Close Diversified Income Portfolio Fund

Monthly fund manager update

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PERFORMANCE

The Close Diversified Income Fund returned 2.5% in January. This compared to 3.1% for the Investment Association (IA) Mixed Investment 20-60% shares sector. This month marks my 12th anniversary of running the Fund, in which time it has returned 72% vs 61% for its IA sector.

Equities bounced in January with the S&P 500 adding +6.2% (+4.3% in sterling terms), Europe +9.7% (+9.2% in sterling terms) and the UK +4.3%. This was despite continued talks of recession and mixed corporate trading updates.

The 10-year gilt yield fell from 3.67% to 3.33% in the month, as prices rose for sovereign bonds. Corporate bond spreads continued to rally, with BBB spreads falling to 2.03% from 2.36% (now back below their 2.1% long-term average). BBB spreads have now tightened by 1% since the height of the panic in October 2022. BB spreads fell to 4.59% from 4.94% (still a tad higher than their 4.25% long-term average).

The alternatives put in a more mixed performance with gold leading the way (+5.8% or +3.9% in sterling terms). The infrastructure holdings were the most muted, with the majority in the 0-1% return range for the month.

Greencoat UK Wind, the Fund's largest position, was the stand-out infrastructure holding, rising +4.8% after reporting its Q4 2022 Net Asset Value (+9.1% total return in the quarter) coupled with a 13.4% rise in its dividend. This will further drive the yield generation of the Fund.

In the month, the vote to wind up Starwood European Real Estate Finance was approved by investors so this now joins ICG Longbow (who announced a further return of 5.5p in the month) in being wound up. This means 4% of the Fund is in the process of being wound up. Both investment trusts trade at discounts to their NAVs, so those discounts should unwind as the monies are returned to shareholders – boosting future performance.

PORTFOLIO ACTIVITY

In the month we continued to add to bonds. After all the bond additions of 2022 the Fund is generating a lot of income (~£1.4m in January 2023 versus ~£0.85m in January 2022) and the re-investment of this income into further high-yielding opportunities will help drive even more income generation. Because we constantly have cash to reinvest (from maturing bonds, accrued income and now also from investment trusts that are being wound up) it is not in our long-term interest to see bond spreads and gilt yields collapse back to where they were in 2020. Falling yields might give short-term capital gains (as seen in November and January, when Diversified Income returned 2.7% and 2.5% respectively) but these mean that forward looking returns are less attractive.

- We added to Bupa Perpetual (2031 call) at a 9% yield.
- We added to IPF 2025 at a 16.8% yield.
- We reduced the Lloyds Banking Group Perp (call 2027) at a yield of 8.15% having bought in at a yield of 8.5%.
- We bought the new Lloyds Banking Group Perp (call 2028) at an 8.5% yield.
- We added to TP Icap 2028 at a 7.5% yield and TP Icap 2026 at a yield of 6.6%.

To reinforce the point again about compounding returns – as I write this commentary we are being offered TP Icap 2028 bonds at a 6.8% yield. This means we have made a 3.6% capital return on our last purchase in just a few weeks. But that also means our reinvestment rate (if we want to buy more with our income) has just shrunk from 7.5% to 6.8% - compound that decrease over many years and it impacts the long term return projection.

The cash weighting fell in the month from 2.6% to 2%.

YIELD

Close Diversified Income Fund's yield (based on end of month prices) fell to 6.6% from 6.9% due to the strongly rising NAV.

OUTLOOK

The US yield curve remains inverted (see November's commentary for more detail on that), which suggests a US recession is increasingly likely. We think this is most dangerous for equities (given the increased chance of profit warnings, and current high valuations).We remain underweight equities. Volatile markets increase the likelihood of finding more investments at valuations we consider good risk/reward and which will aid forward looking returns.