Despite Liquidity Concerns, Non-Listed Interval Funds Can Be An Attractive Choice

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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 of the Active Investment Company Alliance. Read the Q & A below as John and Chuck compare traits, characteristics, and results of closed-end funds with non-listed interval funds offered by the same management company. The analysis – which you can request by writing to TheNAVigator@AICAlliance.org – shows that while interval funds raise some liquidity concerns, they also can create a performance edge in certain market conditions.

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 comparing the performance of listed closed-end funds with their non-listed interval fund siblings. That's today on 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, which is 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 will point you in the right direction. Joining me again today, John Cole Scott, who not only runs the Active Investment Company Alliance, but who is chief investment officer at Closed-End Fund Advisors in Richmond, Virginia. Which has helpful research tools online for your to use at CEFdata.com. You can learn more about the firm at CEFadvisors.com, about the Alliance at AICAlliance.org, and you can follow John on Twitter @JohnColeScott. John Cole Scott, great to have you back on The NAVigator.

JOHN COLE SCOTT: Always good to be here, Chuck.

CHUCK JAFFE: Today we're going to talk about listed and non-listed closed-end funds. Or maybe I should say listed closed-end funds versus non-listed interval funds. It's a subject we've talked about a little bit before, but today I think you and I are going to be able to put some meat on the bones. So first a quick refresher, help my audience understand. A listed closed-end fund, they're familiar with that, that's what they think of generally. But explain what a non-listed interval fund is, how it works, and maybe why you want to consider that as an alternative to your closed-end funds.

JOHN COLE SCOTT: Sure. So the interval fund structure is kind of an adaptation of the traditional closed-end fund structure. As in managers can be active and focused on less liquid investments. You may understand that the ETF and open-end fund rules require less than 15% of the portfolio's assets to be seven days liquidity or less. So you need to have liquidity in those two types of funds. And traditional closed-end funds don't have that issue, but they have that market price. Which has discounts and premiums which are good or bad, depends on the direction of the current you're in. So when fund sponsors wanted to add another type of alternative less liquid investment structure, they kind of migrated the open-end fund daily inflow, so you can buy it every day. Manager can buy stocks or bonds. There's a lot more credit funds than equity funds. And then they're able to offer liquidity periods quarterly, the most common is 5% a quarter. There's a small risk that you may not get your shares redeemed that quarter. We just did some redemptions to rotate out of some interval funds for our clients, into some listed closed-end funds at discounts. And we got all the shares we timed there, so that wasn't an issue for us. But that's the main difference, is the ability to inflow daily. There's no listing, so it's a less volatile experience. And then you still have the ability to have very large buckets of less liquid investments, and often more than even in listed closed-end funds.

CHUCK JAFFE: Well this is where we're about to put a little bit more meat on the bone. Because one of the things that happens that I've noticed, is you've got a number of situations in the industry where you've got a fund company, a fund sponsor, and they have one of each in the same space. In other words, they've got a listed closed-end fund and then they kind of have the non-listed fund in the same space. Help us understand, I've got one from column A or one from column B, how is the performance difference? What's the difference in yields or leverage or costs, or whatever it might be that is going to help me to decide, "Do I want the listed option from a company? Or do I want the non-listed option?"

JOHN COLE SCOTT: Great. There's four credit managers that have a lot of experience with listed closed-end funds. There's PIMCO, there's Ares, there's GSO Blackstone, and of course BlackRock. And they also have a non-listed interval closed-end fund. We're going to make this data available to the listeners of our podcast on our website and to email us. But basically there's less leverage traditionally in the interval fund, about 24% on average versus 39% for the listed. We do see lower yield, about 7.3 versus 11 and change. One of the reasons we think that happens is again partially less leverage, and then partially the dividends are truly the dividends. There's no reason to overpay because of discount fears in the interval fund. So both ratios are honestly very similar, slightly less for interval funds by about 50-basis points. The volatility of the interval funds is about 22% less than their traditional listed peers. And that's the volatility of the NAV, not even the volatility of the market price, which are generally higher for listed funds and their NAVs. And that's both standard deviation and for beta. We looked at how the funds performed year to date through April 20th, a sense in this rough market we've had, and the average difference for the interval fund was an outperformance of 5.7% versus the NAV performance of their listed funds. And then going back even further, a one-year look back, was a 10% out performance for the interval fund versus the listed funds. Now again, a couple of caveats, every fund is a little bit different. And of course listed funds have a market price, and when discounts widen, you'll underperform. Which would have been worse in this case. But when discounts narrow, those funds should generally out perform their non-listed peers.

CHUCK JAFFE: And it's a case where, because you're basically in the same asset class. You wouldn't say, "Let me split my money between the PIMCO Flexible Credit Income Fund," for example, the listed one, "and the PIMCO Dynamic Credit and Mortgage Income Fund." Its non-listed sister. You would just say, "I want one or the other. That gets me the space." It's really which vehicle I want that's going to drive the decision. Correct?

JOHN COLE SCOTT: It is. When PCI, the PIMCO listed fund, went to a premium of over I think 5 or 6%, we sold it for our clients and put that money last year in the PFLEX, the interval fund. And then when discounts blew out in March, the next 90-day redemption window, we actually redeemed the shares of PFLEX, and then reallocated into listed closed-end funds at wider discounts. It can't be done daily. I had to wait 60 days from the desire to get the cash. But that is one way to rotate if you like to stay in the same manager and the same sector.

CHUCK JAFFE: And that's one of the other things here that I think is important. Because when we talk about that timing, when we say non-listed interval funds, they have ticker symbols. For the audience out there who's listening to The NAVigator, and by the way, if you want the research that John was talking about that shows these pairs, send an email to TheNAVigator@AICAlliance.org. Send it, request the chart, and he will send it to you. But when you look, it's actionable because there are ticker symbols. They are listed. It's called not listed, it's more like not traded every day funds versus traded every minute funds. Right?

JOHN COLE SCOTT: Well, just like open-end funds aren't listed, you inflow daily and it can outflow daily. Because interval funds don't outflow daily, the SEC requires them to be called closed-ended management companies. And because they are actively managed, they generally employ leverage, and they have a lot of that illiquid stuff akin to traditional closed-end funds. They're great related cousins.

CHUCK JAFFE: Yes. But again, for somebody who's going, "Where would I find out about this?" I like the things you said about non-listed funds. Like I said, for each of the pairs that we have, but for anytime we're going to look at an interval fund that's not listed, it's got a ticker. So sometimes people think, "Well, if it's got a ticker, it must be listed." And it is listed, it's an SEC jargon kind of thing.

JOHN COLE SCOTT: And again, we do have a public profile page on AICAlliance.org, with a screener for non-listed closed-end funds. We power that with CEFdata, so that there is some information available on every non-listed closed-end fund or BDC for people on that website. We thought that was very important when we launched AICA last year.

CHUCK JAFFE: And that's what we're trying to do. We're trying to make sure that people understand that here's an option for you. It has different characteristics. John, thanks so much for taking the time to help us understand how it works. We always like chatting with you. Please stay safe, we'll talk to you again soon.

JOHN COLE SCOTT: Thank you so much, Chuck.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. I'm Chuck Jaffe, your host, and 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, and you can get the research John Cole Scott was talking about by writing TheNAVigator@AICAlliance.org. Thanks to John Cole Scott, AICA's founder and chief investment officer at Closed-End Fund Advisors. He's on Twitter @JohnColeScott. The firm's online at CEFadvisors.com, and you can use his research tools at CEFdata. The NAVigator will be back for you next Friday. Stay safe everybody.

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