Close Diversified Income Portfolio Fund

Monthly fund manager update

SEPTEMBER 2021

STEPHEN HAYDE
Managing Director

PERFORMANCE

Close Diversified Income fund fell -1.17% in September. This compared to a 1.24% fall for the Investment Association Mixed Investments 20-60% Shares sector.

It was one of those months where correlation between asset classes rose close to one, and pretty much everything fell.

In terms of equities, the US fell -4.5% (-2.3% in sterling terms), Europe fell -3.5% (-3.4% in sterling terms) and the UK fell -0.5% (though mid-caps dropped -4.4%). China's continued political clampdown in September included declaring all crypto transactions illegal, a shortage of power and over-leveraged Evergrande trying to avoid a major default. Hong Kong equities slid 5% as a result. The only bright spot in global equities was Japan which added +4.9% (+5.7% in sterling terms).

Turning to alternatives, gold fell -3% (-0.8% in sterling terms), the UK REIT market was off -6% and all areas of infrastructure were down. One reason for the sell-off in the investment trust space was the large number of fund raisings being undertaken (the big post-summer holiday rush), be they new IPOs (leading to the selling of existing holdings) or individual placings announcements. In the Fund we had placings announced for Tritax EuroBox at 111.5p (leading to the share price falling -6.3% in the month), Supermarket REIT at 115p (share price down -3.3% in September) and rumours of an impending raise for Greencoat UK Wind (which brought an abrupt halt to its brief ranking as the largest alternatives position in the Fund). The shares had been up as high as +9% in September but actually ended the month down – which had a marked impact on Fund performance.

As mentioned last month, Greencoat UK Wind is the main renewables company benefiting from the current spike in electricity prices given it has no hedging in place. The surge continued in September with winter prices soaring +90%! With the autumnal winds finally arriving and the electricity price remaining high, Greencoat UK Wind is ideally placed to generate some strong cash flows – so it was disappointing to see the share price end down for the month.

Looking ahead, the Fund has lined up a new renewables idea for investment in November (more information to follow) which is targeting a yield of 5% and total return in year one of 10%.

In fixed income, the 10-year gilt yield rose to 1.02% from 0.71% in September leading to large losses for long-dated bonds. Corporate bond BBB spreads fell slightly from 1.27% to 1.26% whilst riskier BB spreads went from 2.59% to 2.5%. 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, and hence our exposure is all in corporate bonds. The bond portfolio has a yield of 3.3% and 4.2 years of duration. We remain fairly short duration and have 11.3% cash (zero duration) after selling several bonds earlier in the year. The weighting to bonds is 33.5%, the lowest it has even been.

PORTFOLIO ACTIVITY

So what did I do in the month?

Trafigura decided to tender early for its Perpetual bond (callable 2022) at a yield of just 2.05% and to refinance it with another Perpetual bond (callable 2027) at a much higher yield of 5.875%. This was a very popular new issue but we were able to get a top allocation as existing bondholders. This means we were able to maintain the same level of credit risk but increase our yield nearly 3-fold for taking on a 5-year longer maturity date.

TP ICAP 2024 (1.25% yield) and BBGI Global Infrastructure were both further reduced on valuation grounds.

YIELD

The Fund's yield (based on end of month prices) rose slightly to 3.6% from 3.5% despite rising cash levels. This was due to the falling NAV (lower prices mean higher yields) and the Trafigura trade mentioned above. The cash weighting rose to 11.3% from 10.4%. This will rise to 12% in a week's time with the impending maturity of another bond. Counterintuitively, as this maturity currently trades on a negative yield (it is an index-linked bond and these tend to have negative yields before you add on the positive return from inflation), this will actually increase the yield of the Fund. The Fund's yield 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 our proprietary Quant Model to focus research efforts on those areas and ideas with better value. With the potential for continued inflation and news on Q.E. tapering driving higher interest rates, we are happy to have cash on the sidelines in case the sell-off continues.