Close Sustainable Select Fixed Income Fund

Monthly fund manager update

December 2024

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FUND PERFORMANCE

The Close Sustainable Select Fixed Income Fund returned -0.6% in December, and +4.4% year-to-date (YTD). In comparison, the Investment Association (IA) Sterling Strategic Bond sector returned -0.4% in December, and +4.6% YTD.

While we do not wish to focus on the one year performance differential versus the IA sector peer group, it is worth highlighting that the fund was ahead of the IA sector for the first 11 months of 2024.

The 2024 underperformance was generated wholly in Q4 2024. Quite simply, we reduced portfolio risk and significantly increased fund quality too early. We therefore missed the final (and in our opinion, irrational) High Yield rally in December 2024. Looking forward, we believe this risk-reducing decision will be justified – and we highlight Rich valuations in more detail below.

The Close Sustainable Select Fixed Income Fund has therefore underperformed the IA sector by -0.2% in 2024. It remains a 1st or 2nd Quartile fund on a 3yr and 5yr basis (versus the IA sector).

MACRO BACKDROP

Newsflow in December was largely focused on how the new Trump administration's policies will impact the rest of the world. Alongside this newsflow, credit spreads rallied to the richest levels since 2007 (see table, below). We believe that credit spreads today offer extremely poor risk/reward characteristics, and do not sufficiently compensate investors for the risks they are taking.

Global Credit Spreads

Currency	Rating	1-Jan-25	20yr Avg
GBP	BBB	112	219
	BB	241	429
USD	BBB	102	197
	BB	183	350
EUR	BBB	113	180
	BB	204	369

The Bank of England held policy rates on 19 December at 4.75%. The Bank also maintained the Quantitative Tightening programme ("QT") at GBP 100bn / year. Futures markets expect 2-3 rate cuts over the next 12 months.

The Federal Reserve cut policy rates on 18 December to 4.50% (from 4.75%) and maintained the QT programme at USD 60bn / month. Futures markets expect 2 rate cuts over the next 12 months.

The European Central Bank cut policy rates on 12 December by -0.25% and maintained the QT programme at EUR 25bn / month. The Deposit Rate was reduced to 3.00% (from 3.25%), and the Refinancing Rate was reduced to 3.15%

(from 3.40%). Futures markets expect c. 4 rate cuts over the next 12 months.

In the UK, the Composite Purchasing Managers Index (PMI) data weakened to 50.4 (Nov-24 = 50.5), while consensus 2025 GDP growth forecasts were stable at +1.6% (Nov-24 = +1.4%). CPI inflation increased to +2.6% (Oct-24 = 2.3%), while core inflation (ie excluding volatile energy and food prices) increased to +3.5% (Oct-24 = +3.3%). Forecasts indicate inflation will remain at c. 2.6% over the next 12 months. Unemployment was stable at 4.3% (Sep-24 = 4.3%).

In the US, Composite PMI data strengthened to 56.6 (Nov-24 = 54.9), while consensus 2025 GDP growth forecasts improved to +2.3% (Nov-24 = +2.0%). US CPI inflation increased to +2.7% (Oct-24 = 2.6%) – and forecasts indicate inflation will remain at c. 2.3 – 2.7% over the next 12 months. Unemployment increased to 4.2% (Oct-24 = 4.1%).

In the Eurozone, Composite PMI data strengthened to 49.6 (Nov-24 = 48.3), while consensus 2025 GDP growth forecasts weakened to +1.1% (Nov-24 = +1.3%). Eurozone inflation increased to +2.2% (Oct-24 = +2.0%), and forecasts indicate inflation will remain at c. 2.0% over the next 12 months. Unemployment was stable at 6.3%.

PORTFOLIO ACTIVITY

December was a relatively quiet month for the fund. Key investment themes include:

1– Conservative Positioning: Given credit spreads continue to trade at all-time / near all-time Rich levels across all currencies, the fund remains very conservatively positioned. At the same time, potential Trump policies have created significant uncertainty in US government bond markets.

As a result of these two factors, the fund has reduced credit holdings to 41% of the fund (the vast majority of which are very short duration and very high quality), while also continuing to reduce exposure to USD bonds. Indeed, USD holdings have reduced to 16% - the majority of which are short duration, “cash +” holdings.

2– Trading Activity: Despite Rich valuations, the team continues to identify attractive opportunities, and the fund also continues to benefit from our in-depth credit research:

- Firstly, we bought a 0.7% position in the ATS Perp-2026 bond at a very attractive yield of 21% (unrated). This is a special situation opportunity and one of the most attractive risk/reward opportunities the team has encountered.

- Secondly, three of our holdings were called (as expected) in December 2024, including a 0.7% position in the Merck Perp-2024 bond (rated BBB+); and a 3.1% position in the Nationwide Perp-2024 bond (rated BBB-). 50% of our holding in the Perenti 2025 bond (rated BB+) was also called in December, reducing our holding to 0.8% (from 1.6%).

On the portfolio construction side, the yield-to-call is 5.4%; duration is 4.0 years; the average rating of the fund is A+; cash levels are 8%; and the unrated portion of the fund is 4%.

It is also worth noting that the fund continues to deliver a comparable yield to BBB indices (5.6%), despite enjoying an average rating of A+ (ie 5 rating notches higher). While the fund aims to deliver a much higher level of monthly income ‘through-the-cycle’, very rich valuations in credit markets mean the fund is positioned very conservatively at this time.

OUTLOOK AND STRATEGY

Fixed Income sub-asset classes:

Sovereign bond yields are Fair Value / Slightly Cheap in the UK and US, and Slightly Rich in the Eurozone.

Sterling Investment Grade bonds are Rich versus all historical timeframes, with sterling ‘BBB’ credit spreads at 112bps, versus their 5yr average of 180bps; 10yr average of 182bps; and 20yr average of 219bps.

Sterling High Yield bonds are Rich versus all historical timeframes, with ‘BB’ spreads at 241bps (5yr average = 362bps; 10yr average = 345bps; 20yr average = 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.

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