Close Brothers Asset Management

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Close Sustainable Fixed Income Fund

Monthly fund manager update

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FUND PERFORMANCE

The Close Sustainable Select Fixed Income Fund returned +1.3% in April, bringing the year-to-date (YTD) return to +1.8%. In comparison, the Investment Association (IA) Sterling Strategic Bond Sector returned +0.4% in April, and has delivered +2.0% YTD.

MACRO BACKDROP

Newsflow in April was relatively muted. On the positive side, markets calmly digested the US government-sponsored rescue of First Republic Bank; macro data forecasts were generally upgraded across the UK, US and Eurozone; and Central Banks continued to signal that both policy rates and inflation are “at or near peak”.

On the negative side, US politicians failed to make any progress on raising the US debt ceiling which – if the impasse is not resolved soon – it will result in the US government facing a shutdown sometime between June and September of this year. Markets fully expect the debt ceiling to be raised, albeit negative headlines and volatility are likely ahead of a resolution.

The Bank of England (BoE) did not meet in April after raising the policy rate to 4.25% (from 4.00%) on 23 March. Futures markets expect a +0.25% rate hike on 11 May 2023, though remain volatile on a day-to-day basis.

The Federal Reserve (Fed) did not meet in April after raising the policy rate to 5.00% (from 4.75%) on 22 March. Futures markets expect a +0.25% rate hike on 3 May 2023, followed by 2-3 rate cuts in the second half of 2023.

While we do not expect the Fed to cut rates by this magnitude in 2023 (futures markets are volatile and changeable), the Fed clearly communicated that the current policy rate of 5.0% is unusually high, and that it expects to cut rates in 2024 and 2025 towards more normal levels (i.e. 2-3%).

The European Central Bank (ECB) did not meet in April after raising policy rates by +0.50% on 16 March and commencing quantitative tightening at a rate of EUR 15bn / month. The Depo Rate was raised to 3.00% (from 2.50%); and the Refi Rate was raised to 3.50% (from 3.00%). ECB rhetoric remains relatively hawkish, and futures markets expect a +0.25% rate hike on 5 May 2023, and an additional +0.25% rate hike in June 2023.

In the UK, the Composite Purchasing Managers Index (PMI) data strengthened to 53.9 (from 52.2 in Mar-23), while consensus 2023 GDP growth forecasts improved yet again to -0.2% (from -0.7% in Feb-23 and -0.4% in Mar-23)). At the same time, Consumer Price Index (CPI) inflation decreased to +10.1% in Mar-23 (from +10.4% in Feb-23). Forecasts indicate inflation will continue to decline throughout the year to c. +3.4% in Q4 2023. Unemployment remained low at 3.8%.

In the US, Composite PMI data improved to 53.5 (from 52.3 in Mar-23), while consensus 2023 GDP growth forecasts improved to +1.2% (from +0.7% in Feb-23 and +1.0% in Mar-23). US inflation declined for the ninth consecutive month to +5.0% (from +6.0% in Mar-23 and a peak of +9.1 in Jun-22), and forecasts indicate inflation will decline to c. +3.2% in Q4 2023. Unemployment improved to (a very strong) 3.5%.

In the Eurozone, Composite PMI data improved to 54.4 (from 53.7 in Mar-23), while consensus 2023 GDP growth forecasts improved to +0.6% (+0.5% in Mar-23). Eurozone inflation declined to +6.9% (from +8.5% in Feb-23), and forecasts indicate inflation will decline to c. +3.3% in Q4 2023, albeit forecasts are volatile given ongoing concerns over Russian gas supplies. Unemployment remained stable at 6.6%.

PORTFOLIO ACTIVITY

April was a relatively quiet trading month for the fund, albeit we remained nimble and opportunistic throughout the month.

Key investments during the month include:

1 – We decreased our holdings in Government bonds to 6.2% (from 8.3%) by opportunistically selling our US Government bond holdings following a strong rally. Potential US Government bond volatility linked to the ongoing debt ceiling issue also prompted us to reduce exposure. As a result, 100% of our Government bond holdings are now in UK Gilts.

2 – We increased our holding (to 2.5%) in the GBP Ford Motors 2026 bond at a yield of 6.9% (rated BB+). We expect

the bond be upgraded to Investment Grade (BBB- or better) over the coming 6 – 12 months.

3 – We increased our holdings (to 3.7%) in Trafigura bonds, by adding to the EUR 2024 Corporate Hybrid bond at a yield of 10% (unrated).

4 – We also added to the GBP Rothesay Life 2026 bond and EUR Pershing Square 2027 bonds at a yield of c. 6.5%. Both bonds are rated BBB+.

On the portfolio construction side, the yield-to-call is 7.9%; duration is 4.2 years; the average credit rating of the fund is BBB+; cash levels are 7% (though largely attributable to an inflow on the final day of the month which we expect to invest over coming days); 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 – but currently 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 214bps, versus their 5yr average of 188bps; 10yr average of 188bps; and 20yr average of 216bps

- **Sterling High Yield** spreads are slightly cheap versus all historical timeframes, with 'BB' spreads at 440bps versus their 5yr average of 373bps; 10yr average of 349bps; and 20yr average of 429bps)

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.