Close Brothers Asset Management

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Close Diversified Income Portfolio Fund

Monthly fund manager update

DECEMBER 2021

STEPHEN HAYDE
Managing Director

PERFORMANCE

The Close Diversified Income Fund returned +2.42% in December which compared favourably to the IA 20-60% Shares Sector which returned +1.25%.

Markets were buoyant, despite Central Banks starting to reduce their monetary largesse. The Bank of England raised the base rate by 0.15% to 0.25%, the European Central Bank said it would end its Pandemic Emergency Purchase Programme (PEPP) of asset purchases by March 2022 and the Federal Reserve accelerated the withdrawal from its asset buying policy, which will now also end in early 2022. The US market was up +4.6% (+3.2% in GBP terms), the UK was up +4.6% and Europe was up +5.8% (+4.4% in GBP terms).

A strong December rounded off a particularly strong year for Diversified Income. The fund returned +8.9% over 2021, which compared to an average annual rise of +5.4% over the Fund's near 12-year history, whilst it also finished +1.7% ahead of the IA sector for the year. Monthly performance was helped by yet another bid approach, the third this year, for one of the Fund's holdings. Clinigen rose +53% over the month after a bid from private equity. This follows bids for GCP Student Living and UDG Healthcare, which also came from private equity.

The alternatives allocation also put in a strong showing, especially the Real Estate Investment Trusts (REITs), with four of them posting double-digit gains over the month. Elsewhere, Greencoat UK Wind rebounded +4.8% after concluding its discounted placing and open offer last month, and Gold was up +2.6% (+1.2% in GBP terms). Many of the investment trust holdings put in strong performances over the year, in part because they began the year trading at large discounts to their Net Asset Values (NAVs). This will be no surprise to avid readers of this commentary, as I have given regular updates on these undervalued positions. Overall, about +2% of the performance in 2021 was attributable to the NAV discounts closing on the investment trust holdings.

The 10-year gilt yield rose from 0.81% to 0.97% over the month, and was up from +0.20% at the start of the year (The IA Gilts Sector declined -5.4% in 2021). Corporate bond BBB spreads, fell slightly from 1.41% to 1.39%, whilst riskier BB spreads went from 3.04% to 2.80% in sympathy with rising equity markets. 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 the bond exposure is all in corporate bonds. The bond portfolio has a yield of 3.8% and 4.2 years of duration. We remain very comfortable with the short duration position and have 10.8% cash (essentially zero duration) after selling many bonds earlier in the year. The Fund's overall weighting to bonds is 32.8%, which is close to historical lows.

PORTFOLIO ACTIVITY

In the bond section of the portfolio, we added a new holding in an Abrdn 5.25% perpetual bond (Abrdn is the new name for Standard Life Aberdeen). For long-time followers of the Fund you will recall that we invested in the two previous Aberdeen Perpetual bonds. Whilst the yields were higher back then (7.9% and 7%), this was in a time of much higher sovereign yields. The current spread, the compensation above the sovereign yield for taking on the corporate risk, is at the average level of these two previous issues at 470bps (4.7%). This was a very popular new issue, being eight times oversubscribed, and as a result we were scaled back a little from the position we would have liked to acquire. The bond currently has a 0.65% weighting in the Fund.

YIELD

Diversified Income's yield (based on end of month prices) was maintained at 3.8% despite the strongly rising NAV, helped by the new purchase of the Abrdn Perpetual bond. 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 we view as more expensive (lower forward-looking returns) and continue to use the team's Quant Model to focus research efforts on those areas and ideas with better value.

IMPORTANT INFORMATION