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Close Diversified Income Portfolio Fund

Monthly fund manager update

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PERFORMANCE

The Close Diversified Income Fund returned +2.7% in April. This compared favourably to the +0.6% for the Investment Association (IA) 20-60% Shares Sector peer group.

US equities rose +1.5% (although this was reduced to -0.3% in GBP terms due to sterling strength relative to the US dollar over the month) and the tech-heavy NASDAQ was flat (-1.8% in GBP terms), European equities were +1% (+0.8% in GBP terms). The UK equity market bounced back from being last month's laggard, finishing up +3.1%. This shows how the psychology of markets can swing around in a heartbeat, and a whole host of fund holdings were up over 5%, in many cases on no particular news, but in some cases significant moves came after announcements, such as Burford Capital (+82% from the final pricing point of March) on the back of a major case win against the Argentinian government, and Mears Group (+12% on consensus-beating results and a share buyback announcement). Mears also increased their dividend by +31.25%, which will help further increase the income generation of the Fund.

Whilst the US banking crisis rumbles on (First Republic Bank was acquired by JP Morgan over the bank holiday weekend at the behest of the regulators), European banks had a strong month of Q1 updates and both UniCredit and Lloyds redeemed AT1 bonds. In addition, NatWest Group received a credit rating upgrade (BBB+ from BBB) from Standard & Poor's (S&P), following on from Barclays last month. The U.K. sovereign had its credit rating outlook revised to stable from negative by S&P. S&P said the current UK government's decision to abandon, "*most of the unfunded budgetary measures proposed in September 2022,*" has bolstered the fiscal outlook for the country. This is good news for "UK Plc", considering the battering that UK stocks suffered back then (many investment trusts are still trading at large discounts as a result of that particular sell-off).

The 10-year gilt yield rose from 3.49% to 3.72% (in part due to the "sticky" inflation number that came out in March). However, mathematically it looks like inflation will finally see a material pull back in May, as the April 2022 inflation jump will drop out of the annual figure. Sovereign bonds therefore reversed the gains made in March (the IA UK Gilts sector was -1.7% in April) – but this is an asset class we still have zero allocation to within the Fund. BBB corporate bond spreads fell in the risk-on environment from 2.23% to 2.14% (in line with the 2.1% long-term average). BB spreads fell from 4.56% to 4.40% (above the 4.25% long-term average). Subordinated bank bond (AT1) spreads came back down in the month as sentiment improved, from 5.16% to 5.05%.

The alternatives were largely positive contributors to fund performance over the month, again in contrast to last month. MSCI reported that total returns for UK real estate were +0.67% in March (the first positive month in 9 months). AEW UK REIT announced a total return of +2.4% for Q1 2023, outperforming the sector. Private equity giant, Blackstone, announced it had raised $30.4bn for its latest global real estate fund. Blackstone has been a prolific buyer of UK REITs: Hansteen (December 2019), St Modwen (May 2020), GCP Student Living (July 2021) & Industrials REIT (April 2023).

So with no gilts, little tech exposure, little US equity and a general overweight to UK assets (UK listed alternatives and corporate bonds in particular) it meant April was a positive month relative to the IA sector. Given our active management approach, we are not a closet-tracker fund, so investors should expect the Fund to perform differently to the IA. We hold direct holdings in equity, bonds and alternatives, with conviction weightings, and with an income tilt, which can lead to a very different outcome to other funds in the same sector – especially when looking at statistically insignificant periods such as one month. As previously mentioned, given we are now fully invested (having maintained a high cash weighting through 2021 and into 2022), the Fund is likely to be more volatile too (as cash has no volatility at all).

To quote renowned fund manager Terry Smith, "*Be warned: in our view, even a year is a short period to measure things by. Moreover, a year does not have its foundations in the business or investment cycle. It is, in fact, the time it takes the earth to go around the sun and is therefore of more use in studying astronomy than investment*."

Over the long-term the Diversified Income Fund has outperformed the peer group, and with a lower volatility too.

PORTFOLIO ACTIVITY

We sold the Schroder US Maximiser holding and top-sliced Schroders during the month. Despite this, the equity weighting still rose given some of the large share price rises seen in April.

TP ICAP 2024 bonds were tendered for at 100p. This meant we could sell these bonds back to the company at a price equating to a yield of 5.25%. We sold the entire position and reinvested it all in their new 2030 bond, which came with a return of 7.98% per annum. This return comes in two parts: a 7.875% coupon, plus a small amount of capital gain as the price of the bonds was 99.1, but we will be repaid 100 pence in the pound upon maturity in 2030. We then added to the position size in the secondary market, following the sell-off in gilts following the monthly inflation data (at a yield of 8.16%).

At the risk of sounding like a broken record, future returns look more attractive than in recent years. Just look at the difference between TP ICAPs recent issue, versus their identical 7 year bond issue back in 2021. Good for bond investors, not so good for equity investors who have to foot the higher interest bill.

The cash weighting rose in the month from 2.2% to 2.5%. The duration of the bond portion remains at 3.9 years. We remain short duration and believe the higher yield will help offset any future bouts of volatility.

YIELD

Diversified Income's yield (based on end of month prices) fell back from the record highs, to 7.1%, due to the strong rise in the Net Asset Value (NAV) over the month.

Lower valuations can be viewed as a positive for long-term investors. In April the Fund accrued £1.6m of income and this needs re-investing. So the better the yields and valuations we can reinvest at, the better for long-term wealth creation.

OUTLOOK

The jury is out on whether the current interest rate hiking cycle will lead to a recession. We think that an economic slowdown would be most dangerous for equities (given the increased chance of profit warnings and the current high valuations in many markets). We remain underweight equities. Volatile markets increase the likelihood of finding more investments at valuations we consider good risk / reward and which offer good forward looking returns.