Close Sustainable Bond Portfolio Fund

Monthly fund manager update

NOVEMBER 2022

FUND PERFORMANCE

The Close Sustainable Bond Fund returned +4.5% in November, bringing the year-to-date (YTD) return to -13.8%. In comparison, the Investment Association (IA) Sterling Corporate Bond Sector returned +3.8% in November, and has now returned -14.8% YTD.

MACRO BACKDROP

Newsflow in November was dominated by debate around the future path of inflation – specifically "have major markets reached peak inflation already?" Bond markets rallied against a backdrop of falling Consumer Prices Index (CPI) data across the US and the Eurozone (though not yet in the UK).

The Bank of England raised the policy rate to 3.00% (from 2.25%) on 3rd November, and clearly signalled that a 0.50% increase is expected in December 2022. The Banks's economic projections also forecast a long, but shallow, recession in 2023.

The Federal Reserve raised the US policy rate to 4.00% (from 3.25%) on 2nd November. Futures markets expect a 0.50% increase in December 2022.

The European Central Bank did not meet in November, but futures markets are expecting a 0.50% increase to policy rates in December. The Depo Rate is currently 1.50%; and the Refi Rate is 2.00%.

In the UK, Composite Purchasing Managers' Index (PMI) data slightly improved to 48.3 (from 48.2 in October), while consensus 2023 GDP growth forecasts weakened to -0.8% (from -0.4% in October) following negative macro updates from the Bank of England and the UK Government. Inflation forecasts indicate that the UK is 'at or near' peak inflation following the +11.1% year on year (YoY) metric in November, and will decline over 2023 to +4.6% in Q4 2023. Unemployment remained low at 3.6%.

In the US, Composite PMI data declined to 46.3 (from 48.2 in October), while consensus 2023 GDP growth forecasts remained stable at +0.4%. US inflation declined in November to +7.7% (from +8.2% in October), and forecasts indicate inflation will decline to +4.1% in Q4 2023. Unemployment increased slightly, but remained strong at just 3.7% (from 3.5% in October).

In the Eurozone, Composite PMI data improved to 47.8 (from 47.3 in October), while consensus 2023 GDP growth forecasts remained stable at -0.1%. Eurozone inflation declined in November to +10.0% (from +10.6 in October), and forecasts indicate inflation will decline to +3.1% in Q4 2023, albeit forecasts are volatile given ongoing concerns over Russian gas supplies. Unemployment improved further to 6.5% (from 6.6% October).

PORTFOLIO CHARACTERISTICS

The average credit rating on the portfolio remained strong at 'BBB+' with 26% of fund holdings in AAA to A- rated bonds. The fund offers a yield of 7.6% and duration of 5.1 years. We believe the very strong credit quality of the fund helps de-risk it from potential future volatility.

OUTLOOK AND STRATEGY

Fixed Income sub-asset classes:

- **Sovereign bond yields** are volatile and reactive to macro data – and 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 245bps, versus their 5yr average of 188bps; 10yr average of 188bps; and 20yr average of 215bps.
- **Sterling High Yield** spreads are cheap versus history, with 'BB' spreads at 505bps versus the 5yr average of 347bps; 10yr average of 345bps; and 20yr average of 429bps).

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.