Close Sustainable Bond Portfolio Fund

Monthly fund manager update

JULY 2022

FUND PERFORMANCE

The Close Sustainable Bond Fund returned +3.23% in July, bringing the year-to-date (YTD) return to -10.77%. In comparison, the Investment Association Sterling Corporate Bond sector has returned +3.0% in July, and -9.9% YTD.

The 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. 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 July was dominated by macro data - with markets increasingly volatile on the outlook for H2 2022 and the debate around 'soft-landing' for the economy versus recession. Against this backdrop, central banks remained active in their bid to tame inflation:

The US Federal Reserve (Fed) raised rates to 2.50% (from 1.75%); clearly signalled more rate hikes in September 2022 (of 0.50-0.75%); and continued Quantitative Tightening (unwinding the USD 9trn of debt on the Fed's balance sheet).

While **The Bank of England** did not meet in July, **The European Central Bank** raised rates for first time in 11 years – taking its key interest rate to 0.0% (from -0.50%).

In the UK, Composite Purchasing Managers' Index (PMI) data declined slightly but remained in positive territory at 52.8 (June's reading was 53.7). Consensus 2022 GDP growth forecasts reduced to +3.4% (from +3.6% in June; +4.0% in March, and +4.5% in January). Inflation forecasts remain elevated, and end of 2022 Consumer Prices Index (CPI) inflation is now forecast to reach +9.9% (likely peaking in October of this year). Unemployment data remained strong at just 3.8%.

In the US, Composite PMI data weakened to 47.5 (June was 52.3), while 2022 consensus GDP growth forecasts declined to +2.0% (June = +2.5%). US inflation forecasts for the end of 2022 rose to +7.3%, a significant increase on the +4.5% forecast in March. Unemployment remained strong at 3.6%.

In the eurozone, Composite PMI data weakened to 49.4 (June was 52.0), while consensus 2022 GDP growth forecasts remained flat at +2.7% (March reading was +3.2%). End of year 2022 inflation expectations increased significantly to +7.9% (June = 7.0%; March = 5.1%) 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+' and 39% of fund holdings are in AAA to A- rated bonds. The fund offers a yield of 5.0% and duration of 4.8 years. We believe the very strong credit quality of the fund de-risks the fund 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 'cheap' versus all historical timeframes, with sterling 'BBB' credit spreads at 234bps, versus their 5yr average of 173bps; 10yr average of 191bps; and 20yr average of 215bps

- **Sterling High Yield** spreads are 'cheap' versus history, with 'BB' spreads at 563bps (5yr average = 329bps; 10yr average = 346bps; 20yr average = 431bps)

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.