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Close Diversified Income Portfolio Fund

Monthly fund manager update

June 2019

Performance

The Close Diversified Income Portfolio Fund rose 0.88% in June. This compares to 2.12% for the IA 20-60% sector and takes the year to date return for Diversified Income to 5.18%.

Market roundup

Equity markets were all very positive in June, driven by dovish comments from central bankers and hopes of a deal between the US and China at the G20 meeting.

In the month, UK large caps were up +3.7%, US +6.6% (+6.2% in GBP terms), Europe +5.9% (+7.6% in GBP terms) and Japan +3.3% (+3.5% in GBP terms). Given that Diversified Income has a low weighting to equities and a Beta of just 0.52, it is not a surprise it has underperformed the sector in a month like June.

The results of Trump and Xi's meeting were that Trump softened his tone on US companies selling to Huawei, Xi agreed to buy more US food produce, both sides agreed to halt any new tariffs for now and to re-start trade talks. As mentioned last month, the Chinese are in for the long game, whilst commentators suggest that Trump is motivated by the timing of the 2020 election, and so may be more likely to back down or make concessions to get a deal.

The US Federal Reserve were seen as guiding to an interest rate cut as they removed the reference to being "patient" in their interest rate outlook, and said that uncertainties had increased. "We will act as appropriate to sustain the expansion", they commented. Powell even opened the door to more QE when he stated, "Perhaps it is time to retire the term unconventional when referring to tools that were used in the crisis." President Draghi of the European Central Bank hinted that he was ready to act further too if required whilst the UK's Monetary Policy Committee stuck to its guidance of raising rates at "a gradual pace and to a limited extent."

But whilst the markets fixated on Trump headlines and the desire for more central banker largesse, the economic data continued to weaken, particularly within the manufacturing sector – linked to global trade.

Alternatives

Within the portfolio, the PFI funds remained in the doldrums with all four holdings down in June. They should be a big beneficiary from the current collapse in Gilt yields (I consider them my Index-Linked Gilt alternative) but recent comments from Labour continue to hold them back. This does mean that they are looking even more attractive on a relative basis. REITS and the property debt funds put in a mixed performance. All the renewables funds performed positively, but Gold was the best performing alternative, up 7.7%.

Last month I mentioned the headwind from a number of holdings raising money at a discount. Whilst Greencoat UK Wind bounced back 4.4% in June, unusually most of the others did not, and in fact Starwood European and Real Estate Credit Investments continued falling. These last two are now trading close to Net Asset Value when they usually trade at a decent premium.

Fixed income

Turning to bonds, it was a strong month for returns with the 10 year gilt yield falling to 0.83% from 0.89%, and BBB corporate spreads falling to 1.84% from 2.01%. The

first half of 2019 saw bond markets deliver the strongest six-monthly return since the financial crisis in 2008, and returns were paradoxically strong across all segments, with both long-dated gilts (a 'risk-off' instrument) and High Yield (a 'risk-on' instrument) both delivering returns of around 8%. Being short duration, we have not captured all of this upside, but we are almost entirely in corporate bonds (rather than Sovereigns) which have seen spreads tighten. Given that government bond yields around the world are at or near all-time lows, coupled with below average credit spreads, we still think that short duration corporate bonds are the place to be to generate the best risk:adjusted returns.

In the month Helical Bar Convertible Bond, Nationwide Contingent Convertible and TP ICAP all matured successfully. This took the cash balance up sharply but with hardly any impact to the Fund's prospective yield, because the bond yields were very low given they were so close to maturity last month.

Some new small positions were initiated:

- PHP Convertible Bond 2025 – this convertible comes with a yield of 2.875% and an initial conversion premium of 15%. What is interesting is that the conversion premium comes down each year depending on the level of dividend it pays. This makes the bond more likely to convert at some point in the future – which is actually what the management stated they want to happen.
- Trafigura 2020 – this was bought after a negative research note was released on the company. This short dated bond fell sharply and we were able to pick some up at a 6.2% yield in Euros.

Other existing positions were added to, such as Pennon Perpetual (2020 call) at 2% yield, PHP 2019 at 3.15% yield and Burford 2026 at 5%.

Equities

Burford had some more good news in the month after the US Supreme Court rejected Argentina's appeal over a pending lawsuit. Burford has been funding an energy company called Peterson Energia, which held a 25% stake in a state-run oil producer YPF, when the Argentinian government nationalised YPF in 2012. This clears the way for a shareholder lawsuit to begin.

On this positive news Burford announced it had sold a further 10% of its entitlement in the Petersen case for $100m (implying a $1bn valuation on this one case alone). This leaves them with a 61.25% stake. Despite this, the shares fell 7% in the month. This could be Woodford related as he has been a large supporter of Burford, but has been, and may still be, selling down his stake.

We also added to Babcock, after its Capital Markets Day – one of their new medium term targets is to keep the strong free cash flow generation going, to the tune of £1.4bn by 2024 – which actually equates to 60% of the group's market cap in just 5 years. Babcock's shares rose in the month.

Yield and NAV

The rise in Net Asset Value combined with high cash levels (5.8% from 2%) meant that the yield fell to 3.9% from 4%. The yield on the Fund is the result of all the individually picked attractive risk:reward ideas. In this tough environment, we continue to work hard to find attractive risk:reward ideas across the whole spectrum of asset classes that the Fund is able to invest in.

Close Diversified Income Portfolio Fund discrete performance as at 30 June 2019

	YTD	2018	2017	2016	2015	2014
Close Diversified Income Portfolio Fund	**5.2%**	**-1.8%**	**5.4%**	**7.8%**	**2.4%**	**5.0%**
IA Mixed Investment 20-60% shares	8.1%	-5.1%	7.2%	10.3%	1.2%	4.9%

Source: FE Analytics 05.07.2019; all are X Acc share classes; performance is total returns, net of fees with dividends reinvested.