Close Brothers Asset Management

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# Close Diversified Income Portfolio Fund

## Monthly fund manager update

JULY 2021

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### PERFORMANCE

The Close Diversified Income Portfolio Fund rose 1.9% in July, with a further positive month meaning the fund recorded another all-time high Net Asset Value (NAV). This compare to a 0.6% rise for the Investment Association Mixed Investment 20-60% Shares sector.

In terms of equities, the US was the strongest region for the Fund (+2.4% in USD terms and 1.9% in GBP terms), whilst China rattled the Asian markets with their draconian regulatory changes (within the education sector for instance) and a further clampdown on freedoms in Hong Kong (the Hong Kong market suffered a 10% drop as a result). The Fund has very little invested in Asian shares, helping this month's relative outperformance. The UK market was flat, whilst European markets gained +0.9% (+0.3% in GBP terms). On a relative basis, Sterling's strength was also a positive for the Fund, given the half-hedged position.

Specialist insurer Beazley, a recent addition to the portfolio, got off to a flying start, rising 17% over the month on strong interim results that beat consensus estimates on nearly all metrics.

Turning to the alternatives, gold was up 2.9% in USD terms and 2.4% in GBP terms in July. The performance of the infrastructure holdings was mixed, though it was pleasing to see Greencoat UK Wind finally rebound (+7.7%) after I made it a major position in the Fund earlier in the year. Greencoat is a beneficiary of both rising inflation and rising electricity prices (at the time of writing winter 2021 electricity prices are up 91% year-to-date). REITS had a stellar month, driven by some huge NAV moves from those companies reporting; AEW UK REIT recorded a NAV total return of 10% in Q2 2021; GCP Student Living (NAV total return of 9% in Q2 2021) and Ediston REIT (NAV total return of 4.9% in Q2 2021). Regular readers will recall that I have previously noted the differing attitude to REITS from the private market compared to public investors, and how this has led to a number of takeover approaches. In July, the Fund was a beneficiary of one of these approaches, as a consortium of investors made a bid for GCP Student Living at a price of 213p (9.3% premium to June NAV of 195p).

Within the fixed income space, the 10-year gilt yield fell to 0.58% from 0.72%. Investment grade corporate bond spreads rose slightly from 1.28% to 1.30%, whilst riskier BB spreads went from 2.61% to 2.66%. Bond spreads remain well below the long-term averages of 2.13% for BBB and 4.32% for BB. The Fund still has no Gilts, with the bond exposure is made up entirely of corporate bonds. The bond portfolio has a yield of 3.25% and 4 years of duration.

### PORTFOLIO ACTIVITY

I took the decision to sell GCP Student Living after the takeover approach. I sold at 214.5p (above the agreed takeover offer price of 213p) with the shares up 32% in the month and up 49% year-to-date.

When the Fund first bought into the Initial Public Offering (IPO) of Cordiant Digital Infrastructure we asked for, and got, some free warrants. These were exercisable at 100p, so when the Cordiant Digital ordinary shares were trading at 105p during the month of July I decided to exercise the warrants and immediately sell the resultant shares at 105p – generating a riskless and costless 5p gain. This represents as good a risk / reward outcome an investor can ever hope to get; a potential profit from no initial outlay and with no risk.

Coming a close second in terms of risk / reward outcomes during the month was the investment we made in Sainsbury's convertible bond back in early March 2020. Given the solid finances and trading of Sainsbury's in the midst of the uncertainty caused by Covid-19 we would have been happy just to make the 5% per annum yield, but as it happens - thanks to rallying markets and the bid approach for Morrison - the bond went into conversion territory, allowing us to make double digit returns (equity-like returns from a very low risk bond). Given that we sold the bond at 105p while the bond was so close to the maturity date, it equated to selling it on a yield of -167% (a record for the fund).

Last month I mentioned how a number of placings hit the share prices of a number of holdings. We used this as an opportunity to double up the holding size in Urban Logistics (warehouses) at 155p, a price very close to its March NAV. The shares closed the month at 172p as there was very positive news on the sector from peers such as AEW UK

REIT (also held in the Fund as noted above) who reported that industrial / warehouse values has risen 10.2% in Q2 2021. This bodes well for their next NAV announcement.

We also continued to add to Phoenix Group, whose share price remained at the lower levels of June (yield c7.1%). I sold some more Phoenix 2025 bonds at a yield of 1.68% to finance the investment.

Philip Morris (4.8% yield) was further up weighted and we added to the Jupiter 2030 (callable in 2025) bond at a yield of 3.5% (they went on to report a solid set of numbers, with their 6 month profit figure more than their entire debt).

## YIELD

The Fund's yield (based on end of month prices) was static at 3.6% with new investments helping to offset the impact to yield from another strong month of rising NAV and a rising cash balance. The cash weighting increased to 10.8% from 10.2% after the sale of GCP Student Living. Having cash gives optionality and it will be invested in new ideas as they are identified, or when any market pull back makes valuations in general more attractive. The yield on the Fund is the result of all the individually picked attractive risk / reward ideas.

## OUTLOOK

The Fund remains diversified by asset class, geography and sector with the purpose of generating attractive risk adjusted returns for clients. We will continue to tilt the portfolio away from areas and ideas that are more expensive, with lower forward-looking returns, and continue to use the Quant Model to focus research efforts on those areas and ideas with better value.