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Close Portfolio Funds

Monthly fund manager update

JANUARY 2023

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STRATEGY OVERVIEW

The Close Portfolio Funds seek to achieve resilient returns over the long-term through an equity-led approach to investing in a multi-asset context. Our strategy of acquiring 'cheap durables' – direct interests in predictable and sustainable businesses purchased at attractive cash-based valuations – is complemented by allocations across fixed income and alternatives as appropriate.

MONTHLY PERFORMANCE REVIEW

Global equities resumed their rally in January, rising 5.6% in US dollar terms (constrained to a +3.3% gain for the sterling-based investor as the pound strengthened), as the valuation impact of falling yields (sterling bonds rose +3.0%) outweighed the decline in corporate earnings as economic growth continues to slow. Each Fund delivered positive returns in January with Conservative and Balanced slightly behind their respective Investment Association (IA) peer groups, whilst Growth marginally outperformed. Fund returns for the month and those of the respective IA Sectors (in brackets) were as follows: Conservative: 2.4% (3.0%); Balanced 3.0% (3.4%); Growth 3.5% (3.4%).

Asset allocation was a negative in performance attribution over the month, because we entered the year still underweight, duration within our fixed income allocation and bonds rallied. This was roughly compensated for by positive stock selection – continuing the story of the fourth quarter of 2022. We ended January at neutral duration, closing out a position that was profitable last year. In terms of individual holdings, the most significant contributors over the month were Alphabet, 3i Group and LVMH, while the three most significant detractors were O'Reilly Automotive, UnitedHealth Group (added to in the month), and Booz Allen.

JANUARY THOUGHTS – UNDER THE HOOD

This month we break with the usual format and in lieu of the monthly commentary refer to a separate document written in response to frequently asked questions about the headline performance of the funds relative to their IA peer groups over the past year. This document, entitled: *Portfolio funds update – January 2023* can be found here. In the meantime, the too long didn't read (TLDR) summary is as follows:

- Losses on the prior currency overlay programme account for much of the headline performance gap. Now reformed, up to 100% of the fixed income assets only are now hedged back into sterling. This has the additional benefit of expanding our fixed income investment universe beyond the sterling market.

- Stock selection was negative in calendar year 2022. Reshaping forty percent of the equity assets 'worked' well in 4Q21, pulling forward returns from the future, which unwound sharply in 1Q22. With the benefit of hindsight we could have been aggressive here, selling what we had just bought as well as what we had only just decided to keep – even if it entailed turning over >100% of the assets in under two months. Stock selection has stabilised since the second quarter and returned to positive trend.

- Asset allocation was ultimately positive in calendar year 2022. In a year when the two main building blocks of a multi-asset fund – equities and fixed income – both went down, large holdings in cash and short duration bonds provided relatively safety. We feel that our macro investing framework passed the test in a difficult year for investors when it mattered.

LOOKING AHEAD

The forward strategy outlined in our September commentary 'Preserve Capital, Make Money' remains in action. We maintain our slight underweight position in equities. With rising conviction that yields have peaked, we have swapped some equities for gold – which doesn't have earnings risk – and reduced our cash position by adding long-term Treasury bonds, which will benefit from interest rate cuts in a recession. Both measures should help protect portfolios. We are looking for final confirmation that the US is entering recession before moving outright long duration. We have begun to add selectively to new cyclical equities on profit warnings on the basis that those companies who have been first to see their earnings decline will likely be the first to see them recover.

As a long-term strategy with low turnover we fully expect and recommend that unitholders judge our performance over a period of five years or more.