Close Brothers Asset Management

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Close Diversified Income Portfolio Fund

Monthly fund manager update

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PERFORMANCE

Diversified Income was down -1.3% in February. This compared favourably to the peer group average within the Investment Association Mixed Investments 20-60% Shares, which was down -1.7% over the month.

Russia's invasion of Ukraine was a key driver of volatility in markets, though it has reduced the market's expectation for future central bank rate hikes (one of the causes of January's declines). Whether ongoing political turmoil diminishes central banks' willingness to raise rates, we will have to wait and see, but with oil up +8%, gas up +15%, electricity up +37% and wheat up +17% in the month, it is likely to keep inflation higher for longer. This higher inflation was one of the reasons central banks were starting to raise rates in the first place. China will be keenly watching how the West deals with Russia, given their own aims of potentially increasing their territory beyond the current borders with regard to Taiwan.

In the month, the US market was down -3.2% (-3% in GBP terms), the UK was flat and Europe was down -6.2% (-5.9% in GBP terms). The 10-year gilt yield rose from 1.3% to 1.4%. Corporate bonds underperformed sovereign bonds as BBB spreads rose to 1.9% from 1.5%, whilst riskier BB spreads went from 2.9% to 3.5%. Bond spreads are getting closer to their 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 yield of the bond holdings rose sharply to 4.9% from 4.3% (up from 3.8% two months ago) and has 3.9 years of duration. We remain short duration and have 12.4% cash (essentially zero duration). The weighting to bonds is 32.9%, close to historical lows for the Fund.

The high cash weighting and precious metal exposure helped the Fund outperform in February. The gold price rose +5.7% (5.9% in GBP terms) and silver rose +8.2% (+8.4% in GBP terms). The holding in goldminer Barrick Gold, was up +18%, helped by a good set of results where they announced a new dividend structure which will see it return cash to shareholders depending on the net cash on their balance sheet (the higher the gold price the more cash they will have on the balance sheet to distribute). The gold and silver-related holdings together now account for 4.8% of the Fund. Whilst the Fund has no emerging market equity or bond funds which would likely have a lot of Russian exposure, of course a lot of the equities are global in nature so will have some exposure to Russia and Ukraine, for instance Philip Morris, Visa and Nestle (all single digit percentages of profit).

In terms of newsflow, Greencoat UK Wind posted a positive set of final results, and looking ahead into 2022 are seeing above-average wind speeds so far, at historically high electricity prices, and will see their regulatory revenues rise by the latest RPI figure (+7.8%) which is also above expectations. Greencoat UK Wind rose 4.2% in the month and remains the Fund's largest holding. REIT performance was mixed, though a number of the holdings will be a beneficiary of the inflation we are seeing (Supermarket REIT, Residential Secure and Tritax EuroBox all have inflation linked revenues). The other warehouses names are seeing strong growth in rents due to the tight supply dynamics. Bunzl, an equity holding, noted the "property cost inflation" they are seeing in the warehouse segment but given their business model they are able to pass through inflation, and so actually see inflation as a positive growth driver which helped their share price performance in the month.

PORTFOLIO ACTIVITY

With the alternatives close to their maximum permissible overweight position, some of the infrastructure names were trimmed. The Jupiter 2030 bond position was added to at a yield of 3.8%.

YIELD

Diversified Income's yield (based on end of month prices) rose to 4.2% from 4.0%. Given the short duration nature of the bonds, it does not take much of a drop in prices to materially increase the yields (forward looking returns). 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 aim of generating attractive risk-adjusted returns for clients. We will continue to tilt the portfolio away from areas and ideas that are more expensive (lower forward-looking returns) and continue to use the Quant Model to focus research efforts on those areas and ideas with better value.