Close Brothers Asset Management

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Close Portfolio Funds

Monthly fund manager update

JUNE 2022

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STRATEGY OVERVIEW

The Close Portfolio Funds seek to achieve resilient returns over the long term through an equity-led approach whilst investing in a multi-asset context. Our strategy of acquiring 'cheap durables' – direct interests in predictable and sustainable businesses purchased at attractive cash-based valuations is complemented by allocations across fixed income and alternatives as appropriate.

MONTHLY PERFORMANCE

Each Fund delivered negative returns in June, with mixed performance relative to their Investment Association peer groups (in brackets): Conservative fell -3.4% (-4.1%), Balanced -4.3% (-4.5%) and Growth -5.2% (-4.2%). The currency overlay detracted notably over the month, by -0.5%, -0.8% and -1.0% respectively across the three funds, principally because sterling weakened by -3.4% against the US dollar.

Since inception the Funds have increased by an annualised 4.3% (4.2%), 5.8% (5.9%), 6.9% (6.1%), with capture ratios of 101%, 100% and 103% across Conservative, Balanced and Growth respectively.

MONTH IN REVIEW

Bonds fell in June as markets continued to price for higher interest rates. UK gilts fell -2.1% and UK corporates dropped -3.2%. Our positioning in cash and other short-dated gilt securities protected on a relative basis, further assisted by low exposure to corporate bonds, as credit spreads continued to widen. Stock markets resumed their slide, with global equities falling -4.6% over the month. Our equities outperformed the wider market, with the top three contributors being UnitedHealth Group, Alphabet (described as 'value in plain sight' in last month's commentary), and Nestle (purchased in the month). The worst performing equity holdings in June were Applied Materials, Partners Group, and Canadian Natural Resources.

JUNE THOUGHTS: LONG LIVE 60/40!

Central banks have a dual mandate; full employment and low inflation. Today inflation is high and rising; although employment is still growing, the rate of growth is slowing. The Federal Reserve has indicated that they are committed to raising interest rates as far and as often as they can in order to bring inflation under control until they are presented with clear evidence that the US economy is in recession. This combination – a central bank raising interest rates into a growth slowdown – is typically associated with stock market corrections, whilst the increases to short-term interest rates are pushing up the yields (lowering prices) of all bonds. Potentially, these actions could induce a recession.

Year-to-date Sterling bonds have declined by -14% and global equities are down -12%. We prepared for this outcome in two ways. The first was by reducing the amount of equities and corporate bonds that we own. In the Balanced fund, our equity weighting is c.62%, compared to levels of around 70% for the peer group average. In corporate bonds, our weighting is c.9%, compared to the peer group level of around 18%. The second was that, on the other side, we instead own lots of cash and where we have gilts these have such short-duration (low average maturity) that they are almost cash-like. The weighted average duration of our fixed income holdings is c.2 years, substantially less than where we believe peer funds to be positioned. Moreover, recognising that this market environment is different to any other this century, we have resisted the temptation to 'buy the dip' – in contrast to many market commentators judging by the financial press.

Where we go from here with our positioning depends on the economic data and central banks. If the economic data accelerates we will breathe a sigh of relief, and get more constructive. If the data decelerates, and the Federal Reserve remains hawkish whilst inflation remains high then, depending on market levels at the time, we may get even more cautious from here. The latest communication from the US central bank is that they will continue to raise interest rates if inflation remains high even if the economy is in recession and unemployment is rising.

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Much ink has been spilt recently debating the 'death of 60/40', concerns seemingly validated by the subsequent substantial decline across asset prices this year, with fixed income notably recording losses greater than those incurred by equities in some instances, rather than delivering offsetting gains. The capital losses have been painful, however from here the setup for forward returns is more attractive. Yields are now higher – so much higher that active investors could ultimately make greater returns than they would have otherwise if yields had remained unchanged without the capital volatility. Yields on corporate bonds are the highest they have been in a decade, and valuations on broad equities have improved. The arithmetic is such that a hypothetical 60/40 investor making 7% in equities and 2% in bonds over a ten year period is overtaken in the ninth year by an investor who suffers starting capital losses of -20% in equities and -15% in bonds but thereafter is able to harvest ongoing prospective returns of 8% and 7%. The investment landscape beyond the near-term difficult patch is rich. .

LOOKING AHEAD

As a long-term strategy with low turnover we fully expect and recommend that unitholders judge our performance over a period of five years or more.