NAVigator Bonus: Look Beyond Yield And Discount In Picking Closed-End Funds

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Chuck Jaffe, in The NAVigator podcast interviewed Maury Fertig, chief investment officer at Relative Value Partners. Read the Q & A below as Maury discusses the factors he considers when picking closed-end funds to add to client portfolios, and how those criteria are impacted by current market conditions that have seen closed-end issues get whipsawed by the market over the last year. Fertig appeared on The NAVigator last week, but this appearance in the Money Life Market Call serves as a special bonus episode/follow-up with much more of his closed-end fund insight.

Maury Fertig

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

CHUCK JAFFE: Hi, it's Chuck Jaffe, host of The NAVigator podcast from the Active Investment Company Alliance. On Friday we brought you Maury Fertig from Relative Value Partners, but I mentioned that he was also going to be a guest on my show Money Life in a segment we call the Money Life Market Call. It's all about picking individual investments and building portfolios, and because Maury does that with closed-end funds, we didn't want you to miss it. So here's that Market Call interview as a bonus edition of The NAVigator, we hope you enjoy it. Maury Fertig, chief investment officer at Relative Value Partners is here, and we're talking investing in closed-end funds now in the Money Life Market Call. Welcome to the Market Call, the part of the show where we talk with experienced money managers about how they do their job. And yes, back to talk a little bit more about closed-end funds is Maury Fertig, he is chief investment officer at Relative Value Partners, and if you want to learn more about the firm, RVPLLC.com, the website that will get you there for more information. Now if you listen to the show, well you know that we don't normally have guests do multiple segments. But we don't get that many guests who talk closed-end funds in the Market Call and I particularly wanted to do it, but then I also wanted to talk with Maury about closed-end funds so that's why we put him in The NAVigator segment as well. So you get a second helping but it's well worth it. Maury Fertig, great to have you back on Money Life.

MAURY FERTIG: Good to be here, thank you.

CHUCK JAFFE: So we always talk about methodology because buy, sells, and holds are meaningless if somebody doesn't know where you're coming from. And it's not that you just of course use closed-end funds, it's that you look for very specific things. So help us understand what those are.

MAURY FERTIG: Well I think the first thing you have to look for is how does a closed-end fund meet a certain objective, an investment objective? Whether it's in fixed-income, equities, or in some specific asset class within those categories. That's the first thing. So you don't just buy closed-end funds just because it's at a discount and has a nice yield, it has to meet some other investment criteria that you're trying to—. If you have fixed-income money for example, and you have money that you might allocate towards leverage loans because they're floating-rate assets and you're concerned about interest rates rising in an improving economy, there's a couple ETF ideas out there, there's some mutual funds. But you might want to look at closed-end funds in that situation because there might be a more attractive way of owning that asset. So that's really the first thing. Then you want to look at how's this asset performed? Has the manager performed well in different environments? You would also want to look at if the fees are reasonable. You also want to look at the discount, where has it been historically? Where is it in relation to that historical relationship, is it at a premium? And then also just be mindful if the fund has leverage, that can magnify the returns in both directions. So those are some of the broader criteria that we use when evaluating closed-end funds and I think your listeners should be aware of.

CHUCK JAFFE: Yeah, I want to jump on one of those things. Because so often when people talk to me about closed-end funds, what they're really looking for is yield and discount, and that's the entire decision-making process. "It's the type of assets that I want, it's good yield at a nice discount. That'll do it." Explain the trap that that can set. I mean, it doesn't always set it but that it can set for investors.

MAURY FERTIG: There are some funds that are paying out more than they earn, so they have what they call a managed distribution, and this is essentially a return of some of the capital. If the fund's trading at a deep discount and it's returning some capital, that's not necessarily a bad thing because the fund is sort of self-liquidating over time and you're getting more of your money back. The traps really are funds that perpetually trade at a deep discount, it may be because of the underlying performance has historically been very poor. It may be because it's a manager maybe charging 2% for fixed-income investments. So there's things like that that sometimes can explain why certain funds trade at a discount. The biggest reason a fund can trade at a discount is the asset class has been out of favor, investors sold the asset class very hard and it's really finding a new group of investors to be attracted to that particular asset class.

CHUCK JAFFE: It has been a fascinating last 12 months. I mean, last year entering into the fast, deep, bear market that we had that started virtually a year ago this week. Well, closed-end funds were already showing narrowing discounts then they got hammered, then they climbed a lot of the way back. So how do you see the closed-end landscape right now?

MAURY FERTIG: Well we started the year where closed-end funds were at about their 75th percentile based on the last 25 years, meaning 75% of the time they actually trade richer as an asset class just purely on the discount. Now we're somewhere between 65-70%, so we're still historically cheaper than where they've been, and there are periods of time where believe it or not they're going to trade richer than they've been going back several years. Particularly like 2012, 2013, it was hard to find fixed-income funds of any kind that were trading at a discount. So with this hunt for yield going on, provided we don't dramatically move up sharply in rates in the near-term, I think this hunt for yield will continue this year and you might see a gradual tightening very similar to the one we saw in 2019.

CHUCK JAFFE: So what areas does that specifically drive you to in terms of your investing? What are the places where you're adding, what are the places that you're either holding steady or pulling back from?

MAURY FERTIG: The areas where we're holding steady would be the long levered muni funds, which have very long duration. They have very nice yields still because they use leverage and they can pay 4% tax free, but now they're trading at discounts of 5-7% and the underlying has a fair amount of interest rate risk. So we're kind of holding those, we're not buying them or selling them right now, but I just exercise caution in terms of putting new dollars there. In particular we like floating-rate funds which are levered loan funds which are very sensitive to the economy. But if we're going to have higher rates it's going to be because the economy is growing, credit markets do well, so we're comfortable holding those here and there's many funds still trading at discounts of around 10%. We also like some equity funds, particularly things that have a covered call nature or a convertible bond nature that are still trading at historically attractive discounts.

CHUCK JAFFE: What's a poster child or two for the methodology? What is a closed-end fund right now that stands out to you as kind of being in the sweet spot?

MAURY FERTIG: We really like FRA is the ticker, it's the BlackRock Floating Rate Income Strategies Fund. It's trading at around 10% discount. It's all leveraged loan funds. It yields around 6.25% and it floats. So we think this is the kind of fund in an economic recovery, the net asset value will be stable, they employ leverage, and there were periods of time back in 2012, 2013 a fund like this actually traded at a premium. So we think a fund like this is a very good fund for 2021 and particularly how the economic environment is shaping up.

CHUCK JAFFE: So that's ticker symbol FRA. What's something outside of that space elsewhere in the closed-end space?

MAURY FERTIG: I'll give you one other bond fund that's interesting and it's sort of under the radar screen, it's Vertical Capital Income Fund, the ticker is VCIF. This fund owns first mortgage residential loans, so they're pretty secure in terms of the credit markets. The fund trades around a 15% discount, and they have a managed distribution on it, yields about 9.5%. We really like this fund because we think the NAV is somewhat stable, we like the discount, and we think that this is the kind of fund that will have some interest rate sensitivity but not nearly the kind of sensitivity as a long levered muni fund or long dated corporate fund. So that's just one of our favorite fixed-rate funds right now.

CHUCK JAFFE: And again that's VCIF, Vertical Capital Income Fund. What makes you sell? When you find all the right conditions and you're getting the kind of yield that you want, what ultimately makes you say, "Time to move on"?

MAURY FERTIG: A couple things. One is the underlying asset class gets very expensive, that is clearly—it's sort of shaping up right now, municipal bonds are trading historically relatively expensive, so that's one factor. Then the underlying discount gets to a level that is well through its historical averages, that can be another factor. One other factor could be that the manager, we're seeing too much volatility in the NAV in a particular market environment, we can lose confidence in the manager. The best way to sell that I'll remind all of your investors in this space is when there are tender liquidation events, corporate actions is a great way to sell because usually you're getting out close to NAV or NAV, and that's pretty much a no-brainer way of exiting when those events happen. And there are quite a bit of those take place in any given year.

CHUCK JAFFE: But are there telltale clues that help you understand that, hey, this is where that kind of action is likely? Because it may be something that you can recognize, but the typical investor out there who's looking at closed-end funds and maybe doing this on their own doesn't necessarily have an ability to say, "Wait, this is a fund that I'd expect an action on." Is there something that you look for that makes you say, "Okay, I can't be sure that this is going to happen but this is the environment where it's more likely to happen"?

MAURY FERTIG: If you have a fund trading at a double-digit discount that if you're an investor that has access to holding lists, there's different sites you can find and see who the holders of the funds are, and you see institutional ownership. I'm not talking about the brokerage firms, but you see other institutional firms such as ourselves, Saba, 1607, there's other people that are playing the space and you see meaningful institutional ownership. That tells you that there is an investor base in that fund as well that's kind of keeping an eye on things and just making sure that the shareholders are treated fairly. Because very often shareholders will do whatever management says in these funds and from time to time there's opportunities that take place that institutions are more aware of can facilitate that change. So that would be the one simple way of spotting that.

CHUCK JAFFE: Now we're going to get Maury's quick and dirty opinions on some closed-end funds that my audience has asked about. And we're boogying through Quick and Dirty today with Maury Fertig, chief investment officer at Relative Value Partners, RVPLLC.com, the website for the firm. And of course Quick and Dirty's where we put our guest to your test. If you want to test our guests directly, send your name, your hometown, and the ticker symbols you're interested in to Chuck@MoneyLifeShow.com. Now sometimes names stay on here for a long time, and our first request today, well Herb in Oradell, New Jersey and Andrew in San Jose, California both wanted to know about BDJ, the BlackRock Enhanced Equity Dividend Fund. Which by the way is in my portfolio. It's in my portfolio because I told my father to get it, and my father whose name was Herb happens to know Herb in Oradell. They were long-time friends and sadly Herb in Oradell was lost to the coronavirus last year, but I know his wife will want your opinion too. So BDJ, Maury?

MAURY FERTIG: I like BDJ. It's a covered call fund so it has a little less volatility in the overall market, invests in the large cap space, trading around a 10% discount. I'd be a buyer of BDJ here. I think it's a good fund and they've done a good job in this environment.

CHUCK JAFFE: When you talk about something being a covered call fund, is that a case where because of the strategy that's involved, we normally are talking about asset classes, and you don't want to have too much in say, muni bonds or what have you.

MAURY FERTIG: Right.

CHUCK JAFFE: When you think about a covered call strategy fund, do you want to be in a situation where you limit how many funds you would allow have that strategy in a portfolio?

MAURY FERTIG: Yeah, typically just thinking about how we manage it, we could have 10-15% of our equity exposure in this type of strategy. Typically in a very strong market this will lag so you don't want to have too much of it, and it's not immune to going down either. It's a really good fund for an environment where things chop around and where a stable market might be slightly increasing. But you probably don't want to have your entire portfolio invested in the covered-call space.

CHUCK JAFFE: So a little bit more education on the covered call space, but that was a buy on BDJ, BlackRock Enhanced Equity Dividend Fund. Andrew in San Jose shares our next request with Dale in London, Ohio, they both want to know about JRI, Nuveen Real Asset Income and Growth.

MAURY FERTIG: Well JRI's a fund that we like at our firm. It invests in preferred stocks, infrastructure plays, utilities, it does it on a global basis, a lot of hard to follow, hard to invest assets for the average investor. It trades at around a 12% discount with an 8% yield, and I think it's the kind of fixed-income-ish equity holding that could do well in this type of environment, so I would be a buyer. As I said, we own it across the board at RVP and I like it.

CHUCK JAFFE: It's a buy on JRI, Nuveen Real Asset Income and Growth. Dale in London, Ohio shares this next request with Richard in Chula Vista, California. Both want to know about ADX, Adams Diversified Equity.

MAURY FERTIG: This is one of these funds that's been around I think for 80-90 years, one of these original very old funds. It's a large cap fund that has a lot of growth stocks in it, that's done well recently, but the discount it's probably not going away. There's been a couple contested issues over the years, the discount's been kind of perpetually 13-15%. I'm not a particularly big fan of this fund, but if I had it I wouldn't tell somebody they need to sell it so I'd put that one as a hold.

CHUCK JAFFE: It's hold it if you've got it, but don't buy more on ADX, Adams Diversified Equity. Simon in Kingfield, Maine who only asked us about a couple of closed-end funds, his only request finally gets on the show with Tortoise Power and Energy Infrastructure, TPZ.

MAURY FERTIG: I like TPZ. It is part of a space that got hammered in 2020 because of where energy did very poorly. Energy funds have lagged the recovery in oil prices, the fund's been trading around a 20% discount. We own about 12% of it at RVP so we really like it and I think this is a good way to play the reflation, economic recovery, and buy something at a pretty steep discount, so I would be a buyer.

CHUCK JAFFE: Well in fact if you own 12% of it, you have been a buyer of TPZ, Tortoise Power and Energy Infrastructure. And last for Jeff in San Jose and Mark in Mitchell, South Dakota, it's Eaton Vance Risk-Managed Diversified Equity Income, that's ETJ.

MAURY FERTIG: ETJ, it's a fund that we've owned from time to time at RVP. They employ a put strategy so it's very defensive in nature. But historically it's traded at a modest discount, there's been times it traded at a 10% discount in the right environment. These days it's been trading at premium of about 4%. And as we talked about earlier, I'm not a fan of owning things at a premium because you don't have any margin of safety built in, so I would be a seller of ETJ.

CHUCK JAFFE: A sell on the ETJ, the Eaton Vance Risk-Managed Diversified Equity Income Fund. And as Maury said, well we discussed that earlier in The NAVigator segment. Maury, we've run out of time, which seems impossible because we had so much time. Thank you for sharing it with us both on The NAVigator segment and here in the Market Call. We'll talk with you again down the line.

MAURY FERTIG: Thank you.

CHUCK JAFFE: That's Maury Fertig, he is chief investment officer at Relative Value Partners, online at RVPLLC.com.

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