Close Select Fixed Income Fund

Monthly fund manager update

SEPTEMBER 2022

FUND PERFORMANCE

The Close Select Fixed Income Fund returned -4.7% in September, bringing the year-to-date (YTD) return to -12.8%. In comparison, the Investment Association (IA) Sterling Strategic Bond Sector returned -5.0% in September, and has declined -14.3% YTD.

The Fund has therefore outperformed the IA sector by +1.5% in the first 9-months of 2022.

MACRO BACKDROP

Newsflow in September was dominated by continued Central Bank rate hiking, and the 'mini-budget' in the UK. The latter prompted global investors to sell UK government bonds; a rapid intervention from the Bank of England to stymie risks of financial contagion in the UK insurance and pensions sectors; and the outlook on the UK Sovereign credit rating to be downgraded by two rating agencies.

The Bank of England (BoE) raised interest rates to 2.25% (from 1.75%) and clearly signalled more rate hikes in November and December. It was also confirmed that Quantitative Tightening (i.e. selling bonds) would begin in the latter part of the month. However, just one week after the Bank's meeting, it was forced to actually restart Quantitative Easing (i.e. buying bonds) in order to assuage investor concerns following the UK's 'mini-budget'.

The Federal Reserve (Fed) raised rates to 3.25% (from 2.50%); clearly signalled more rate hikes in November and December; and continued with its programme of Quantitative Tightening at c. USD 95bn per month (unwinding the USD 9trn of debt on the Fed's balance sheet).

The European Central Bank (ECB) raised the Depo Rate to 0.75% (from 0%); and the Refi Rate to 1.25% (from 0.50%). In-line with the BoE and Fed, the ECB also signalled further near term rate hikes in October and December.

In the UK, Composite Purchasing Managers' Index (PMI) survey data declined to 48.4 (August = 49.6). Consensus 2022 GDP growth forecasts were stable at +3.5%, albeit they remain significantly lower than March (+4.0%), and January 2022 (+4.5%). Inflation forecasts reduced following the announcement of the energy price cap, but remain elevated with end of year 2022 the Consumer Prices Index (CPI) inflation forecast to reach c. 11% (likely peaking in October this year). Unemployment data improved to an exceptionally strong 3.6%.

In the US, Composite PMI data strengthened to 49.3 (August = 44.6), while 2022 consensus GDP growth forecasts declined to +1.6% (August = +1.7%). US inflation forecasts for the end of 2022 reduced slightly to +7.1% (August = +7.3%), while unemployment remained strong at 3.5%.

In the Eurozone, Composite PMI data weakened to 48.2 (August = 48.9), while consensus 2022 GDP growth forecasts increased for the second consecutive month to +2.9% (August = +2.8%). End of year 2022 inflation expectations increased significantly to 9.5% (August = 8.9% and March = 5.1%) given ongoing concerns over Russian gas supplies. Unemployment remained stable at 6.6%.

PORTFOLIO ACTIVITY

The Fund continued to take advantage of attractive opportunities over the month – routinely buying bonds at record yields for the fund. As a result of our trading activity, 34% of holdings offer a yield of over 10%, and 83% of fund holdings offer a yield of over 8%. Key investments in September include:

1 – We increased our holding (to 2.2%) in the EUR International Personal Finance 2025 bond (rated BB-) at a yield of 25%. This is a record-high yield purchase for the Fund;

2 – We increased our holdings (to 3.2%) in GBP Just Group bonds by adding to the Just Group 2031-PERP at a yield of 12.3% (rated BBB-);

3 – We increased our holding (to 3.6%) in the GBP Rothesay Life bonds by adding to the Rothesay 2028-PERP bond at a yield of 11.6% (rated BBB-);

4 – We bought a new 0.8% holding in the GBP Legal & General 2031-PERP bond at a yield of 10.1% (rated BBB);

5 – We increased our holdings in a series of high quality Issuers (Aviva, Enel, Nationwide, Lloyds and Pension Insurance Corporation) at yields of 8% – 12%. These bonds are rated to BBB / BBB- (i.e. all Investment Grade).

On the portfolio construction side, the yield to expected call reached a record high of 9.5%; duration is 3.9 years; the average rating of the fund is BBB; cash levels are 2%; and the unrated portion of the fund is currently just 4%.

OUTLOOK AND STRATEGY

Fixed Income sub-asset classes:

- **Sovereign bond yields** are volatile and reactive to macro data – we believe they offer fair value in the UK, US and Eurozone.
- **Sterling Investment Grade** bonds are cheap versus all historical timeframes, with sterling 'BBB' credit spreads at 289bps, versus their 5yr average of 176bps; 10yr average of 189bps; and 20yr average of 215bps.
- **Sterling High Yield** spreads are cheap versus history, with 'BB' spreads at 565bps (5yr average = 337bps; 10yr average = 344bps; 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.