Close Brothers Asset Management

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# Close Portfolio Funds

## Monthly fund manager update

AUGUST 2022

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Managing Director

### 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 negative returns in August and underperformed their Investment Association peer groups (in brackets): Conservative fell -1.8% (-0.6%), Balanced -1.9% (-0.1%) and Growth -2.0% (+0.5%). The currency overlay detracted significantly by -0.6%, -1.0% and -1.2% respectively.

Since inception the Funds have increased by an annualised 4.3% (4.3%), 5.9% (6.1%), 7.1% (6.4%) with capture ratios of 100%, 99% and 103% across Conservative, Balanced and Growth respectively.

### MONTH IN REVIEW

Fixed income yields reversed course in August with the ICE Bank of America Sterling Broad Market index declining by -7.5%. Global equity markets fell too, by -3.6% in US dollars, although the pound depreciated sharply by -5.1% so this was converted into a +1.6% gain in GBP terms. Our bias towards cash and cash-like short-duration bonds within fixed income helped cushion against the rise in yields. However, the currency overlay suffered materially from US dollar strength. The period of very strong stock selection in recent months cooled somewhat; the top three contributors were Canadian Natural Resources, Hoya (reduced in the month), and Ally Financial; while the largest detractors were Avantor (added), Schneider Electric, and Relx.

### AUGUST THOUGHTS: PRINT THE DIFFERENCE

Equity and corporate bond markets initially continued the rally that began in June into the middle part of August. However, the European energy crisis deteriorated from bad to awful thanks to a combination of a dry summer stymieing hydroelectric output, ongoing operational issues with the French nuclear fleet, and Russian gas pipelines remaining shuttered in retribution for Western sanctions over its Ukraine invasion. Electricity prices consequently ratcheted higher to levels that are simply unaffordable for most low and middle income consumers and low-margin or energy-intensive businesses. The sums involved are colossal. Taking the UK example, the collective household energy bill is projected to rise to 7% of GDP in 2023 at current market rates, from 1.3% in 2021 (itself an elevated level). The impact is on par with the economic contractions of -4.2% in 2009 and -9.3% in 2020.

Governments are under pressure to react to the situation and broadly have two options: either ‘helicopter money’ handouts direct to consumers and some businesses (a fiscal experiment trialled in the pandemic) or capping bills and bailing out energy firms (not unlike the bank bailouts during the financial crisis). The inflationary implications of the former are more corrosive than the latter, but both ultimately amount to the same thing: printing the difference with currency devaluation as the relief valve. Eventually markets will adapt through a combination of demand destruction and new sources of supply generation, as Russian gas exports to Europe account for “only” 1% of global energy consumption. But in the meantime Europe is scrambling for seaborne imports of liquefied natural gas to fill the gap, dragging up natural gas prices globally, and worsening the inflation picture in the US.

All roads lead to the Federal Reserve (Fed). The US central bank is less likely to slow the rate of interest rate increases as a result of European events. In a speech towards the end of the month, Chair Jerome Powell gave a speech in which he said, “While higher interest rates, slower growth, and softer labour market conditions will bring down inflation, they will also bring some pain to households and businesses. These are the unfortunate costs of reducing inflation. But a failure to restore price stability would mean far greater pain.” Meanwhile, the US government made good on a Democratic Party campaign promise to write-off student debt equivalent to almost 2% of GDP – a soupcon of 'helicopter money' to address a prior misallocation of economic resources.

After a stock market rally that retraced half of the year-to-date drawdown we maintained a very cautious positioning by selling more equities. Many of our other investments are in cash and fixed income securities with durations so short they are effectively cash-like.  Markets then slumped into the end of the month.  At this stage we are reluctant to buy risk assets until we have sight that the Fed will stop raising short-term interest rates as the hikes are putting downward pressure on all asset classes – equities, longer-duration bonds, industrial commodities, and precious metals.

## IN OTHER NEWS

Senior Analyst Henry Frewer, who has worked on your funds since 2015, has been promoted to Investment Manager in recognition of his growing responsibilities – congratulations, Henry!

## 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.