Close Sustainable Bond Portfolio Fund

Monthly fund manager update

SEPTEMBER 2022

FUND PERFORMANCE

The Close Sustainable Bond Fund returned -6.9% in September, bringing the year-to-date (YTD) return to -19.6%. In comparison, the Investment Association (IA) Sterling Corporate Bond Sector returned -7.5% in September, and has declined -20.6% YTD.

The Fund is focused on risk-adjusted returns and has historically operated with lower duration than the IA Sterling Corporate Bond Sector. As a result, the Fund has outperformed the sector c. 83% of the time in 'down' markets, and c. 84% of the time when the sector is down by -25bps or more (since February 2014).

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 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 CHARACTERISTICS

The average credit rating on the portfolio remained strong at 'BBB+', with 31% of fund holdings invested in AAA to A- rated bonds. The Fund offers a yield of 8.3% and duration of 4.6 years. We believe the very strong credit quality of the fund de-risks it from future volatility.

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 sustainable investment grade sectors. We maintain our focus on stock selection reinforced by in-depth credit research.