

Close Diversified Income Portfolio Fund

Monthly fund manager update

NOVEMBER 2020



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PERFORMANCE

The Close Diversified Income Portfolio Fund rose 3.6% in November, bringing the year-to-date (YTD) return into positive territory. A monthly return of 3.6% is the 2nd best month in the Fund's history (the best month was also in 2020, when the market rebounded in April following the Covid-19 sell-off in February and March). This rise compares to a 5.8% monthly return for the Investment Association Mixed Investment 20-60% Shares sector.

Stock markets rebounded strongly on numerous vaccine trial data readouts, and despite victory for Joe Biden in the US presidential election - which up until recently had been considered negative for risk assets given his intentions to hike corporation tax. The UK market rose 12.7% (the highest monthly rise in the index since the fund's inception), whilst the European market was up 14.0% (+13.4% in GBP terms), and the US market rose 11.5% (+8.1% in GBP terms).

As far as alternative investments were concerned, returns were mixed as usual, which - whilst helping in a month like October - detracted from performance in November. Gold, a big winner up until this month, sold off 5.1% in USD terms and 8.1% in GBP terms. Amongst the fund's Infrastructure holdings there were as many gainers as losers, whilst the property related REITs and debt funds rebounded strongly after being heavily impacted this year on Covid-19 concerns (the highest riser in the space being GCP Student Living at +31%).

Gilt yields rose and credit spreads fell as one would expect given the strongly rising equity market, therefore corporate bonds outperformed sovereign debt over the month. The 10-year Gilt yield rose slightly to 0.30% from 0.26%. BBB spreads fell, from 185bps to 151bps. This remains below the long term average of 213bps, and very close to the 148bps low seen in February 2020 (before Covid-19 was part of most people's vocabulary). This is a very clear sign of how bullish the market is at the moment, seemingly signalling that it believes Covid-19 to be a thing of the past.

As mentioned last month, there was a lot of potential performance to come from the fund's investment trust holdings which are trading at a discount. Some of this was

indeed captured in November. If all of the holdings were to trade back at their respective Net Asset Values (NAVs) it would add 3.1% (down from 4.8% at the end of October) to Diversified Income's performance. We continued our dialogue with managers and board directors over the month to encourage proactive action to address these discounts. In addition, Honeycomb Investments PLC looks set to join the FTSE indices in December which could help close the discount further as index-trackers will have to buy the shares.

PORTFOLIO ACTIVITY

The Tesco Personal Finance 2020 bond matured, turning into cash. Travis Perkins issued a new 2026 bond at a 3.75% yield which the fund participated in. This position will replace the Travis Perkins 2021 bond holding which the company has elected to redeem early in December at a punitive (to them) price equating to a yield of just 0.4%. After these two transactions the fund will retain the same level of exposure to Travis Perkins, but at a much higher yield.

Over the month a new position was initiated in the Aberdeen Standard Asia Focus 2025 convertible bond. Regular readers will know of our occasional forays into the world of convertible bonds, and we have tended to find good value in those issued by investment trusts or where little value is given to the callable option, meaning they are trading like a normal bond (something convertible bond investors do not tend to want to hold). Therefore we are being paid c.2.8% p.a. with equity upside if Asian equities rally and / or the trust closes its discount to NAV.

In line with our investment process, the BHP Billiton Perpetual (callable in 2022) bond was reduced at a yield of 1.35% - this had been one of the positions we added to in the Covid-19 sell-off at yields of 6%. As one can see, markets are pricing risk very differently today compared to earlier in the year, and the risk / reward dynamic has deteriorated somewhat. The Pension Insurance Corp 2024 bond was also reduced at a yield of 1.57%. Top slicing these lower yielding names has had barely any impact on the forward looking yield of the fund. Proceeds will be reinvested when better risk / reward ideas present themselves.

YIELD

The fund's yield (based on end of month prices) reduced to 3.7% (from 4%) as a result of the strong rise in the NAV, and the increase in cash levels to 9.8%. 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

Despite current low bond yields, the forward yield on the fund at 3.7% is still some way above the fund's low point of 3.2% in 2016. The conundrum for all income managers is whether

to de-risk, (replacing fixed income assets with zero-yielding cash) or rotate fixed income positions into alternatives and equity. Whilst the latter may optically increase the yield, it will also raise the risk profile of the fund. Furthermore, given they are longer duration assets than fixed income (and all asset classes valuations have been boosted by QE and low interest rates) investors are not necessarily escaping the root problem. If rates ever increase then longer duration assets will suffer the most.

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 30 NOVEMBER 2020

	YTD	2019	2018	2017	2016	2015
Close Diversified Income Portfolio Fund	-0.5%	9.8%	-1.8%	5.4%	7.8%	2.4%
IA Mixed Investment 20-60% shares	1.6%	11.8%	-5.1%	7.2%	10.3%	1.2%

SOURCE: FE Analytics 03.12.2020; YTD data as at 3.11.2020. Performance is total return, net income reinvested after fees, X Acc share class.

IMPORTANT INFORMATION

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