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Close Select Fixed Income Fund

Monthly fund manager update

DECEMBER 2022

FUND PERFORMANCE

The Close Select Fixed Income Fund returned +0.7% in December taking the year's performance to -7.9%. In comparison, the Investment Association (IA) Sterling Strategic Bond sector returned -0.4% in December, and -11.0% for the year.

The Select Fixed Income Fund therefore outperformed the IA sector by +3.2% in 2022.

MACRO BACKDROP

Newsflow in December continued to be dominated by three key questions:

- **1) Have major markets reached peak inflation already?** CPI fell in Europe, UK and the US in November 2022;
- **2) Will there be a 'more severe than expected' recession in 2023?** Consensus forecasts expect a very shallow recession in 2023, with growth of -1.0% to +0.3%;
- **3) Are Central Banks near the end of the rate-hiking cycle?** The futures markets indicate that the answer is "almost there", with another 0.5% to 1.5% of hikes currently expected.

The Bank of England raised the raised the UK's policy rate to 3.50% (from 3.00%) on 15th December 2022, and signalled further rate rises in 2023. Futures markets expect a 0.50% rate rise in February 2023.

The Federal Reserve raised the US policy rate to 4.50% (from 4.00%) on 14th December 2022. Futures markets expect a 0.25% - 0.50% rate rise in February 2023.

The European Central Bank raised European policy rates by 0.50% on 15th December 2022. The Depo Rate was raised to 2.00% (from 1.50%); and the Refi Rate was raised to 2.50% (from 2.00%). ECB rhetoric was hawkish and clearly signalled that more rate rises will be necessary in 2023. Futures markets expect a 0.50% rate rise in February 2023.

In the UK, Composite PMI data slightly improved to 49.0 (from 48.2 in Nov-22), while consensus 2023 GDP growth forecasts weakened to -1.0% (from -0.8% in Nov-22) as economists adjusted their outlook following negative macro updates from both the Bank of England and the UK Government. CPI inflation reduced to +10.7% in Nov-22 (from +11.1% in Oct-22), and forecasts indicate inflation is expected to continue to decline throughout 2023 to c. +4.4% in Q4 2023. Unemployment remained strong at 3.7%.

In the US, Composite PMI data declined to 44.6 (from 46.4 in Nov-22), while consensus 2023 GDP growth forecasts remained broadly stable at +0.3%. US inflation declined for the second consecutive month in Nov-22 to +7.1% (from 7.7% in Oct-22 which was down from +8.2% in Sep-22), and forecasts indicate inflation is expected to decline to +4.1% in Q4 2023. Unemployment remained stable at (a strong) 3.7%.

In the Eurozone, Composite PMI data improved to 48.8 (from 47.8 in Nov-22), while consensus 2023 GDP growth forecasts remained stable at -0.1%. Eurozone inflation declined in Nov-22 to +10.1% (from +10.6% in Oct-22), and forecasts indicate inflation is expected to decline to +3.5% in Q4 2023, albeit forecasts are volatile given ongoing concerns over Russian gas supplies. No unemployment data was published given the Christmas break and public holidays, but forecasts expect data to remain stable at c. 6.5% (compared with November's 6.6% reading).

PORTFOLIO ACTIVITY

After a relatively busy October and November, December 2022 was a relatively quiet month for both the fund and bond markets in general. The fund continued to gently increase 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).

On the trading side, we increased our holdings in a series of high quality Issuers (Orange, Enel, EDP, Iberdrola and Nationwide) at yields of 7 – 10%. These bonds are rated BBB to BB+.

On the portfolio construction side, the yield to call is 8.1%; duration is 4.2 years; the average rating of the fund is BBB; cash levels are 2%; and the unrated portion of the fund is 3%.

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

236bps, versus their 5yr average of 182bps; 10yr average of 188bps; and 20yr average of 215bps.

- **Sterling High Yield** spreads are cheap versus all historical timeframes, with 'BB' spreads at 494bps versus their 5yr average of 352bps; 10yr average of 345bps; and 20yr average of 428bps.

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.