For professional adviser use only.
Not for distribution to retail clients.

# Close Sustainable Bond Portfolio Fund

## Monthly fund manager update

MAY 2022

### FUND PERFORMANCE

The Close Sustainable Bond Fund returned -0.9% in May, and -9.2% YTD. In comparison, the Investment Association Sterling Corporate Bond sector returned -0.97% in May, and -8.8% YTD.

The Close 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 c. 85% of the time in 'Down' markets, and c. 86% of the time when the sector is down by -25bps or more (since February 2014).

### 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 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 slightly 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 CHARACTERISTICS

The average credit rating on the portfolio remained strong at 'A-' and 44% of fund holdings are in AAA to A- rated bonds. The fund offers a yield of 4.2% and duration of 4.4 years. We believe the very strong credit quality helps de-risk the fund from potential future volatility.

### 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; 10yr average of 349bps; and 20yr average of was 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 sustainable investment grade sectors. We maintain our focus on stock selection reinforced by in-depth credit research.