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AICA's Founding Chairman Looks Back on 2019 and Ahead to 2020

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Chuck Jaffe, in The NAVigator podcast, interviewed John Cole Scott, chief investment officer at Closed-End Fund Advisors and the founder and executive chairman at the Active Investment Company Alliance. Read the Q & A below as Chuck and John look at the year that was in closed-end funds for 2019, starting from the Christmas holiday a year ago when the business had been decimated by a market downturn to turn things around in the course of one of the industry's best years ever, as well as what lies ahead for closed-end funds in 2020.

John Cole Scott

The podcast can be found on AICA's website by clicking here: https://aicalliance.org/alliance-content/pod-cast/

CHUCK JAFFE: John Cole Scott, chief investment officer at Closed-End Fund Advisors, the founder and executive chairman of the Active Investment Company Alliance is here, and we're reviewing 2019 and looking ahead at 2020 today in The NAVigator. Welcome to The NAVigator from the Active Investment Company Alliance, where we talk all-weather active investing and plotting a course to financial success. The AICA is a unique industry organization because it represents investment firms, creators of closed-end funds, users and investors, everyone in the industry from all different facets, and The NAVigator looks at all of those aspects of investing in closed-end funds and business-development companies. If you're looking for excellence beyond indexing, this is where you should be. The NAVigator's going to point you in the right direction. Joining me today, it's John Cole Scott, the founder and executive chairman of the Active

Investment Company Alliance, but he's also chief investment officer at Closed-End Fund Advisors in Richmond, Virginia. If you want to learn more, AICAlliance.org is the website for the Active Investment Company Alliance. CEFadvisors.com and CEFdata are the websites for Closed-End Fund Advisors. John's on Twitter @JohnColeScott. JSC, good to have you back. Happy holidays.

JOHN COLE SCOTT: Happy Holidays to you Chuck. So glad to be here as well.

CHUCK JAFFE: Man, what a difference a year makes. It's not that just we're having all the fun that we have talking about The NAVigator, which has helped to make 2019 a blast for me. But a year ago at this time, just before Christmas, the market was bottoming out and nothing was bottoming out quite like closed-end funds. So let's talk about a bit of perspective. It was kind of dark if you were a closed-end fund investor a year ago, wasn't it?

JOHN COLE SCOTT: It was. I mean, discounts for the whole universe were an average just around fifteen percent, which is very, very wide. Versus about a four percent discount today.

CHUCK JAFFE: So as things got dark last year, you should have been buying like crazy.

JOHN COLE SCOTT: Absolutely. I mean, the average closed-end fund from Christmas Eve last year was up about thirty-three and a half percent, and if you dig into the details, that's about twelve percent discount narrowing. And the balance or the other two thirds roughly, is actual net asset value improvement. And so this reminds you about closed-end funds, when discounts widen, you lose extra money and when they narrow, you make extra money. And that's one of the main reasons we think it's worth being both active in asset allocation and active in fund selection in this space. You've got a couple of sectors that had amazing years; REIT and real estate funds on average up forty-eight percent from that low. Convertible funds, which are bond in their core but equity-like as well, forty-seven percent on average returns. And we're using our index data on CEFdata to power this, so it's diversified and not cherry picking funds. Even muni bond funds, which there's duration risk and they're kind of boring, they're up twenty percent from that level. And preferred equity funds, another kind of tax duration focused sector, up forty-some percent. The worst sectors are up sixteen and seventeen percent by that time period, and twenty-five percent in the past one year. So it's been an amazing, amazing time for the sector, and it's really led to growth and new funds being able to be launched again, which is really nice.

CHUCK JAFFE: A year ago, as you were talking about it, when things were going to so badly and as you point out, the discount situation makes it that, yeah, it can be tough to ride along. But at the same time, that's exactly when you want to buy. If you're the kind of person who says, "I want to buy when the discounts are bigger," and on The NAVigator we have talked to some of the guys who run funds. If I'm running a mutual fund of closed-end funds, it's all about the discount. When you see those discounts widen, you're feeling that the blood is running in the streets. Is that the other lesson that people need to look at? To ride out those downturns, you really have to make sure that you're going to be okay with white knuckles for a while. But oh, by the way, while you're okay with white knuckles or trying to get okay with white knuckles, you are trying to size up all your positions because now is the time.

JOHN COLE SCOTT: Absolutely. I would say things that are really important and that can happen some years, are if you have losses during the year, take them. Or if you've taken so many losses at the end of the year like this year, I was actually realizing gains for clients because they were free from a tax perspective, and that's looking at the portfolio. I talk about that because a lot of investors, whether individual investors or financial advisors I've gotten to know in my twenty-year career, they often say, "This fund's done so great, who cares if it's at a ten premium. I've made so much money." I find it's really healthy to sell those winners and decide where to put the money based on your own research and where you have outlook for the future. But then be thoughtful in taxes as well. So blood in the streets is what John Templeton loved to say, is when you should be investing at the value approach. And if you think about an investment, a listed closed-end fund where there's generally a daily net asset value and every time it trades market price that's dislocated, you want to fight the human behavior of euphoria with success and fear with loss. Because at the end of the day, these are not operating companies. They've never gone to zero. They could, I guess, but they're diversified usually into fifty to two hundred things. So all you have to be thinking of is, where do I want to be because it can recover best next?

CHUCK JAFFE: And next week in fact, we're going to talk a little bit more about some history and the future of the industry based on some research that your father did decades ago. But this year I also want to point out, we saw tremendous rebound as we've said, in closed-end funds. We saw a development near and dear to our heart, that being your launch of the Active Investment Company Alliance, but there's also been some changes and some growth in specific areas of closed-end funds. How much do you think that's going to continue in 2020? And what's your outlook on the space in general for the year ahead?

JOHN COLE SCOTT: I would say that talking to all the major fund sponsors and even new players, that the IPO calendar for traditional funds is pretty full. This year, it's still 2019, we had two direct listings from interval funds, two closed-end funds. I don't think that's going to happen regularly, but it's possible and interesting. We had one conversion of an open-end fund into a closed-end fund. I don't think it was the best use of the idea, but it's able to happen as well in the space. We had six interval funds launch. I mean, these things are relatively new. There's only fifty-eight, but they've grown to thirty-four billion in assets and we had six new ones that we just got track records for starting this calendar year. We had one listing of a BDC from a private BDC, and came out and gave it a seven billion dollar, the third largest in the sector. And then we had nine traditional closed-end fund IPOs. And what I liked from that is we had from Calamos, the most recent one we saw was a long/short fund. So it's thinking about an active manager, deciding what stocks could go up and what stocks could go down, and that's the way you get involved in the equity markets versus the great ten year record we've had. We had Alliance come out with kind of an artificial intelligence flavored closed-end fund. I'm really excited to watch how it performs once I get the semiannual report. We had BlackRock launch another ginormous biotechnology fund. Nuveen did a muni bond fund. Tortoise did a fund that's less focused on energy and more on infrastructure and some other areas. And then PIMCO did a kind of combo energy fund. So lots of big name sponsors, a couple of new players to the space, and they're doing different things, that to me, don't feel like they're taking the last five years of success and just following it. They're thinking about the next five years of success.

CHUCK JAFFE: A year from now when you and I are talking about the end of 2020, are you thinking we're going to be a good year for closed-end funds from a performance standpoint? Or a good time to buy because a year from now after the election, we're going to see those discounts grow again and whatever else?

JOHN COLE SCOTT: I think you have to think of three things for 2020. You have to think about what evolves with the trade tension and trade wars, because a lot of the cause of a recession, are businesses and humans deciding to stop spending, and then that tends to tip the scale to recession. So if we get enough negative press, enough people really, really worry about it, that could cause the headwinds that take us into recession. You then have to think about the election because every four years we have one and it always seems to provide the volatility that can exist. I would say the third idea is more of going back to the sectors where we have personal opinion at Closed-End Fund Advisors, that the senior loan sector at an eight discount and an average seven yield, has it's leverage tied to rates and it's a little more secure than the regular high-yield bond funds. If you want to give up one percent less average yield then its peers, it's a great place, I think, to be waiting for whatever's going to happen because you're wider than normal. The universe is at a four and change discount, the average fund there is at an eight discount, and you can find obviously some wider than that. International equity, there's been some optimism in Europe now that we've got Brexit, that there's a couple international equity funds. There's a relatively new one, it's got some more interesting provisions than the older school ones that First Trust has, FDEU. If you want to play that space, is an attractive distribution rate and an attractive discount. And then MLP funds, which are interesting. They're up thirteen percent this month, so they're only up sixteen percent this year. They weren't doing well at Thanksgiving, but they've turned in a lot of ways. That's still a sector bet and it's definitely a more volatile bet, but you're able to get regular tax adjusted dividends that are very useful as long as you size it right. So we just built a portfolio for a client who wants a lot of yield, who's in the highest federal tax bracket, and we put him in about eleven percent MLP exposure. If you go back to our fourteen sectors, seven percent is average, and so this is definitely a double weight almost, and that's our conviction to that. One of the funds in that space that Legg Mason runs is interesting, is a CTR at a relatively wide discount of ten and change, and a solid distribution yield in our opinion. So I think there's some interesting funds to look at in that sector. A year from now, those areas have the best chance of relative alpha, but the five year and twenty-five year number for closed-end funds is more like seven to eight percent a year. So we'd be happy to get seven to eight percent next year because that's normal.

CHUCK JAFFE: John, great stuff, always is. We're going to have another conversation next week as we get through the holidays. I'm looking forward to that already. Meanwhile, Happy New Year. We'll talk to you again next week.

JOHN COLE SCOTT: Thanks Chuck. Thanks for having me on the show and happy holidays to you.

CHUCK JAFFE: That's John Cole Scott, chief investment officer at Closed-End Fund Advisors. Learn more at CEFadvisors.com, CEFdata.com, and follow him on Twitter, where he's @JohnColeScott. He's also the founder and executive chairman of the Active Investment Company Alliance, which brings you The NAVigator in conjunction with Money Life with Chuck Jaffe. I'm Chuck Jaffe, your host, and you can learn more about my show at MoneyLifeShow.com. To learn more about closed-end funds and business-development companies, go to AICAlliance.org, the website for the Active Investment Company Alliance, on Facebook and LinkedIn @AICAlliance. The NAVigator podcast is available every Friday. John Cole Scott will be my guest again next week, we hope to hear from you again then.

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TheNAVigator@AICalliance.org

Click the link below to go to the home page of Active Investment Company Alliance to learn more:
https://AICalliance.org/

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