

# Close Portfolio Funds

## Monthly fund manager update

**December 2024**



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Managing Director

### STRATEGY OVERVIEW

The Close Portfolio Funds seek to achieve resilient returns over the long term through a company-led approach to investing in a multi-asset context. Our strategy of acquiring 'cheap durables' – direct interests in predictable businesses that will grow in value and repay their debts purchased at attractive cash-based valuations – is complemented by allocations to fixed income securities and alternative assets as appropriate.

### MONTHLY PERFORMANCE REVIEW & ACTIVITY

Perhaps Father Christmas isn't real after all?! For the second consecutive year the "Santa Rally" failed to materialise in global equity markets, with negative monthly performance of -2.6% (MSCI World Index), translating to -1.2% in sterling terms. This followed a strong run in 2024, with global equity markets returning +20.8% in sterling terms. Whilst investors locking in year-end profits and reducing those stocks trading on now expensive valuations contributed to the December pullback, it was the US Federal Reserve's (Fed) meeting in mid-December which prompted a critical review of the market's monetary policy easing expectations in 2025. Minutes released after the meeting indicated committee members expressed caution on reaching the inflation target of 2%, fuelling speculation the Fed may skip (or prolong to a pause) interest rate cuts at future meetings, increasing pressure on debt costs and equity valuations.

Following the outperformance of US equities in November, we sought to retain the portfolio's relative "cheapness" to the market. We trimmed

the regional outperformers, and for additions we looked to Europe, finding stocks with free cash flow yields too high for underlying business stability. We introduced new positions in defence stock Thales, and European stock-exchange business, Euronext. Thales underperformed post the US election despite the incoming Trump administration likely putting upwards pressure on NATO defence spending. As a long cycle defence business, topline growth is durable, and management have done an excellent job driving positive high-single-digit profit growth, with the stock trading on an attractive free-cash-flow yield. Euronext currently holds a superior asset mix to its history, having sustainably driven up its organic growth rate through portfolio additions, whilst the free cash flow yield remains similarly attractive.

All three of the Portfolio Fund strategies delivered strong returns ahead of their respective Investment Association (IA) benchmarks in 2024, despite underperforming in December.

### LOOKING AHEAD

It is over a year since we reversed our more cautious stance on markets and became the most optimistic we have been since assuming responsibility for the management of the Close Portfolio Funds. As long as there are no signs that America has entered recession we will maintain an overweight stance on equities. Within fixed income we will continue to seek out above-average yields for below-average risk in corporate bonds, complemented by sovereign bonds to protect against a recession scenario should it come to pass, which is the main risk to the portfolio. However, whilst a 'soft landing' for

the US economy and interest rates remains on track, we are also vigilant for exogenous shocks such as pandemics and geopolitical upsets.

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.

## STOCK OF THE MONTH - THALES

This month's stock is Thales, which is held across the Close Portfolio Fund range.

Headquartered in Paris, Thales designs and produces systems, software, services, and equipment for aerospace, defence, and cyber/digital markets. As a trusted partner for governments and businesses, it provides end-to-end solutions, from contract initiation to final equipment delivery.

By division, the core Defence & Security unit (53% of sales) is the standout 'jewel'. The division produces long cycle (not munitions) defence products covering air defence systems and radars, surveillance drones, missile systems and digital intelligence systems. Thales' dominant position in this tightly regulated market ensures stable demand, high barriers to entry, and reliable investment returns. In 2024, the company committed to delivering 6–7% "bulletproof" long-term growth, with material upside potential given the majority of what they will produce does not yet exist! A key driver of stability is the division's strong monopsony relationships with key governments such as France, which accounts for 20% of Thales' defence sales. These relationships guarantee demand even during market downturns, and historically Thales' management has successfully defended profits during industry weakness. Their growth outlook is supported by high visibility on rising global defence spending - particularly with the incoming Trump administration putting upwards pressure on NATO members' current 2% budget commitment, seeking 3% to 5%.

The Aerospace division (31% of sales) is Thales' second largest business, covering avionic systems - ranging from navigation to inflight entertainment - and space satellite technology. The post-Covid-19 recovery in commercial aviation spending helps to drive mid-to-high-single-digit growth, as airlines upgrade technology. Meanwhile, margin recovery in space, a weak point in 2024, provides additional

medium-term profit potential. The Digital Identity & Security division (18% of sales) represents a newer growth area. Leveraging its expertise in government technology, Thales has expanded into the civilian market. A series of acquisitions, including the \$5.4 billion Gemalto deal in 2019, has positioned Thales as a top five global cybersecurity leader. The division offers biometrics and authentication solutions, mobile connectivity, and cyber and payment security services to clients such as banks, telecoms, and financial services companies. As synergies are realised and this division grows in relevance, it offers a diversified high-single-digit growth opportunity for Thales.

Share price action in 2024 provided an appealing entry point, as French stocks sold off amid government budget drama despite bipartisan support for "Loi de Programmation Militaire" - France's military programming law. With high-single-digit growth for over 90% of company profits and an irrationally high free cash flow (FCF) yield, we believe the stock offers significant value here.

## ESG

On environmental, social and governance (ESG) credentials, Thales has significant shareholder ownership by the French government, who have 36% of voting rights, classifying it as a controlled company. We would highlight that defence companies like Thales play a key role in sustaining national security and the maintenance of civil liberties, and the stability of national ownership helps to promote this. We also highlight that, whilst some defence manufacturers produce civilian firearms or controversial weaponry, Thales is not engaged in these activities.

**IMPORTANT INFORMATION**

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