Close Brothers Asset Management

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Close Select Fixed Income Fund

Monthly fund manager update

JULY 2022

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FUND PERFORMANCE

The Close Select Fixed Income Fund returned +1.62% in July, bringing the year-to-date (YTD) return to -7.64%. In comparison, the Investment Association (IA) Sterling Strategic Bond Sector returned +2.56% in July, while it has fallen -8.1% YTD.

The Select Fixed Income Fund has therefore outperformed the IA sector by +0.45% in the first 7 months of 2022.

MACRO BACKDROP

Newsflow in July was dominated by macro data with markets increasingly volatile on the outlook for H2 2022 and the debate around a '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 ACTIVITY

The Fund continued to take advantage of attractive opportunities in July 2022, and key investments include:

1 – We increased our holding (to 3.6%) in the USD Trafigura 2027 Hybrid bond at a yield of 10.0% (unrated)

2 – We increased our holding (to 3.3%) in the USD Perenti 2025 bond at a yield of 9.5% (rated BB)

3 – We increased our holdings in a series of high quality European utilities (Iberdrola, Enel, EDP, Engie) to a 10% portfolio position at yields of 6.5 – 8.5%. These bonds are rated BB+ to BBB, and are callable between 2026 and 2029

4 – We continued to generally extend spread duration on the fund by selling shorter-dated bonds that have performed relatively strongly YTD (Trafigura 2023; Louis Dreyfus 2023; Travis Perkins 2023; Shawbrook 2025), and replacing them with 'best ideas' at considerably more attractive yields of 6 – 9.0%

In mid-July, we actively boosted the yield to expected call of the fund to 7.2%, before enjoying a strong rally in global bond markets in the final 2 weeks of the month. These positive returns mean that as of 1st August 2022 the yield to expected call is 6.5%, and cash levels are 5%. 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 5%; duration is 3.5 years; and the yield to expected call is 6.5%

(Yield to Maturity also = 6.5%). The average rating of the fund is BBB, and the unrated portion of the fund is just 3.6%.

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 investment grade, high yield and unrated sectors. We maintain our focus on stock selection reinforced by in-depth credit research.