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Close Sustainable Bond Portfolio Fund

Monthly fund manager update

AUGUST 2022

FUND PERFORMANCE

The Close Sustainable Bond Fund returned -3.2% in August, bringing the year-to-date return to -13.6%. In comparison, the Investment Association (IA) Sterling Corporate Bond sector returned -4.7% in August, has declined -14.2% YTD.

The Fund is focused on risk-adjusted returns and has historically operated with lower duration than the corporate bond sector. As a result, it has historically 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 August was dominated by macro data and geopolitical events - with markets volatile on the outlook for gas and electricity markets in Q4 2022 - and the potential impact power prices will have on inflation and global GDP growth. Against the backdrop of volatile data, central banks remained active in their bid to tame inflation:

The Bank of England raised rates to 1.75% (from 1.25%) and clearly signalled a further rate hike in September 2022. Additionally, it was announced that Quantitative Tightening would begin from September 2022, while macro forecasts were updated - indicating inflation would reach 13.3% and the UK would enter a c. 15 month recession.

The Federal Reserve (Fed) did not meet in August but continued to increase the level of Quantitative Tightening (unwinding the USD 9trn of debt on the Fed's balance sheet).

The European Central Bank did not meet in August either, but language remains geared towards further rate hikes following their July decision to raise rates for first time in 11 years – taking the Depo Rate to 0.0% (from -0.50%), and the Ref Rate to 0.5% (from 0.0%).

In the UK, Composite Purchasing Managers' Index (PMI) data declined slightly – but remained in positive territory at 50.9 (July's reading was 52.1). Consensus 2022 GDP growth forecasts increased to +3.5% (from +3.4% in July), albeit they are significantly lower than March (+4.0%) and January (+4.5%). Inflation forecasts remain elevated, and end of year 2022 Consumer Prices Index (CPI) inflation is now forecast to reach +12% (likely peaking in October 2022). Unemployment data remained strong at just 3.8%.

In the US, Composite PMI data weakened to 45.0 (July = 47.7), while 2022 consensus GDP growth forecasts declined to +1.7% (July = +2.0%). US inflation forecasts for the end of 2022 remained stable at +7.3%, while unemployment strengthened further to just 3.5%.

In the Eurozone, Composite PMI data weakened to 49.2 (July = 49.9), while consensus 2022 GDP growth forecasts increased to +2.8% (July = 2.7%). End of year 2022 inflation expectations increased significantly to 8.6% (July = 7.9%; March = 5.1%) given ongoing concerns over Russian gas supplies. Unemployment remained stable at 6.6%.

PORTFOLIO CHARACTERISTICS

The average credit rating on the portfolio remained strong at 'BBB+' and 35% of fund holdings are in AAA to A- rated bonds. The Fund offers a yield of 6.3% and duration of 4.7 years. We believe the very strong credit quality of the fund may 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 243bps, versus their 5yr average of 175bps; 10yr average of 190bps; and 20yr average of 215bps
- **Sterling High Yield** spreads are <u>cheap</u> versus history, with 'BB' spreads at 491bps (5yr average = 333bps; 10yr average = 345bps; 20yr average = 430bps)

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.