Close Diversified Income Portfolio Fund

Monthly fund manager update

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PERFORMANCE

The Close Diversified Income Fund was marginally down -0.05% in August. This compared favourably to a -0.55% decline for the Investment Association (IA) 20-60% Shares Sector. The year-to-date return for the Fund now stands at -2.46%, which again compares favourably to the IA 20-60% peer group at -7.61%.

Following a rebound in July, markets resumed their fall in the latter part of August, with talk of recession becoming ever more commonplace and central bankers continuing to raise interest rates to combat inflation. Federal Reserve Bank of Richmond President, Thomas Barkin, warned that, "*The Fed must curb inflation even if this causes a recession*." The Bank of England forecasts now see the UK falling into recession in the fourth quarter of 2022.

UK inflation is set to increase further (by c.4% according to economists) as the regulator Ofgem lifted the energy price cap to £3,549 from £1,971. Ofgem estimates that over 50% of UK households will now spend 10% or more of their disposable income on energy. This is not just a consumer problem either as all businesses consume energy too. As an example, bingo hall and casino operator, Rank Group, (which is not held in the Fund) guide to their energy costs in 2023 being £46m, up from £23m in 2022. This is quite significant compared to their last annual profit of £40m, and highlights that this cost is yet another headwind for corporate profits and equities. This is not just a European problem either with Bloomberg reporting that 20 million US homes (1-in-6) are behind on their energy payments. Research by Canada Life revealed that 1-in-20 UK adults have stopped pension contributions due to rising cost of living.

Over the month the S&P 500 fell -4.2% (+0.5% in GBP terms), European equities fell -5.2% (-2.2% in GBP terms) and the UK was down -1.9%.

The 10 year gilt yield rose significantly over the month to 2.8% (from 1.86%), leading to losses in the bond market (especially for longer duration bonds). So-called risk-free gilts have experienced huge losses at the longer end of the curve. For instance, the 2073 index-linked gilt is down 65% year to date.

Corporate bonds delivered a mixed performance compared to sovereign bonds, as BBB spreads rose from 2.34% to 2.43% (still above the long-term average of 2.1%) and riskier BB spreads fell from 5.63% to 4.91% (still well above their long-term average of 4.25%).

PORTFOLIO ACTIVITY

The sell-off led to a number of investment opportunities arising in bonds (again)...The month we:

Added to the IPF 2025 bond at a yield of 16.3%. These bonds yielded 7.1% in September 2021.

Added to the Abrdn Perp bond at a yield to call of 8.64%. This bond did not exist back in September 2021.

Started a new position in a Just Group Perp bond at yields as high as 9.8%. These bonds yielded 4.7% in September 2021.

Started a new position in a Barclays USD Perp bond at yields as high as 8.5%. This bond did not exist back in September 2021.

Started a new position in a Barclays GBP Perp bond at yields as high as 8.4%. This bond did not exist back in September 2021.

Started a new position in a Lloyds Perp bond at yields as high as 7.63%. This bond yielded 3.5% back in September 2021.

The overall weighting to fixed income is now up to 45.4%, from 32.9% back in February, and the duration remains at 3.9 years.

The cash weighting reduced further, to 3.9% from 5.1%.

YIELD

Diversified Income's yield (based on end of month prices) rose to a new record of 6% (up from 5.7% last month). 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 (lower forward-looking returns) and continue to use our Quant Model to focus research efforts on those areas and ideas with better value. Volatile markets should increase the likelihood of finding more investments at valuations we consider to offer attractive risk / reward characteristics.