Close Brothers Asset Management

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Close Select Fixed Income Fund

Monthly fund manager update

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FUND PERFORMANCE

The Close Select Fixed Income Fund returned -3.8% in June, bringing the year-to-date (YTD) return to -9.1%. In comparison, the IA Sterling Strategic Bond Sector returned -3.9% in June, and is down -10.4% YTD.

The Fund has therefore outperformed the IA sector by +1.3% over the first 6-months of 2022.

MACRO BACKDROP

Newsflow in June was dominated by macro data - with markets increasingly volatile on the outlook for the second half of 2022 and the debate around a 'soft-landing' versus recession. Against a backdrop of volatile data, central banks remained active in their bid to tame inflation.

The US Federal Reserve (Fed) raised interest rates to 1.75% (from 1%) and clearly signalled more rate hikes in July and September 2022 (of between 0.50 to 0.75% each). They also kick-started Quantitative Tightening on the 1st June, at a pace of c. USD 47.5bn / month, as they look to unwind the USD 9trn of debt on their sheet.

The Bank of England raised rates to 1.25% (from 1%), and **The European Central Bank** continued to release hawkish statements indicating that it will raise rates in July and September this year, likely bringing them to 0% from -0.50% currently.

The UK's Composite Purchasing Managers' Index (PMI) data remained stable - and in positive territory - at 53.1 (May was 53.1). Consensus 2022 GDP growth forecasts reduced to +3.6% (from +3.8% in May, +4% in March, and +4.5% in January). Inflation forecasts remain elevated, and end of year 2022 Consumer Prices Index (CPI) inflation is now forecast to reach +9.2% (likely peaking in October). Unemployment data remained strong at just 3.7%.

In the US, Composite PMI data weakened to 51.2 (May was 53.6), while 2022 consensus GDP growth forecasts declined to +2.5% (from +2.7% in May). US inflation forecasts for the end of 2022 rose to +6.5% - a significant increase on the +4.5% forecast back in March. Unemployment remained low at 3.6%.

In the Eurozone, Composite PMI data weakened to 51.9 (May was 54.8), while consensus 2022 GDP growth forecasts remained flat at +2.7% (March was +3.2%). End of year 2022 inflation expectations increased significantly to 7% (having been 6.3% in May and 5.1% in March) given ongoing concerns over Russian gas supplies. Unemployment continued to fall, reaching 6.6%.

PORTFOLIO ACTIVITY

After extremely active trading in May, activity in June was naturally more subdued, albeit we continued to take advantage of very attractive opportunities.

Key investments in June 2022 included:

1 – We increased our holding (to 3.9%) in the GBP Travis Perkins 2026 bond at a yield of 7.1% (rated BBB-).

2 – We bought a new 1.6% position in the GBP Aviva 2031-PERP bond at a yield of 6.9% (rated BBB).

These purchases were chiefly funded via the partial sale of our Louis Dreyfus 2023 bond, which has performed extremely well over the life of our investment. Longer term holders of the Select Fixed Income fund will recall that Louis Dreyfus has been a 'textbook' holding. We initially bought Louis Dreyfus bonds when the company was unrated (necessitating a particularly in-depth research process). As expected, the company sought a credit rating and was ultimately awarded an Investment Grade rating from the ratings agencies. As a result of the strong credit rating and recent uptick in global commodity markets, Louis Dreyfus bonds have outperformed, and we have now decided to reduce our holding to take advantage of more attractive market opportunities elsewhere.

We have actively boosted the yield on the Fund given current attractive market levels, and our active, nimble strategy has resulted in a yield to expected call of 6.9%, with cash levels reduced to 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.

On the portfolio construction side, cash levels are 2% as noted; duration is 3.3 years; and the yield to expected call is 6.9% (Yield to Maturity = 6.9%). The average rating of the Fund is BBB, and the unrated portion of the fund is just 5.3%.

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 cheap versus all historical timeframes, with sterling 'BBB' credit spreads at 249bps, versus their 5yr average of 172bps; 10yr average of 192bps; and 20yr average of 215bps
- **Sterling High Yield** spreads are cheap versus history, with 'BB' spreads at 600bps (5yr average = 324bps; 10yr average = 347bps; 20yr average = 432bps)

In an effort to preserve capital and deliver a good 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.