Close Brothers Asset Management

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Close Sustainable Bond Portfolio Fund

Monthly fund manager update

JANUARY 2023

FUND PERFORMANCE

The Close Sustainable Bond Fund returned +3.2% in January. In comparison, the IA Sterling Corporate Bond sector returned +3.6% in January.

MACRO BACKDROP

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

- **1) Have major markets reached peak inflation already?** CPI fell again across major markets in December 2022;

- **2) Will there be a 'more severe than expected' recession in 2023?** Consensus forecasts are improving – and expect either no or a very shallow recession in 2023, with growth of -0.9% to +0.5% across UK, US and Eurozone;

- **3) Are Central Banks near the end of the rate-hiking cycle?** Futures markets indicate that the answer is "almost there", with another 0.5% to 1.0% of hikes expected.

The Bank of England raised the policy rate to 4.00% (from 3.50%) on 2nd February 2023, and signalled further rate rises in 2023.

The Federal Reserve raised the policy rate to 4.75% (from 4.50%) on 1st February 2023. Futures markets expect just one more rate hike in 2023 (to 5.0%).

The European Central Bank raised policy rates by 0.5% on 2nd February 2023. The Depo Rate was raised to 2.5% (from 2.0%); and the Refi Rate was raised to 3.0% (from 2.5%). ECB rhetoric was relatively hawkish and signalled that more rate rises will be necessary in 2023. Futures markets expect a 0.50% rate rise in March 2023.

In the UK, Composite PMI data weakened to 47.8 (from 49.0 in Dec-22), while consensus 2023 GDP growth forecasts improved to -0.9% (from -1.0% in Dec-22). CPI inflation reduced to +10.5% in Dec-22 (from 11.1% in Oct-22 and 10.7% in Nov-22), and forecasts indicate that inflation is expected to continue to decline throughout 2023 to c. +4.2% in Q4 2023. Unemployment remained strong at 3.7%.

In the US, Composite PMI data improved to 46.6 (from 45.0 in Dec-22), while consensus 2023 GDP growth forecasts improved to +0.5% (from +0.3% in Dec-22). US inflation declined for the sixth consecutive month to +6.5% (from +9.1% in June and +7.1% in Nov-22) and forecasts indicate that inflation is expected to decline to +2.9% in Q4 2023. Unemployment improved further to 3.5%.

In the Eurozone, Composite PMI data improved to 50.2 (from 49.3 in Dec-22), while consensus 2023 GDP growth forecasts improved to 0% (from -0.1% in Dec-22). Eurozone inflation declined to +8.5% (from +10.6% in Oct-22 and +9.2% in Dec-22), and forecasts indicate that inflation is expected to decline to +3.4% in Q4 2023, albeit forecasts are volatile 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+' and 90% of the Fund's holdings are rated investment grade. The Fund offers a yield to call of 6.8% and duration of 4.5 years.

OUTLOOK AND STRATEGY

We maintain our focus on stock selection reinforced by in-depth credit research.

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 slightly cheap versus all historical timeframes, with sterling 'BBB' credit spreads at 201bps, versus their 5yr average of 185bps; 10yr average of 189bps; and 20yr average of 216bps.
- **Sterling High Yield** spreads are cheap versus all historical timeframes, with 'BB' spreads at 460bps (versus the 5yr average of 363bps; 10yr average of 349bps; and 20yr average of 432bps).

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.

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