Close Select Fixed Income Fund

Monthly fund manager update

NOVEMBER 2022

FUND PERFORMANCE

The Close Select Fixed Income Fund returned +4.2% in November, bringing the year-to-date (YTD) return to -8.5%. In comparison, the Investment Association (IA) Sterling Strategic Bond Sector returned +3.0% over the month, and is -10.6% YTD.

The Fund has therefore outperformed the IA sector by +2.2% in the first eleven months of 2022.

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 over the month 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 Bank'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 ACTIVITY

Bond markets rallied in November, and the Fund continued to take advantage of attractive opportunities in both primary and secondary markets. The fund is gently increasing credit quality, with c. 85% of holdings rated Investment Grade and only 12% of the fund in high yield (virtually all of which is 'BB' rated). Key investments during the month include:

1 – We bought a new 3.3% holding in a new issue GBP Natwest 2028-2033 bond at a yield of 7.4% (rated BBB+). The bond is callable in 2028, with a final maturity in 2033.

2 – We bought a new 2.0% holding in the EUR Bank of Ireland 2028-2033 bond at a yield of 8.5% (rated BBB). The bond is callable in 2028, with a final maturity in 2033.

3 – We increased our holding (to 1.6%) in the GBP Bupa 2031-PERP bond at a yield of 10% (rated BBB-).

4 – We increased our holding (to 1.9%) in the GBP Legal & General 2031-PERP bond at a yield of 8.8% (rated BBB);

5 – We increased our holdings in a series of high quality Issuers (Volkswagen, HSBC, Barclays, UBS, Virgin Money, Louis Dreyfus) at yields ranging from 7%-11%. These bonds are rated A- to BBB- (i.e. all Investment Grade).

On the portfolio construction side, the yield to expected call is 8.3%; duration is 4.2 years; the average credit rating of the fund is BBB; cash levels are just 2%; and the unrated portion of the fund is just 4%.

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 investment grade, high yield and unrated sectors. We maintain our focus on stock selection reinforced by in-depth credit research.