.50%) by the end of September 2022; and that ongoing Quantitative Easing would be reviewed in June 2022.

In the UK, Composite PMI data weakened significantly versus April, but still remained in positive territory at 51.8 (Apr-22 was 58.2). Weaker PMI data was reflected in weaker Q1 2022 GDP growth (with March 2022 suffering a negative month-on-month growth rate of -0.1%). However, this small miss did not translate into a downgrade to the consensus 2022 GDP growth forecast of +3.8% (albeit this figure was +4.0% in Mar-22, and +4.5% in Jan-22). Inflation forecasts remain elevated, and end of year 2022 CPI inflation is now forecast to reach +8.1% (after peaking at c. 9% in Q2 2022). Unemployment data remained exceptionally strong at just 3.7%.

In the US, Composite PMI data weakened to 53.8 (Apr-22 was 55.1), while 2022 consensus GDP growth forecasts declined to +2.7% (Apr-22 was +3.2%). The growth downgrade was caused by a shock data point which highlighted that US GDP growth for Q1 2022 was -1.5% (annualised rate) – 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 5.9% - a significant increase on the +4.5% forecast in Mar-22. Unemployment continued to fall, reaching 3.6%.

In the Eurozone, Composite PMI data weakened to 54.9 (Apr-22 was 55.1), while consensus 2022 GDP growth forecasts declined to +2.6% (Mar-22 was +3.2%). End of year 2022 inflation expectations increased significantly to 6.3% (Apr-22 was 5.9%; Mar-22 was 5.1%) given ongoing concerns over Russian gas supplies. Unemployment continued to fall, reaching 6.8%.

PORTFOLIO ACTIVITY

May was a very active month for the Fund, as we again took advantage of negative market sentiment and used excess cash to invest in a series of high quality opportunities at very attractive valuations – especially in EUR credit (given we fully hedge all non-GBP exposure).

As a result of our patient, active and nimble strategy, the yield to expected call on the fund has been boosted to 5.8% (Yield to Maturity is 6.1%), and cash levels have been reduced to under 2%. This compares to December 2021, when the yield on the fund was 2.8%, and the cash level was 15%. We will continue to reinvest upcoming maturities at these attractive all-in yields.

Key investments in May 2022 included:

1 – We increased our holding (to 2.6%) in the GBP Pension Insurance Corporation 2029-PERP bond at a yield of 6.9% (rated BBB-)

2 – We increased our holding (to 3.6%) in the GBP Just Group 2026 bond at a yield of 5.6% (rated BBB+)

3 – We increased our holding (to 3.3%) in the GBP Nationwide 2025-PERP bond at a yield of 6.1% (rated BB+ / BBB-)

4 – We increased our holding (to 3.5%) in the GBP Travis Perkins 2026 bond at a yield of 5.4% (rated BB+ / BBB-)

5 – We increased our holding (to 3.1%) in the EUR Pershing Square 2027 bond at a yield of 6.2% (rated BBB+ / BBB)

6 – We increased our holding (to 3.4%) in the EUR AT&T 2025 Hybrid bond at a yield of 6.8% (rated BB+ / BBB-)

7 – We increased our holding (to 2.2%) in the EUR VW 2029 Hybrid bond at a yield of 7.4% (rated BBB). The bond was also upgraded by Fitch in May on very strong Q1 2022 results

8 – We bought a new 1.6% position in the EUR Enel 2027 Hybrid bond at a yield of 6.3% (rated BBB-)

9 - We bought a new 1.5% holding in the EUR Engie 2028 Hybrid bond at a yield of 6.2% (rated BBB / BBB-).
Purchases were funded by excess cash, a maturing QBE 2022 bond, and small sales of a series of existing holdings which included exiting our Utmost Group 2031 and Scottish Widows 2023 bonds

On the portfolio construction side, cash levels are 2%; duration is 3.2 years; and the yield to expected call is 5.8% (Yield to Maturity = 6.1%, 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 5.7%.

OUTLOOK AND STRATEGY

Fixed Income sub-asset classes:

- **Sovereign bond yields** are volatile and reactive to macro data – but remain rich across the UK, US and Eurozone

- **Sterling Investment Grade** bonds are slightly cheap versus all historical timeframes, with sterling 'BBB' credit spreads at 202bps, versus their 5yr average of 171bps; 10yr average of 194bps; and 20yr average of 215bps

- **Sterling High Yield** spreads are slightly cheap versus history, with 'BB' spreads at 444bps (versus the 5yr average of 320bps; the 10yr average of 349bps; and 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, high yield and unrated sectors. We maintain our focus on stock selection reinforced by in-depth credit research.