Closed-End Funds Can Be Their Own Asset Class For Delivering Income

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Chuck Jaffe, in The NAVigator podcast, interviewed Mitch Reiner, chief operating officer at Capital Investment Advisors. Read the Q & A below as Chuck discusses with Mitch why he considers closed-end funds one of six key asset classes for delivering income in an investment portfolio, and why he says the discount structure makes them unique and therefore a necessary element for strategies where income is the primary focus.

Mitch Reiner

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CHUCK JAFFE: Mitch Reiner, chief operating officer at Capital Investment Advisors is here and it's all about the income for him, and it's all about the income for you in closed-end funds today on 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, and of course money managers like my guest today. The NAVigator is looking at all aspects of investing in closed-end funds and business-development companies, and if you're seeking excellence beyond indexing, The NAVigator will point you in the right direction. My guest today is Mitch Reiner, he is chief operating officer at Capital Investment Advisors. If you want more information, their website is YourWealth.com and they're on Twitter @YourWealth. Mitch Reiner, great to chat with you.

MITCH REINER: Chuck, thanks for having me.

CHUCK JAFFE: As I said in one sentence, for you at Capital Investment Advisors, it's all about the income. You literally try to structure everything with an eye towards income, and closed-end funds are a key element of that. Let's start first and talk about the approach, and then I want to get into the use of closed-end funds.

MITCH REINER: The way I usually put it is, income is what we do. We are obsessed with income. It is our unique value proposition. What makes us different about income and the way that we think about income is in two ways. One, the way that we actually manage the money, and choose investments, and build investment portfolios. And two, the way that we communicate to an end client or an end investor about how they should be thinking about their money as it relates to income as opposed to the traditional ways that we have be trained to think about our money. So on the management of the portfolio side, we do it through what we call a multi-asset class income strategy, where we combine six different asset classes; fixed-income, closed-end funds, income commodities like MLPs and royalty trusts, REITs, preferreds and convertibles, and dividend paying stocks. So those are the six asset classes and we dial up and down the allocation across those asset classes based on when those asset classes are under or overvalued. Then we're very strategic inside of each asset class, trying to identify the right opportunities, the right closed-end funds, the right MLPs to own at the right time. Then on the way that we convey this to end families that we work with, is flipping the script really, for the way that we've all been trained to think about our money and looking at 401(k)s and looking at our balances every single day. When you're retired or moving to a retirement zone, you should be thinking about the consistency of the income that I'm going to have coming off of my portfolio, not the value of the portfolio. It's like a rental house. I don't care if my neighbor's house is a hundred and ten thousand dollars or it's ninety thousand dollars, as long as I'm getting ten grand a year off of that property. So it's really about changing the way that we think about our money, and thinking about it more in terms of a pension income stream, versus the traditional way that we've looked at it in our 401(k)s.

CHUCK JAFFE: Well, you said something in there that is very interesting to me. You named six asset classes, one of which of course was closed-end funds. And yet, by themselves, closed-end funds are not an asset class, they're an asset type that can hold virtually any type of asset. So explain why you consider closed-end funds an asset class unto itself. I understand why it would make sense from an income producing standpoint, but since it can hold anything and could overlap with every other, why are closed-end funds so vital in your income strategy?

MITCH REINER: I'm going to answer that in two way. You kind of asked two questions there. The first question is, why do I consider it an asset class? Really, in short, because closed-end funds often act together. Whether or not that is logical or whether or not it makes any sense from an investment standpoint, they just move in tandem together. They are correlated in closed-end funds. Even if it's an emerging market debt fund and an investment grade fund, they just tend to move together. Obviously, your listeners understand it's because of the very retail nature of them, but that's why we think about them as an asset class. Generally closed end funds as an asset class do tend to get over and undervalued, at the same time, all asset classes do. Now this is where it comes into this tactical versus strategic. So if the whole closed-end fund universe is overvalued like we think it is now, then we may dial back that allocation and roll to one of the other five asset classes that allocation. The second question that you had there was, why do we consider it such a critical part of the income stream? It is because of again, what all your listeners are I'm sure familiar with, which is the fact that you can buy assets at a discount. That this fact that they all move together in tandem creates great value in undervalued opportunities that are moving in one direction, despite them actually, their NAVs not needing to move or not moving in that direction. So there's just an amazing amount of arbitrage and opportunity that exists in the closed-end fund market, and provides us a high-yield to balance out that portfolio that we build.

CHUCK JAFFE: We should point out that your firm, Capital Investment Advisors has about 2.9 billion in assets under management. Of which, about two hundred million is in closed-end funds. You mentioned the importance of the discount and everybody knows the importance of the discount, but to you, is there an absolute discount level that you want? Is there a level where if it is too narrow you think it's unbuyable regardless of the assets it holds?

MITCH REINER: No, we believe more in relative discounts. But we did do a study looking at the deciles of all closed-end funds going back twenty years. It is very clear that obviously the absolute level of the discount and not necessarily over an absolute number, but relative to all other discounts that exist in the marketplace, is one of the best predictors of success with closed-ends.

CHUCK JAFFE: As you are looking at products and developments of things now, because obviously what you do, you are looking at what's being created, what's new, how ETFs are being used, how closed-end funds are being used. Do you think that the closed-end fund space is particular innovative and changing right now, perhaps maybe more than some of the other areas that you're looking at?

MITCH REINER: I can't judge whether it's more or less. I would say that the closed-end fund market will continue to play an important role in our ecosystem. Given the nature of the business as it is today, there will always yield opportunities in that market because they trade at a discount and it's relatively an inefficient market due to its size and lack of institutional players in the space.

CHUCK JAFFE: For you, when you are looking at closed-end funds, if you go through those periods where you own things and the discounts are widening, they're getting deeper. Because you are looking at assets for their income, you presumably don't worry about, "Wow, that discount got significantly wider," do you? That's not really your concern, is it?

MITCH REINER: That is true, however as a fee-only RIA firm, it is in our very best interest to invest in a manner that maintains, grows, and doesn't lose our clients assets in their portfolios. So as I mentioned strategically inside the closed-end fund bucket, I'm going to look for the best opportunities that exist out there. So if something is deepening, if their discount is deepening while another one of my closed-end funds has a narrow discount relative to its historical levels, we are certainly going to make a change and look for a better value and a better deal within the marketplace. Assuming -- this is where I get strategic inside, assuming that the asset class is one that we're comfortable with.

CHUCK JAFFE: Mitch, really interesting stuff. I have more questions but not more time, so hopefully you'll come back and visit with us again on The NAVigator in the future.

MITCH REINER: Thanks for your time.

CHUCK JAFFE: Mitch Reiner is chief operating officer at Capital Investment Advisors. You can learn more about the firm and its income-driven strategies at YourWealth.com, on Twitter also @YourWealth. The NAVigator is a joint production of the Active Investment

Company Alliance and Money Life with Chuck Jaffe. I'm your host Chuck Jaffe 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. They're on Facebook and LinkedIn @AICAlliance, and The NAVigator podcast is available every Friday. For the AICA, I'm Chuck Jaffe. Thanks so much for joining us, we look forward to talking with you again next week.

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