Close Brothers Asset Management

For professional adviser use only.
Not for distribution to retail clients.

Close Select Fixed Income Fund

Monthly fund manager update

AUGUST 2022

FUND PERFORMANCE

The Close Select Fixed Income Fund returned -0.95% in August, bringing the year-to-date (YTD) return to -8.52%. In comparison, the Investment Association (IA) Sterling Strategic Bond sector returned -1.97% in August, and has declined -9.9% YTD.

The Fund has therefore outperformed the IA sector peer group by +1.38% over the first 8 months of 2022.

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 back in 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 ACTIVITY

Over the month the Fund continued to take advantage of the more attractive opportunities now presenting themselves. Key investments include:

1 – Increasing our holding (to 2.2%) in the EUR International Personal Finance 2025 bond at a yield of 17.6% (rated BB-)

2 – Increasing our holdings (to 3.1%) in GBP Just Group bonds by adding to the Just Group 2031-PERP at a yield of 9.8% (rated BBB-)

3 – Increasing our holding (to 2.5%) in the GBP Lloyds 2029-PERP bond at a yield of 7.5% (rated BBB-)

4 – Buying a new (2.3%) holding in the EUR Orange 2029 Hybrid bond at a yield of 6.7% (rated BBB-)

5 – Increasing our holdings in a series of high quality Issuers (Rabobank, Barclays, UBS, Iberdrola, Aviva, Enel, and Volkswagen, Siemens, Zurich) at yields of 4.5 – 8.7%. These bonds are rated A+ to BBB- (i.e. all Investment Grade)

On the portfolio construction side, the yield to expected call is 7.8%; duration is 3.9 years; the average rating of the fund is BBB; cash levels are 1.7%; 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

243bps, versus their 5yr average of 175bps; 10yr average of 190bps; and 20yr average of 215bps

- **Sterling High Yield** spreads are cheap 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 investment grade, high yield and unrated sectors. We maintain our focus on stock selection reinforced by in-depth credit research.