Close Brothers Asset Management

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Close Sustainable Bond Portfolio Fund

Monthly fund manager update

JUNE 2022

FUND PERFORMANCE

The Close Sustainable Bond Fund returned -4.8% in June, bringing the year-to-date (YTD) return to -13.6%. In comparison, the IA Sterling Corporate Bond Sector returned -4.1% in June, and is down -12.5% 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 fund has outperformed the sector c. 83% of the time in 'down' markets, and c. 83% of the time when the sector is down by -25bps or more (since February 2014).

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 balance 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.

In the UK, 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, +4.0% 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 CHARACTERISTICS

The average credit rating on the portfolio remained strong at 'BBB+', with 39% of fund holdings in AAA to A- rated bonds. The fund offers a yield of 5.4% and duration of 4.6 years. We believe the very strong credit quality of the fund helps to de-risk it from 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 <u>cheap</u> 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 <u>cheap</u> 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 sustainable investment grade sectors. We maintain our focus on stock selection reinforced by in-depth credit research.