Close Brothers Asset Management

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Close Portfolio Funds

Monthly fund manager update

JULY 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 to 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 positive absolute returns in July and outperformed against their respective Investment Association peer groups (in brackets) on a relative basis: Conservative increased +3.4% (+2.6%), Balanced +4.5% (+3.5%) and Growth +5.7% (+3.2%).

Since inception the Funds have increased by an annualised 4.5% (4.4%), 6.2% (6.1%) and 7.3% (6.4%), with capture ratios of 100%, 101% and 105% across Conservative, Balanced and Growth respectively.

MONTH IN REVIEW

Our cautious positioning – an underweight stance in equities, light positioning in corporate bonds, no exposure to cyclical commodities, high cash levels and a bias towards cash-like short duration gilts in fixed income – has helped to preserve value from an asset allocation perspective in 2022. However, this positioning was less useful during a rally in both stock and bond markets in July. Nevertheless, this asset allocation headwind in the month was more than overcome by very strong equity stock selection as markets began to price abruptly for an economic slowdown, rewarding our longstanding portfolio bias towards defensive and resilient companies. The top three contributors over July were Partners Group (trimmed towards the end of the month), 3i, and Microsoft. The most significant detractors were Admiral (sold), Suncor Energy (added in the month), and Ally Financial.

JULY THOUGHTS: A PATH THROUGH

After double digit declines in markets over the first half of the year they rallied strongly in July. The MSCI All Countries World Index, a measure of global equities, rose 4.6%, and the ICE Bank of America Sterling Broad Market Index of UK fixed income gained 2.7%. Why the sudden euphoria?

The proximate cause was a sharp reversal in commodity prices. Copper, for example, ended July down -27% from the year-to-date high touched shortly after Russia invaded Ukraine. Central banks were slow to raise interest rates last year when inflation began to accelerate, but have been catching up this year. Falling commodity prices are the first tangible sign that these interest rate increases are beginning to bite by undercutting demand, causing prices to correct. The latest update from the US Federal Reserve is that a growth slowdown is "necessary". Other good news regarding moderating prices can be found in areas such as the used car market and freight rates, which are now growing more slowly than the blistering rates earlier in the year.

A path through has opened up. Although inflation in the US rose 9.1% year-on-year in July – a faster rate than any month in the 1970s – evidence is building that the pace will slow and the headline rate may have peaked already. This, then, means that central banks are nearer to the point at which they can stop raising interest rates. Equity investors, on the back foot all year, are keen to buy beaten-up assets, whilst some conviction of the ceiling in interest rates puts the bond market on firmer ground.

Positioning is simple: if the Federal Reserve is able to 'pivot' and stop raising rates just in time to avoid a recession, then the worst is already past and equities could be above the prior all-time highs within a year. If a recession arrives, however, history suggests that the bottom for equity markets will not be reached until three to six months before it ends, after a long string of job losses, with the Federal Reserve cutting interest rates. Until our objective economic measures prove otherwise, we see a greater likelihood that recession still lies ahead, making it premature to buy into the recovery before the downturn arrives.

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.