Close Brothers Asset Management

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Close Diversified Income Portfolio Fund

Monthly fund manager update

AUGUST 2020

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PERFORMANCE

The Close Diversified Income Portfolio Fund rose by 1.44% in August. This compared favourably to a 1.28% rise for the IA 20-60% sector. It was positive to see the Fund outperform despite stock markets being very strong, with the UK large cap index the laggard at +1.1%. In the month, Hastings received a formal takeover offer helping boost the shares by over 20%. Even more pleasing was the resumption of the buyback activities by Honeycomb, helping to boost the shares 7%, though the discount to NAV remains at c20%, so there is still more to go for.

Elsewhere in markets, Gilts fell in the month (the Fund owns no Gilts), as the 10 year Gilt yield jumped over 200% from 0.10% to 0.31%. Gilts from 0-5 years remain negative yielding. BBB spreads continued to drop, down to 186bps from 200bps. This is below the long term average of 213bps, implying again that people are fairly positive on the outlook for credit, despite the unknown length and severity of the recession. An interesting sign of bullishness, or at least the hunt for yield, is that BB rated bonds now only give you c198bps more than BBB bonds. This is below the long-term average of 217bps. Incredibly, Ball Corporation issued a bond with the lowest "high" yield ever for a 10-year junk bond, at 2.875%. It is BB+ rated.

These below average spreads are despite huge swathes of downgrades coming from ratings agencies. According to Moody's, some 62% of bonds within the Hotel, Gaming & Leisure sector have seen downgrades, while 61% of the Transport and Consumer sector have also been downgraded.

In the alternative space, infrastructure, REITs and property debt were largely up, with GCP Student Living up over 10% as positive noises continue to come out of the university sector regarding the September intake - it was not long ago that a cancellation of the 20/21 student year was a very real possibility. It was also positive to see both Starwood European Finance and Hibernia REIT starting buyback programmes, making it three holdings to do so in the month.

Gold was down 0.6% in the month, but due to dollar weakness it was off over 2% in GBP terms. Silver put in another strong performance, rising over 12%. One huge headline for gold was that Warren Buffett had invested $564million into Barrick Gold, a stock already held by the Fund. He has historically been a well-documented bear on the precious metal, but now it seems that aggressive monetary policy has somewhat changed his thinking. Barrack Gold rose 11% on the day Buffett's holding was announced and gold also went through $2,000 for the first time in the month. The gold, silver and gold mining weighting within the Fund is now up to 5%.

PORTFOLIO ACTIVITY

Over the month, I added to Just Group 2026 at a 7.15% yield, after their results showed a stronger balance sheet than analysts were expecting and Fitch gave the bond an inaugural BBB+ rating; it was previously unrated. I also added to the Sainsbury convertible bond at a yield of 3.1% and National Grid 2021 index-linker at 1.66% plus inflation. A new holding in Beazley 2026 was added at a yield of 4.5% in US dollars.

These are all attractive yields given the 5-year Gilt yield stands at -0.01% and BBB spreads stand at 1.86%.

YIELD AND NAV

AJ Bell's Dividend Dashboard shows that, as at 1st September, 478 UK companies have cut or deferred their dividends by £41.5bn this year.

In the Fund, 4.07% (down from 4.31%) of equity exposure has cut or deferred their dividends reducing the Fund yield by c17bps - this assumes zero dividends all year for those deferring which may prove to be overly conservative. In the month, UDG Healthcare reinstated its dividend from earlier in the year, which is a positive new development we are seeing from UK companies as we enter the latter stages of 2020. REIT dividend cuts have hurt the yield 3bps.

Given that 7.5% of the Fund was invested from cash and Gilts into attractive yields during the sell-off, adding 35bps to the yield, we have more than offset the negative impacts to the yield via active management.

The Fund's yield did reduce over the month, from 3.9% to 3.8%, but this was due to the rising NAV. 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.

OUTLOOK

The key to the economic outlook remains the health of the economy once the government support is reduced or ended. Although Germany and France have extended their schemes into 2021, so far the UK has only recently extended tenant protections.

The Federal Reserve said of the US, "*Members agreed that the ongoing public health crisis would weigh heavily on economic activity, employment, and inflation in the near term and was posing considerable risks to the economic outlook over the medium term. Participants saw less improvement in the business sector in recent months, and they noted that their district business contacts continued to report extraordinarily high levels of uncertainty and risks."* The Federal Reserve has changed its policy to now target an average inflation, implying that it is willing to accept inflation higher than 2% for some time. St Louis Fed President, James Bullard, said, *"If you put too much emphasis on the idea that a vaccine is going to come and save us... then you get people not doing anything and sitting around waiting for the vaccine….If you do that, you do risk a depression because you could get a lot of business failures while you're waiting."* However, WHO Director-General Dr Tedros said that a cure for the virus might never be found, and that there is "no silver bullet."

In terms of valuations, which are important for future long-term return expectations, my Quant Model says that the UK stock market price to earnings ratio went to a new high (based on 13 years of data) in August at 17.3x. Another indicator, that Warren Buffett looks at; (market cap of the US equity index to US GDP) has also reached an all-time high and is close to the 200% level that he called*, "playing with fire."*

With all this to consider, I will continue to do my best to find attractive risk adjusted investments, and to be guided by valuations rather than the daily roller coaster of the markets.

CLOSE DIVERSIFIED INCOME PORTFOLIO FUND PERFORMANCE AS AT 31 AUGUST 2020

	YTD	2019	2018	2017	2016	2015
Close Diversified Income Portfolio Fund	**-2.3%**	**9.8%**	**-1.8%**	**5.4%**	**7.8%**	**2.4%**
IA Mixed Investment 20-60% shares	-2.5%	11.8%	-5.1%	7.2%	10.3%	1.2%

SOURCE:

FE Analytics 04.09.2020; YTD data as at 31.08.2020. Performance is total return, net income reinvested after fees, X Acc share class.