CEF Advisors' Scott: Discounts Have Narrowed But Bargains Remain

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Chuck Jaffe, in The NAVigator podcast, interviewed John Cole Scott, chief investment officer at Closed-End Fund Advisors and the executive chairman of the Active Investment Company Alliance. Read the Q & A below as John says that while discounts have narrowed as the stock market has rebounded from its March lows, many closed-end funds and business-development companies remain attractive with prices well below historic norms. John offers four closed-end funds and one BDC to consider as attractive examples now.


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, founder of the Active Investment Company Alliance is here, and we're talking about the discount picture in closed-end funds and where you can go bargain hunting. That's today on The NAVigator. This is 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. And if you're looking for excellence beyond indexing, The NAVigator is going to point you in the right direction. Joining me again today, it's John Cole Scott. He's chief investment officer at Closed-End Fund Advisors in

Richmond, Virginia, and he's also the founder and executive chairman of the AICA. If you want to get more information, go to CEFadvisors.com or CEFdata.com to learn about his day-to-day business and to check your closed-end funds against his data. And of course to learn more about closed-end funds in general, go to AICAlliance.org, the website for the Active Investment Company Alliance. John Cole Scott's on Twitter @JohnColeScott, but right now he's on The NAVigator. John, great to chat with you again.

JOHN COLE SCOTT: So great to be here again, Chuck.

CHUCK JAFFE: The market has created this amazing discount picture where we had the big drop-off and discounts widened dramatically, now we've had a snapback rally. As you are looking at the discount picture right now, is it jump in and go? Or is it jump in and you catch a falling knife?

JOHN COLE SCOTT: Yeah, so remember the discount picture is two things. It's where are NAVs, because NAVs are the anchoring point for any discount number for closed-end funds. And then where are we historically, and then where are we versus the last really big carnage period, 2008? And so the average closed-end fund ended yesterday right around a seven discount, which is nowhere near the twenty-one and a half discount we saw on March 18th. But the net asset values are still down on a three-month basis at about eighteen or nineteen percent, so we've definitely seen discount narrowing tremendously from the lows. But if we go back to the financial crisis, we saw the discounts bottomed out on October 10th, rallied up basically twenty percent, then widened back out about fifteen percent and then narrowed. It didn't get as wide, but the NAVs hadn't stabilized yet. So when we get some fear in the market again, those are some great days to buy, but we are still insanely attractive on a two or three year trajectory.

CHUCK JAFFE: This discount picture relative to history, is this the kind of behavior we saw when the internet bubble burst in 2000? In the financial crisis of 2008 when Lehman Brothers went down? What does this remind you of? Is history here rhyming here with anything in the past?

JOHN COLE SCOTT: It is. So where discounts ended on April 9th will be considered a bottom of regular periods. But the carnage periods, we were lower in December of '18. We were lower in '15-16, those were ten to fifteen discounts that were happening. And like I said, we had fifteen to twenty discounts about ten different days in the financial crisis for a period of time. So there's still a likelihood in our opinion at Closed-End Fund Advisors, that we'll have wider discounts before we're through the woods. But we don't know that to be true, we just think that to be true. Just like if I was on your show six weeks ago, I'd have a very different perspective on markets.

CHUCK JAFFE: What are the areas where the discounts right now are most appealing and most actionable?

JOHN COLE SCOTT: So we go back to trying to think about diversified portfolio. I don't know your audience because I don't work with them as my clients, but areas that we like the asset allocation, like we think it's a good story for the economic backdrop and we find some quality managers with some good entry points, would be in the muni bond space because taxes aren't going up. That's an area where an active manager can do some great work. One of the funds that we think is attractive in the current environment is a Nuveen fund, it's NZF. At about a six discount, 5.3 yield, it's down on the year, but it's still, I think, a place to add some quality dividends. Even though I'll chime in, dividends in the last two months, so March and April, if you look at our big index of eighty-four funds to kind of keep it normalized, about fifteen percent of funds have cut their dividends since the start of that. We expect fifty percent, maybe a touch more, of dividend cuts, because interest rates are down, the economic cycle's weaker. You have to get income from somewhere, and it's going to harder the next year than it was the previous year. But it doesn't mean there's going to be no income, and we can overcome with the discounts and with an active manager.

CHUCK JAFFE: Where are we going beyond the muni space?

JOHN COLE SCOTT: I've been on your show a handful of times, I've been advocating the senior loan sector for a long time because it's the highest capital structure, they're still a high-yieldy type investment. Eaton Vance has a fund, it's EVF, that's trading right now at about a twelve discount, which again is pretty wide, and a yield 7.2. And again, it's one of the ones where I think it can really allow you to gain control of fixed-income and recurring cashflow. It's basically fully taxable income, so it's not great if you're the highest tax bracket in New York and California, but it's a good place to let a manager own investments that sit higher than any other loan at a company.

CHUCK JAFFE: We've covered a couple of sectors, do we want to move from munis and senior bank loans to something else?

JOHN COLE SCOTT: Real estate, in some ways people are fearful about real estate because of the hit to retail and other areas, like I've been paying rent at my office and I've not seen it for more than fifteen minutes in over a month. But there's a quality manager in the space, Cohen & Steers, they have a really old school real estate and REIT fund, RQI. It's coming in at a twelve and a half discount and a nine and low change yield, eight points wider than its three-year average. So my questions is, I don't know where the bottoms ever are, or the tops, but if you could pick a good manager, and you get a good discount, and you can ride through it, I feel like Cohen & Steers, people have heard of them, could navigate whatever the future is. Not perfectly, but well.

CHUCK JAFFE: We've got time for one more, John.

JOHN COLE SCOTT: So for this one I'm going to go after an area that has been painful. Because if you go back to closed-end funds, if you can marry an income investor with a contrarian investor and one that can step into blood in the streets and pick a winner in that space, you are in generally good shape. So if you can believe it, I'm going to actually talk about an MLP fund. MLPs have been thrashed in the energy and they've been delivered. They've had dividend cuts. They've had liquidation. They're having reverse splits to salvage the funds. But First Trust has a fund, FEI, that is large enough and it actually had an option strategy in the portfolio which helped temper the downside. It still got hurt badly, it's at a seventeen discount, the yield is implied at twenty-four. I expect that to come down thirty to forty percent, maybe even fifty. But if you do that math, it's a twelve yield at a seventeen discount, and I believe that there will be a better experience eventually than we've felt this year. Obviously it's a very volatile sector and I'd be careful there, but if you're going to pick a spot, that's one I would suggest looking at.

CHUCK JAFFE: I want to jump in quickly. Eric Boughton from Matisse Capital was on the show, and he was talking about MLPs and kind of the destruction of that space as you alluded to. One of the things that he said, was that he believes that there's going to be some MLP funds where if you held them through the worst of it you're going to be crushed, there's not necessarily a recovery coming. But if you didn't hold them and you're buying them now, congratulations, you just found your pennies.

JOHN COLE SCOTT: It is. We can get back to dividend or principal values that we saw three months ago, I agree with him. But like I said, this is one that handled this the best. It's got a lower beta than any other MLP fund in the sector, and they've had that option strategy helping to handle the downside in a way other funds didn't. And that's been baked into the portfolio for years.

CHUCK JAFFE: One more in the very limited time we've got. BDCs, business-development companies, it's that other side, that other aspect of the closed-end fund world that you deal with at AIC Alliance, that we deal with on The NAVigator, they got hammered as well. Are they are a similar situation to MLPs? You might not have loved owning them before, but you might want to buy them now? Or where are BDCs in your estimation?

JOHN COLE SCOTT: So right now BDCs are up thirty percent in a week, but they're still down tremendously year to date. The largest in the listed sector, and one that got through the '08 crisis, is Ares, ARCC. It's still at a twenty-four and change discount. It's implying a twelve and change yield. It would be reasonable to think that that yield could be clipped a little bit. But if you think about the BDC structure, they work with small businesses, they help them through problems, some will be written off, some will die. We don't know the future. You want a flexible manager with financial resources, and I can't think of a BDC that if you're not going to be picking your spots actively like we do for our clients, that you could have a better place for a small part of your income portfolio.

CHUCK JAFFE: John, great stuff as always. Thanks for joining us. Stay safe, we'll talk to you again soon.

JOHN COLE SCOTT: Always great to be here, Chuck. And remember, these are not recommendations, they're just tools for research.

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 John Cole Scott, the founder and executive chairman of the AICA. He's chief investment officer at Closed-End Fund Advisors in Richmond, Virginia. His firm is online at CEFadvisors.com and CEFdata.com, and he's on Twitter @JohnColeScott. The NAVigator podcast is available every Friday, please subscribe on your favorite podcast platform. We'll see you next week everybody, stay safe.

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