

Close Portfolio Funds

Monthly fund manager update

FEBRUARY 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

Sterling bonds fell -3.1% in February and equities stalled, declining -1.7% in US dollar terms (converted to a +0.3% gain for the Sterling-based investor as the pound weakened). Evidence that the US economy is not yet in recession, whilst inflation remains sticky as it falls, implies that central bankers will need to continue to raise interest rates – continuing the story of 2022.

Each Fund delivered negative returns in February with Conservative and Balanced a shade behind their respective IA peer groups whilst Growth outperformed the IA Flexible Investment Sector. Asset allocation was neutral in the month with stock selection detracting slightly after a strong fourth quarter in 2022 and January 2023. Performance against the respective Investment Association (IA) peer group (in brackets) was as follows: Conservative fell -1.0% (vs -0.8%), Balanced fell -0.6% (vs -0.3%), and Growth declined -0.2% (vs -0.7%).

FEBRUARY THOUGHTS – AREA UNDER THE CURVE

Central banks typically have two mandates: low inflation and full employment. The extraordinary monetary support seen during Covid-19 and the Financial Crisis was designed to protect employment. For decades the inflation aspect to their task has been in abeyance. However, the response of central banks, particularly the Federal Reserve in America, to inflation at levels not seen for a generation has made clear that inflation fighting is now pre-eminent. Indeed, their

thinking is that unemployment affects the few whilst inflation affects the many, and that a rise in unemployment – hopefully controlled – is necessary to lower inflationary pressures.

Monetary policy works to slow an economy with 'long and variable lags' of real-world impact. Less than a year ago the Federal Reserve was setting interest rates at zero and still conducting quantitative easing (buying assets for their own balance sheet). Today, they are expected to take interest rates to at least five percent and have flipped to quantitative tightening (reducing assets). This will have consequences; the debate is around how severe those will be and how quickly they will surface. This can be thought of as 'the area under the curve' topic from GCSE mathematics. The level of short-term interest rates, and the length of time that they have been at higher levels, results in some number which the market is debating. A number that is too low does not tame inflation. A number that is too high will cause a recession. It is possible that a number between the two which tames inflation without causing a recession may exist. But, if it exists at all, each passing day of higher-for-longer interest rates makes it more likely that there will be an overshoot.

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 a bias towards defensives over cyclicals. 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 to 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 are looking to buy new cyclical equities on profit warnings and add to corporate bonds into any selloff.

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.

IMPORTANT INFORMATION

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