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Close Diversified Income Portfolio Fund

Monthly fund manager update

July 2019

Performance

Diversified Income rose 1.5% in July, taking the fund's Net Asset Value (NAV) to new all-time high in the process. This compared to 2.1% for the IA 20-60% sector. This takes the year to date return for Diversified Income to 6.7%.

UK large cap equities returned +2.5% in July, US equites also rose +2.5% (but +6.6% in GBP terms), European equities fell -0.2% (but rose +1.6% in GBP terms) and Japanease equities increased +1.1% (+4.5% in GBP terms). UK mid-caps struggled on a relative basis, returning +1% over the month, held back by on-going Brexit uncertainty. Given that Diversified Income has a low weighting to international equities, a Beta of 0.52 and is half hedged back into sterling, it is not surprising to see it underperform in a month like July.

Market roundup

Most asset classes were buoyed by the prospects of further loose monetary policy. The US Federal Reserve (Fed) cut the policy rate by 25bps, to 2.00% - 2.25%, and also ended the Quantitative Tightening programme (i.e. balance sheet reduction) 2 months earlier than planned. Fed Chairman Jerome Powell said the monetary easing was justified by "uncertainties" stemming from weakness in the global economy and simmering trade tensions. In Europe, the European Central Bank (ECB) kept rates unchanged at -0.4%, but stated that interest rates could be lowered further in the future and that the current highly accommodative stance would be prolonged.

In the UK, Boris Johnson was confirmed as the new Prime Minister but the European Union (EU) were quick to reject his plans to renegotiate the existing Brexit deal. Michael Gove, newly appointed as the Chancellor of the Duchy of Lancaster by Boris Johnson, said that the UK Government must now operate on the assumption that EU negotiators will not change their minds, and therefore plan for a no-deal Brexit on 31st October. This led to a very weak month for sterling, boosting overseas investment returns in GBP terms.

Whilst markets were fixated with the actions of policy makers and the desire for more Central Bank largesse, global economic data continued to show signs of weakness, largely linked to on-going global trade tensions. President Donald Trump tweeted that there was no sign of the Chinese starting to buy the agricultural products they had promised and that a deal was, "a long way away". Talks at the end of the month between the two powers saw no progress. Washington will host the next round of talks in September.

Alongside a deteriorating economic backdrop, various global diplomatic relations frayed somewhat, with tensions rising in the Persian Gulf, Hong Kong and Korean peninsular to name a few.

Fixed income

As with equity markets, it was also a strong month for fixed income returns, with the 10 year gilt yield falling to 0.61% from 0.83%, and BBB corporate spreads falling to 1.76% from 1.84%. To put these returns into perspective, an investor who bought a 10 year Gilt on the 31st December 2018, when the yield was 1.3% per annum, would have made over 5 years' worth of returns in just 7 months. This does of course only leave a return of 6.1% to earn over the next 10 years (unless UK sovereign bond yields move into negative territory like they have in Japan, Germany and Switzerland). Diversified Income has retained a short duration stance within its fixed income exposure – looking to generate returns from the natural yield where attractive opportunities present themselves, rather than seeking capital gains as a result of yields falling from already historically low levels. Two of the fund's dollar bonds performed particularly well during the month, with Aberdeen Standard Life 2028 up 7% and Louis Dreyfus 2023 up 7.5%.

July saw three bonds held in the fund mature successfully (Total Floating Rate Note, Gilt July 2019 and PHP 2019). The cash was reinvested into Shawbrook 2025 (5% yield), Balfour Beatty 2020 (3.6% yield), Sainsbury Perpetual bond (2020 call at 1.4% yield) and a cash proxy, the September 2019 Gilt (0.6% yield).

To illustrate the extreme nature of the bond markets at this juncture, July saw the entire Swiss government bond yield curve move into negative territory. One can currently lend the Swiss government money for the next 50 years at -0.08%, if so inclined! In Europe as a whole, the average investment grade bond yield fell below 0.46% for the first time, while the amount of negative yielding debt now exceeds $14trillion.

Equities

Some of the cash generated from bond maturities was also used to upweight Babcock International and Imperial Brands. Imperial Brands has de-rated significantly in recent months and was added to on a Free Cash Flow Yield of 14%. The shares rebounded strongly in the month, up 13%. This was partly helped by the conclusion of a period of forced selling by Neil Woodford.

Babcock also continued to recover after the end of Woodford's selling. Nevertheless, the Woodford impact is still being felt by Diversified Income, as hedge funds are still shorting some of his holdings to make a quick buck.

Alternatives

In the Alternatives space, it was pleasing to see the property debt funds - which were materially up-weighted recently - start to bounce back post their placings, while all of the PFI infrastructure funds rebounded after a roller coaster ride this year, with International Public Partnerships up +7.3%. The renewable funds retreated from their highs of the year, whilst REITs continued to struggle. The newsflow on UK REITs was quite poor in the month, as UK retail focused firms posted very poor results – Intu (-37%), Hammerson (-22%) and New Frontier Properties (-41%). Diversified Income is not invested in any retail focused REITs, with most of the exposure in industrial, warehouse, student accommodation and offices.

Yield and NAV

The rise in Diversified Income's NAV meant that the yield fell to 3.7% from 3.9%. The yield on the Fund is the result of all the individually picked attractive risk:reward ideas. In this tough environment the hard work continues 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 31 July 2019

	YTD	2018	2017	2016	2015	2014
Close Diversified Income Portfolio Fund	**6.7%**	**-1.8%**	**5.4%**	**7.8%**	**2.4%**	**5.0%**
IA Mixed Investment 20-60% shares	10.2%	-5.1%	7.2%	10.3%	1.2%	4.9%

Source: FE Analytics 02.08.2019; all are X Acc share classes; performance is total returns, net of fees with dividends reinvested.