# Close Diversified Income Portfolio Fund

## Monthly fund manager update

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STEPHEN HAYDE
Managing Director

### PERFORMANCE

The Close Diversified Income Portfolio Fund rose by 4.9% in April. This compared to a 5.7% rise for the IA 20-60% sector. Stock markets were generally buoyant, with the US market up 12%, the UK up 4% and Europe up 5%. The positive moves were driven by central bank stimulus plans, coupled with hopes that the lockdowns will be loosened or lifted soon. Gilt yields fell from 0.36% to 0.23%, but corporate bonds outperformed them as BBB credit spreads fell from 311bps to 250bps. Although this is a fairly significantly fall, BBB spreads remain above the long term historic average of 213bps.

Within the portfolio, a number of the investment trust holdings, mid-cap and bond holdings bounced back strongly given the more positive market backdrop in April – aided by reasonably positive virus impact reports. For example Babcock, which we added to as low as 306p, ended the month at 421p after reporting that the virus has had only a "small impact" on their ability to operate. GCP Asset Backed Income also had a positive month, rallying 18%, after reporting that it had received no requests for deferred payments so far. Clinigen reported "marginal disruption" but announced an earnings enhancing deal sending the stock 33% higher. Burford Capital, which was bought for its non-cyclical, uncorrelated returns, was up 19% having seen "further substantial successes" in a number of court cases and arbitrations over March and April. Starwood European Finance (currently expecting zero losses on their loans) bounced 20%, and three of the REITs bounced over 10%.

On the bond side, the Phoenix 2025 bond, which we noted last month had fallen as heavily as the firm's equity had, bounced back by 11%. As we enter May, it is pleasing to see the Burford Capital bonds starting to bounce too (if the successful case results can be quickly turned into hard cash on their balance sheet it could well prove a catalyst for a further re-rating). We have recently added incrementally to the Burford bonds at double digit yields.

### MARKET BACKDROP

There are clearly lots unknowns to the current market backdrop. Even questions around whether surviving the virus once gives you immunity are yet to be answered. Whilst the lockdown has slowed the number of new cases, there will be concerns of a potential second wave as and when it is relaxed or reversed altogether. Attention will, however, likely switch to the imminent recession before long. How deep will it be, and how long will it last? How many people who have been furloughed will have jobs to go back to? How many small and mid-sized businesses will fall through the cracks of government support and quietly fade away? How much will this alter the world we live in? What are the new norms? How will this impact China's relationship with the world? Will central bank policy continue to work? Will it cause inflation? Plenty to think about indeed as we enter May.

With 4.7% in cash and 4.9% of the fund expected to mature in the next 5 weeks, there is plenty of cash available to put to work if volatile markets return in May and conditions are right. As ever, we continue to do our best to find attractive risk adjusted investments, and to be guided by valuations rather than the daily roller coaster of the markets.

### FIXED INCOME

It was another very active month for the fund. We sold the remaining small positions in four of the renewable infrastructure trusts as they traded back at large premiums to Net Asset Value (NAV). We have been reducing exposure to this sector materially over the past 3 quarters.

Two bonds matured over the month; Hikma Pharmaceutical 2020 – a short dated non-investment grade bond held since 2018, and Trafigura 2020. The proceeds, along with some existing cash, were put back to work in a number of interesting bond ideas, both existing and new.

We added to our existing Trafigura 2023 holding at a yield of 9.25% (in USD). My rationale was that Trafigura often sells off when the oil price falls as it is an oil trader. However, historically Trafigura has made good profits in periods such as those we are experiencing now, with near term oil prices at lower levels than future oil prices (a contango market). Trafigura has the capability to store oil and therefore can buy today, store it and sell it at a date in the future for a known profit.

Last month, we mentioned the Sainsbury Perpetual bond (callable in July 2020) bought at a yield of 6%. This month, we have also added the Sainsbury Convertible Perpetual bond (callable in July 2021) at a yield of 5%. Whilst at a yield lower than the 2020 bond (as the convertible option has a value) the 5% yield is still a sizable spread over gilts for what we deem to be a fairly low risk investment; food retail is quite resilient in a recession. Sainsbury also reported solid results

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at the end of the month, which gave further comfort on the two positions.

The fund also partook in April's buoyant new issue market, purchasing Phoenix Group's 2031 issue. This joins the fund's other positions in shorter dated Phoenix Group bonds. The issue provided an opportunity to lock in some of the higher spreads for years to come; this is a BBB rated bond which came with a spread of 540bps over gilts (5.625% coupon). To put this in perspective, the average BBB yield over time has been 2.13%. This bond was well received by the market and is already up 6% at the time of writing.

Various other small trades were also undertaken, including adding to existing positions such as Pennon Perpetual (callable in May 20) at yields of up to 3.6%, Phoenix 2025 at 5.4% and TP ICAP 2024 at 5.6%.

## EQUITIES

The fund's position in Visa was added to further, taking the equity weight of the fund to 21.3%; up 2% in the past 2 months. This is in stark contrast to the IA 20-60% sector data, which shows that the sector has being reducing equities and increasing gilts in the period to 31st March; readers may remember the fund sold out of Gilts in March.

However, by the end of the month, the rally had meant that equity valuations were no longer looking so attractive. Our Quant Model was showing that price/earnings ratios of the market (using 2021 earnings rather than using bombed out 2020 earnings) are now already above where they stood at the start of the year. The average downgrade seen for 2021 is still 16.9%, which suggests analysts are not expecting a V shaped recovery.

There was a brief period in March where the market started to look cheap again, hence our tentative additions to equities. However, as we enter May we have already sold one equity holding in its entirety, banking a c.9% return on the March purchase of Booking Holdings.

## YIELD AND NAV

As it stands at 30th April, according to Numis Securities, 242 companies had cut or deferred their dividends in the UK, amounting to £35.1bn. Even Shell (a stock we do not own) cut its dividend for the first time since World War II. As at 30th April, companies amounting to only 1.24% of the portfolio have cut or deferred their dividends, reducing the Fund NAV by circa 7bps. However, 9.01% of the portfolio (just shy of half the equity allocation) has confirmed that they will pay their dividends. We keenly await updates from the rest as and when they report their results.

There have been no dividend cuts as yet from the fund's Alternatives holdings, though some of the REITS are seeing reduced rent collections at the moment which may impact Q2 dividends declared in July/August. The fund's yield has been enhanced through a combination of selling the Gilts (yielding just 0.25%), seeing low-yielding short dated bonds mature, and re-investing cash into higher yielding ideas following the sell-off. Such actions have already added c. 35bps to the Fund's yield. However, a strongly rising NAV has ultimately meant the fund's yield has reduced to 5% from 5.3%.

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 PERFORMANCE AS AT 30 APRIL 2020

| | YTD | 2019 | 2018 | 2017 | 2016 | 2015 |
|---|---|---|---|---|---|---|
| **Close Diversified Income Portfolio Fund** | **-7.0%** | **9.8%** | **-1.8%** | **5.4%** | **7.8%** | **2.4%** |
| IA Mixed Investment 20-60% shares | -7.9% | 11.8% | -5.1% | 7.2% | 10.3% | 1.2% |

SOURCE:

FE Analytics 02.05.2020; YTD data as at 30.04.2019. Performance is total return, net income reinvested after fees, X Acc share class.