

# Close Select Fixed Income Fund

## Monthly fund manager update

JANUARY 2023

### FUND PERFORMANCE

The Close Select Fixed Income Fund returned +3.8% in January. In comparison, the Investment Association (IA) Sterling Strategic Bond sector returned +2.9% in January.

The Fund therefore outperformed the IA sector by +0.9% in January, and is a 1<sup>st</sup> Quartile fund on a 1yr, 3yr and 5yr basis (versus its IA sector).

Another piece of good news for investors: the OCF on the Select Fixed Income X Inc. share class reduced to 0.45% on 31<sup>st</sup> January 2023 (from 0.48%).

### 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 2<sup>nd</sup> February 2023, and signalled further rate rises in 2023.

**The Federal Reserve** raised the policy rate to 4.75% (from 4.50%) on 1<sup>st</sup> February 2023. Futures markets expect just 1 more rate hike in 2023 (to 5 %).

**The European Central Bank** raised policy rates by 0.5% on 2<sup>nd</sup> February 2023. The Depo Rate was raised to 2.5% (from 2%); 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 ACTIVITY

The Fund continued to gently increase credit quality during January - with its average rating maintained at BBB (but trending towards BBB+) - and c. 85% of holdings rated Investment Grade. Only 12% of the Fund is in high yield (virtually all of which is 'BB' rated). Key investments during the month include:

- 1) We increased our holdings (to 3.8%) in GBP Just Group bonds by adding to the Just Group 2031-PERP bond at a yield of 9.7% (rated BBB-);
- 2) We increased our holdings (to 3.5%) in GBP Bupa bonds by adding to the Bupa 2031-PERP bond at a yield of 9.1% (rated BBB-);
- 3) We increased our holdings in a series of high quality Issuers (Volkswagen, AT&T, Pershing Square, EDP and Paragon Bank) at yields of 6% to 10%. These bonds are rated BBB+ to BB+.

On the portfolio construction side, the yield to call is 7.4%; duration is 4.2 years; the average rating of the fund is BBB; cash levels are 3%; 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 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 investment grade, high yield and unrated sectors. We maintain our focus on stock selection reinforced by in-depth credit research.

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## **IMPORTANT INFORMATION**

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