Close Brothers Asset Management

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# Close Diversified Income Portfolio Fund

## Monthly fund manager update

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### PERFORMANCE

The Close Diversified Income Fund was down -0.7% in January. This compared very favourably to the -3.1% fall for the Investment Association (IA) Mixed Investment 20-60% Shares Sector. Over the 11 years that I have now been running the fund, the annualised performance stands 5.3% p.a. versus 4.75% for the IA 20-60% sector. On a risk adjusted basis (Sharpe Ratio) the Fund is now in 2nd spot out of the 83 funds in the IA sector with a track record that long (the Fund has typically had lower volatility than its peers).

Most asset classes fell over the month of January, as the market suddenly seemed to panic over the prospect of rising interest rates and the reduction of monetary stimulus from Central Banks. The trigger seemed to be the US Federal Reserve outlining a timetable to begin Quantitative Tightening. The last time Quantitative Tightening was tried was 2018, which also coincided with a sell-off across asset classes. As we have mentioned many times over the years, rising interest rates / reducing monetary stimulus is most impactful to long duration assets (long-dated bonds and equities, in particular loss making technology stocks with no immediate prospects of generating positive cash flow). This is why we hold over 10% in cash (no duration), a bond portfolio with duration of just 4 years, alternatives (which are generally lower duration than equities) and an underweight position in equities (and with a particular focus on cash generative companies that are lower duration than average due to their high starting cash flow). The Fund is short duration across the board.

Over the month, the US market was down -5.3% (-4.8% in GBP terms), the NASDAQ was down -9% (-8.5% in GBP terms), the UK was up +1.1%, and Europe was down -2.9% (-3.6% in GBP terms). The 10-year gilt yield rose from 0.97% to 1.30% in the month (as prices fell). Corporate bond BBB spreads, rose to 1.5% from 1.41%, whilst riskier BB spreads went from 2.8% to 2.9% in sympathy with generally weak equity markets. Bond spreads remain well below the long-term averages of 2.1% for BBB and 4.3% 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 4.3% (up from 3.8% last month) and 4.0 years of duration. We remain short duration and have 11.8% cash (essentially zero duration). The overall weighting to bonds remains close to historical lows at 33%.

January proved to be a particularly strong month for the Fund on a relative basis, with some strong performances from the equity picks. Philip Morris rose 8.3%, while Visa and Mastercard were both up strongly following strong Q4 results. AEW UK REIT rose 2.8% after reporting a Net Asset Value (NAV) total return of 5.6% in Q4 21. Greencoat UK Wind (the largest holding in the Fund) also reported a stellar NAV total return of 5% for Q4 21. Gold was a detractor – down -1.8% (-1.3% in GBP terms).

For those investors interested in Environmental Social & Governance (ESG) or sustainability matters, the following two snippets may be of interest:

1) Measuring ESG and sustainability can be quite hard (many different providers score companies very differently) but what I can say for certain is that over its lifetime Diversified Income has had significant impact, evidenced today by the positions in the likes of Greencoat UK Wind, Greencoat Renewables, Next Energy Solar Fund, and Octopus Renewables. Diversified Income investors have provided £109m worth of capital directly to the green-economy as the fund has participated in various IPOs and Placings involving these types of securities.

2) Over January we engaged with Unilever (along with many other shareholders by the sounds of things), laying out our reasoning for abandoning the large scale takeover of GlaxoSmithKline's consumer healthcare division. We continue to engage with our holdings when we believe that board decisions are not in the best interests of shareholders, or we see that governance can be improved.

### PORTFOLIO ACTIVITY

Our holding in the Paragon Bank 2022 bond successfully matured. Given the very short duration, the yield on this bond was very low by the end (c.1%). We took profits on the Lancashire Holdings 2041 bond, which has performed very strongly in a falling market. We used the proceeds to continue adding to the Abrdn Perpetual bond (callable in 2026) at a yield of 5%, taking it into the top 10 bond holdings in the fund.

A new holding was added in the alternatives space; Digital 9 Infrastructure (5.6% yield). Similar to our holding in Cordiant Digital Infrastructure, this vehicle invests in the infrastructure of the telecom / internet sector. We added to Digital 9 in a discounted placing being undertaken with institutional investors.

In the equity space specialist insurance group Beazley was sold after a rapid appreciation in its share price, and pharmaceutical group Clinigen was sold after the share price went above the original takeover approach price from Triton Investment Management Ltd. Honeycomb Investment Trust (8.5% yield) was added to with some of the proceeds.

## YIELD

Diversified Income's yield (based on end of month prices) rose to 4%, from 3.8% last month due to three key reasons: 1) the slight fall in NAV, 2) high yielding purchases of Abrdn Perpetual bond and Honeycomb, and 3) the natural move to using 2022 forecast dividends from 2021 dividends (note that quoted equity yields are based on expected dividends). 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 our Quant Model to focus research efforts on those areas and ideas we believe offer better value.