Shaker: Don't Trade Closed-End Funds On Days When The Market Is In Turmoil

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Chuck Jaffe, in The NAVigator podcast, interviewed Rob Shaker, portfolio manager at Shaker Financial. Read the Q & A below as Rob shares that the current market has been hard on closed-end funds because closed-end instruments suffer any time there is fear-based selling. He warns against trading any time CNBC carries a graphic saying 'Markets in Turmoil'. Yet, he adds, troubling times also make closed-end funds compelling values once long-term investors are comfortable that the market has stabilized, and talks about whether that time is now.

Rob Shaker

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CHUCK JAFFE: Rob Shaker, portfolio manager for Shaker Financial is here and we're talking closed-end funds in this crazy mixed-up market today in The NAVigator. Welcome to The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator is brought to you by the Active Investment Company Alliance, a unique industry organization that represents all facets of the closed-end fund industry, from users and investors to fund sponsors and creators. If you're looking for excellence beyond indexing, The NAVigator is going to point you in the right direct. Today we are pointing you in the direction of Rob Shaker, portfolio manager for Shaker Financial. If you want to learn more about him and the firm, it's ShakerFinancial.com. If you are a fan of The NAVigator, you know that we talked with Rob last back in November when the Active Investment Company Alliance was having a closed-end fund conference. By the way, if you want to find out what the Alliance does, and find out about their next conference, which I think they're hoping to hold assuming everybody's allowed to be out and about as we get into the summer, you go to AICAlliance.org. But we're dealing with very different market conditions now, so I'm very pleased to say Rob Shaker, great to get a chance to chat with you again.

ROB SHAKER: Yeah, you too.

CHUCK JAFFE: We were talking in November at the Active Investment Company Alliance Conference, life then was very different than it is right now. Now we are talking about the gaps, the discounts are wide and the dividends and yields are so huge that I think a lot of folks aren't particularly trusting of the closed-end fund space right now. You, of course, are looking at it going, "It's all about the discount. Let's try to find the right things." How much is this buyers paradise? How much of this is buyer trap?

ROB SHAKER: Well, you raise a good point, and discounts have been pushed around. It's funny because we actually talked about this even when things were stable back at the conference. One of the things we discussed on the panel, and one of the things I told the people there, there are days in which you do not want to sell closed-end funds. And those typically are days in which CNBC has a special on called *Markets in Turmoil*. Because if they are selling things in the general markets and if you have a fear-based selling period, closed-end funds will widen. As we you know we are, at Shaker Financial, all about purchasing at attractive discounts and then rotating out when discounts are no longer attractive. You did wind up in a situation this time, that when the selling really hit hard last week, you had discounts widen very dramatically.

CHUCK JAFFE: That being the case, you've got wide discounts right now, you don't want to buy when the market's in turmoil. But the market's in turmoil right now no matter which direction it's going. Nobody complains when the volatility works in your favor, right? Nobody's like, "Oh man, we gained a thousand points. That's too much." They only complain when it works against you, but these are still markets in turmoil, so can you be buying and investing in closed-end funds even if it's good news?

ROB SHAKER: Yeah, you raise a really good point. Because there really is no reason to believe that we'll all of a sudden get to some sort of peak stability here, because the uncertainty in the overall market is just what it is. The coronavirus is something new, people are trying to price the thing, so you will have uncertainty. We all know markets hate uncertainty. But I think the important thing here is to drill down for a second, if you'll let me, and explain what happens when you have this type of what we call a 'generic widening' across the board of closed-end funds. Closed-end funds typically move about, everyone's trading at their individualized discounts, some move, some don't. Then all of a sudden you'll just have what we call a generic widening where everybody widens. The important thing to know about these is you can look at them in three stages. At the basic level you have the first stage, which is excessive selling pressures appear, typically because of a fear-based panic of some kind. Which is why I sort of tie it to the *Markets in Turmoil* episode on CNBC. But stage one is excessive selling pressures. Stage two is stabilization of those selling pressures. Then stage three, a very nice stage, is when the selling pressures are no longer there, you are at an equilibrium. Then all of a sudden people come in and swoop up these bargains, and they are bargains. So as a person who's sort of on the outside trying to figure out, "Can I get in? Can I get out?" The real key here is those excessive selling pressures. Everything else is going to take care of itself, but it's about the excessive selling pressures.

CHUCK JAFFE: As you look forward, it sounds like if you can ignore the selling pressures, if you have a long enough timeframe -- I hate to use phrases like back up the truck -- but we're not going to see this kind of buying opportunity, judging from discounts, for a long time again. If you go back the last six months, discounts were fairly stable. And in the bond space they were close to zero until the market started to fall off in the middle of February. Now, double-digit discounts and you're getting assets on the cheap. So it's not that proverbial value trap, catch a falling knife kind of thing?

ROB SHAKER: We're long-term investors. We believe in taking a long-term investment approach. We do not try and even time these that much in terms of when we're getting in and when we're getting out. We're trying to do the best that we can to limit the impact on our clients when they widen, and then on the way back, try and double collect. Because if you can get into a fund that recovers, sell it, rotate back into a new fund that hasn't recovered yet. You can actually sort of double up, and the recovery treats you a lot better than you were punished on the way down. That being said, it's all about the excessive selling pressures. When those stop, it can be a pretty dramatic jump up. So in terms of, is this the time to back up the truck? Well, unfortunately that was Monday night. After the huge selloff on Monday, you really had discounts, how we tracked them, they sort of widened about twenty percent, twenty discount points. We've gotten about ten or fifteen of those back just over the last two, three days. Once the selling pressures cease and the buyers come in, it can move fast. It's one of those things that makes it, not unlike the market itself, but it's very hard to market time. It's somewhat hard to discount time overall, but you can see it when the selling pressures stop. So that's really what you're looking for. In talking with our clients we like to point out that we need two days of equilibrium stabilization before we really feel the selling pressures have at least paused enough that we can start rotating into those we think will do better on the upside.

CHUCK JAFFE: That also means that you're going to be careful and maybe waiting to see more stabilization if we wind up with other legs down. Because while we're sitting here wondering have we maybe seen the worst, the market can dish out a lot, and there may still be other bad news to come.

ROB SHAKER: Right, and at core level, where do these selling pressures come from? They come from forced liquidation. And forced liquidations are probably going to occur from one of two main ways, the way we track them, to take one quick step back. Forced liquidations are the problem. It's when somebody comes into the market, and you saw this very dramatically Monday morning if anyone was watching closely in the closed-end fund space, you see people come in and they will sell. They're apparently forced to sell because they're selling at ridiculous valuation. They're selling an investment grade bond fund down fifteen percent on a flat market. You'll just see these uniquely irrational traits. So where do these forced liquidations come from? We sort of track them and believe they come from two main sources. One, margin calls, so you'll see a lot of pressure during these downswings in the market around 10:00 to 10:30 and 2:00 to 2:30. But then the other is just simply account closures, liquidations. Someone calls their investment advisor and says -- obviously this happened a lot over the weekend past -- people called in and said, "I want out of these closed-end funds," so they dumped them all in the morning. That can come back. You're never free and clear from there. Just like you're never free and clear from them even during normal times. These can come in, and they will come in from time to time. So yes, you do still have to be careful about those. That's sort of what you're looking at and thinking about. You can monitor the closed-end fund space to see. Take a random selection of things. I like to sometimes look at the PIMCO fund. On the bond side, they seem to be a good indicator for anyone who is just trying to see how are closed-end funds doing on a day-to-day basis. Pull up a couple of the bond funds from PIMCO. If they're outperforming what you think they should be, that probably means closed-end funds as a whole are. Then you can sort of navigate yourself through these periods.

CHUCK JAFFE: Rob, great stuff. Thanks so much for taking the time out. I look forward to our next conversation down the line.

ROB SHAKER: I do too. Hopefully at a conference sometime soon. Be safe and healthy.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. I am Chuck Jaffe, your host. You can learn more about my work and 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. Thanks to my guest Rob Shaker, portfolio manager at Shaker Financial, which is online at ShakerFinancial.com. The NAVigator podcast is available every Friday, please subscribe where you find it. And everybody, be safe, we'll talk to you again next week.

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