Rob Shaker: Tax-Loss Selling Should Spur Closed-End Buying For The Holidays

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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 says that the tax-loss selling season for closed-end funds should be particularly interesting in 2020, given the volatility funds saw throughout the year. That said, he anticipates that discounts will widen in December, making a good opportunity in closed-end issues look even better by mid-month, with the expectation of a January effect that will narrow the discounts back again in favor of investors.

Rob Shaker

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

CHUCK JAFFE: Rob Shaker, portfolio manager at Shaker Financial is here to talk discounts and tax-loss selling in closed-end funds now 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's 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's going to point you in the right direction. Joining me today, Rob Shaker, portfolio manager at Shaker Financial. And if you want to learn more about the firm, you just need to know the name, it's ShakerFinancial.com. If you want to learn more about closed-end funds and investing in them, check out the Active Investment Company Alliance website at AICAlliance.org. Rob Shaker, great to have you back on The NAVigator.

ROB SHAKER: Oh thanks, great to be here.

CHUCK JAFFE: When last we spoke it was the end of March, right there as the market was bottoming out, discounts in closed-end funds had gotten as wide as they had been in ages and you were like, "This looks good to me," because you are very much driven by discounts. So now we've seen closed-end funds have a big recovery, we've seen discounts narrow, so where are you in terms of how attractive closed-end funds are right now?

ROB SHAKER: Closed-end funds have had a great bounce back. They're still a little bit depressed from the earlier year levels, maybe about three or four discount points, but that's sort of to be expected as we enter into tax-loss selling season. It's a different time than when we were talking last time because that was more of an unexpected general widening, and now we enter into what is the most predictable general widening each year, which comes with tax-loss selling.

CHUCK JAFFE: Explain why tax-loss selling is such a phenomenon in closed-end funds, where it's not necessarily in open-end funds or a lot of other types of investments. It is particularly a thing that you need to understand whether you do it or not, your funds are going to experience it.

ROB SHAKER: That's a great point, and it's great to counterpose it to ETFs or open-ended funds, because in those situations selling pressures have a different outcome. What is tax-loss selling really about? And that is for a period of time due to the way that taxes work in terms of only the realized gains are going to be reported, and the realized losses, you'll have people go out and sell, and sell, and sell any loser that they can so you can get those realized losses on the book. So you increase selling pressures. Now what does that mean for these diversified companies? For an open-end fund, that means they're going to have to do some redemptions, that might cause a little bit of extra negativity but not much. An ETF, it's just going to be a sell. They'll lose things but they'll still trade, SPY will still trade alongside the market. With closed-end funds, because they have a fixed-capital structure, what happens when you have increased selling pressures is you get generic widening. The price can go down much further than is rational, especially if it is a thinly traded company. And so what you'll find is, with closed-end funds you have an additive effect to the negative side of a generic widening when you have increased selling pressures.

CHUCK JAFFE: Given the action that we've had this year, the massive decline that we saw at the beginning of the year, but the big bounce back, what's your expectation for how active a tax-loss season we're going to have? Is this going to be one that is particularly frothy from a tax-loss selling perspective, and in terms of how that's going to affect our funds?

ROB SHAKER: It's a real interesting one, and there's a couple of things looking at this year in particular that's going to make it a little bit harder to gauge particularly when things should bounce around. Every tax-loss season is a little bit different, and there's always some things going in where, how much gains have you had, are closed-end funds doing better than other places? It always is a little bit different and you sort of have to weather it through, but generally you still have the same type of pattern. Which is you'll increased selling pressures as you go down into the end of December, and then you'll have a bounce back in this big thing called the January effect, coming out in January. This year it's very hard to know who is sitting with capital gains and who's not. If you sold out and panicked in March, and sold it all as losses and then bought back in later on, you're sitting on so much losses you won't have to tax-loss sell. But almost the beauty - or negativity of the tax-loss selling is there's always somebody out there. There's always somebody who can use the tax-loss, so you almost see it every year. I like to make an analogy about it in terms of how this works out, which is if you can imagine a bunch of balloons in a box. These balloons are the discounts, and there's different funds and each balloon is weighing where it's supposed to be. But you take this box of balloons, and then you slowly put selling pressure on it by taking a lid and pushing those balloons down, and pushing those balloons down. What will happen is the balloons will always be a little lower, you'll get this generic widening int he discount. Then on January second all that selling pressure goes away and there's no longer any benefit to sell, so the lid comes off and boom, all the balloons come back up to where they would normally be and you get this thing called the January effect and this generic narrowing across the board which acts as a nice tailwind to closed-end funds.

CHUCK JAFFE: We know that the January effect in closed-end funds is a little bit more predictable than it is in stocks when we also expect a January effect, but does that also mean that somebody late in the year wants to be a little more circumspect about their timing?

Because in traditional mutual funds, you want to be careful not to buy a fund right before it makes its capital gains distribution because otherwise you're just buying a tax bill. So you might tell somebody, "Hey, if you're ready to buy, you hold off until you see what the fund is going to distribute." With a closed-end fund, you don't necessarily have to worry about that, but what you're thinking might be, "Hey, I could buy now, or I could wait till we get to the last week of the year and buy when all those balloons are being pushed down. Maybe the discount has widened a little bit, aren't I getting an extra bargain?" So at this point, are you shutting down your buying and waiting for discounts to widen at the end of the year to capture the January effect?

ROB SHAKER: Yes. It's very hard, if you really were tracking it you might be able to decide, okay, certain years it's December 17th where you really start getting the bounce back. Typically it is that last week, just to be on the safer side of things you'll be looking for your bargains the last week of December. We've already started this, and what we do is we're trying to position ourselves into two things. We're either going to rotate into closed-end funds that we think are pretty safe from potential tax-loss selling. Funds that have a nice overall annual return, year-to-date, that haven't had huge distributions or are expecting huge distributions which will then make them tax-loss candidates, or ones that have large declines already built in. Also it's the one time of year in which we rotate somewhat into some ETFs, SPY or something, in order to maintain our balance and our equity exposure without any risk of further widening. Then as we enter into - and as I said, it might be a little bit earlier - but generally you can think of it as the last week of December, once we get into December we will liquidate any ETFs we have, we will rotate into the ones that have been most damaged and sold down. And to the extent that we utilize margin in our margin account, we will typically be at our maximum margin at December 31st.

CHUCK JAFFE: Rob, really interesting stuff, thanks so much for joining me to talk about it. I look forward to chatting with you again on The NAVigator down the line.

ROB SHAKER: Thanks, been a pleasure being here.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. I am Chuck Jaffe and you can check out my show on your favorite podcast app or at MoneyLifeShow.com. To learn more about tax-loss selling, closed-end funds, interval 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, learn more about him and the firm at ShakerFinancial.com. The NAVigator podcast is available every Friday, please subscribe on your favorite podcast app and join us again next week to learn more about investing with closed-end funds. Until then, stay safe everybody and have a great holiday.

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