Close Select Fixed Income Fund

Monthly fund manager update

FEBRUARY 2023

FUND PERFORMANCE

The Close Select Fixed Income Fund returned -1.1% in February, and +2.7% year to date (YTD). In comparison, the Investment Association (IA) Sterling Strategic Bond sector returned -1.5% in February, and +1.4% YTD.

The Fund has therefore outperformed the IA sector by +1.3% YTD, and is a 1st quartile fund on a YTD, 1yr, 3yr and 5yr basis (versus its IA sector).

FUND NEWS

In other news, the Fund is undergoing a series of improvements in Q1 2023, and the final changes will be completed in March. They are:

1. On 31st January, the fund OCF reduced to 0.45% (from 0.48%);

2. On c. 3rd March, AUM will increase to c. GBP 410m (from c. GBP 260m currently), as the Close Sustainable Bond Fund is merged into Close Select Fixed Income fund. The funds are fully aligned, and no trading will take place as a result of the merger;

3. On 31st March, the fund will formally incorporate a new sustainable methodology. Given the fund has been operating in-line with the new methodology for the past 12-months, no fund changes / trading will occur following incorporation.

Overall, the Close Select Fixed Income Fund is reducing costs for investors, increasing scale (while remaining nimble), and formally improving already strong sustainability credentials.

MACRO BACKDROP

Newsflow in February was dominated by the recurring themes of Central Bank rate hiking expectations, “at or near” peak inflation debates, and a general optimism around potential for a ‘soft-landing’ in 2023 across the US, UK and Eurozone.

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. Futures markets expect c. 3 small (i.e. +0.25%) rate hikes in 2023 (to 4.75%).

The Federal Reserve raised the policy rate to 4.75% (from 4.50%) on 1st February 2023. Futures markets expect c. 3 small (i.e. +0.25%) rate hikes in 2023 (to 5.5%), followed by 1 rate cut in Q4 2023.

The European Central Bank (ECB) raised policy rates by 0.50% on 2nd February 2023. The Depo Rate was raised to 2.50% (from 2.00%); and the Refi Rate was raised to 3.00% (from 2.50%). ECB rhetoric was relatively hawkish, and futures markets remain volatile - forecasting the Depo rate to reach c. 3.80% in summer 2023.

In the UK, Composite Purchasing Manager Index (PMI) data improved to 53.0 (from 48.5 in Jan-23), while consensus 2023 GDP growth forecasts improved to -0.7% (from -0.9% in Jan-23). CPI inflation reduced to +10.1% in Jan-23 (from 10.5% in Dec-22 and 11.1% in Oct-22). Forecasts indicate inflation will continue to decline throughout 2023 to c. +3.9% in Q4 2023. Unemployment remained strong at 3.7%.

In the US, Composite PMI data improved to 50.2 (from 46.8 in Jan-23), while consensus 2023 GDP growth forecasts improved to +0.7% (from 0.5% in Jan-23). US inflation declined for the seventh consecutive month to +6.4% (having peaked in Jun-22 at +9.1%). Forecasts indicate inflation will decline to +3.2% in Q4 2023. Unemployment improved further to 3.4%.

In the Eurozone, Composite PMI data improved to 52.3 (from 50.3 in Jan-23), while consensus 2023 GDP growth forecasts improved to +0.4% (from 0% in Jan-23). Eurozone inflation declined to +8.6% (from 9.2% in Dec-22 and 10.6% in Oct-22). Forecasts indicate inflation will decline to +2.9% in Q4 2023, albeit forecasts are volatile given ongoing concerns over Russian gas supplies. Unemployment remained stable at 6.6%.

PORTFOLIO ACTIVITY

February was a busy trading month for the fund, as we remained nimble and continued to invest at attractive ‘all-in’ yields – especially after a mid-month period of weakness in bond markets. Key investments during the month included:

1. We increased our holdings (to 2.1%) in the EUR IPF 2025 bond at a yield of 18.0% (rated BB-). The bond was the best performing holding in the fund during February;

2. We increased our holding (to 2.2%) in the GBP Paragon Bank 2026 bond at a yield of 8.4% (rated BBB-);

3. We bought a 1.7% position in a new issue Lloyds Bank 2028 bond at a yield of 6.7% (rated BBB+);

4. We bought a 2.3% position in a new issue Ford Motors 2026 bond at a yield of 6.9% (rated BB+). We expect this bond to be upgraded to Investment Grade (BBB- or better) over the coming 6-12 months;

5. We increased our holdings in a series of high quality Issuers (Volkswagen, AT&T, Pershing Square, Trafigura, Orange, Barclays, Bupa, Aviva) at yields of 6 to 10%. These bonds are rated BBB+ to BB+.

On the portfolio construction side, the yield-to-call is 7.8%; duration is 4.1 years; the average credit rating of the fund is BBB; cash levels are 0%; and the unrated portion of the fund is 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 slightly cheap versus all historical timeframes, with sterling ‘BBB’ credit spreads at 206bps, versus their 5yr average of 186bps; 10yr average of 188bps; and 20yr average of 216bps.
- **Sterling High Yield** spreads are slightly cheap versus all historical timeframes, with ‘BB’ spreads at 409bps versus their 5yr average of 366bps; 10yr average of 349bps; and 20yr average of 431bps).

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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