# Interval Fund Structure Lets Managers Freely Pursue The 'Best Ideas'

Friday, April 2, 2021

Chuck Jaffe, in this episode of The NAVigator podcast interviewed Michael Naughton, chief operating officer for U.S. retail at Lord, Abbett and Co. Read the Q & A below as Michael says the interval-fund structure – which limits shareholder redemptions – has given managers of the Lord Abbett Credit Opportunities Fund the ability to pursue the firm's best ideas, including illiquid investments, and discusses how the liquidity risk of interval funds can balance out other risks faced by fixed-income investors in today's challenging interest-rate environment.

Michael Naughton

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

**CHUCK JAFFE:** Michael Naughton of Lord Abbett is here, and we're talking credit investments and interval 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 space 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. And if you want more direction on closed-end funds, and business-development companies, and interval funds, check out the Alliance website at AICAlliance.org. Today on The NAVigator, I'm joined by Michael Naughton, he is chief operating officer for U.S. retail at Lord, Abbett and Co., which you can learn about online at LordAbbett.com. Michael, thanks for joining me on The NAVigator.

**MICHAEL NAUGHTON:** Thanks for having me, Chuck.

**CHUCK JAFFE:** A lot of times in this space, because we're talking about closed-end funds, we are talking about income opportunities, etcetera. But in your job, well, you guys have made an interesting choice. You sort of were looking at the market and what it called for, and you said, "Here's an opportunity. We think that there's a fund to be created." But then the real opportunity wasn't creating the fund, it was using an interval fund structure. So I'll let you talk about both the fund a little bit in terms of what you were thinking and why the space was there, but also why an interval fund when it's not what first comes to mind for most people who are developing products.

**MICHAEL NAUGHTON:** Yeah, great question. We're excited to be a new entrant into what I would call interval fund 2.0. As you and some of your listeners may know, the structure's been around for a long time but it's been fairly dormant until it's been revitalized here in the last I'd say two or three years alongside the closed-end fund market more generally. The reason that we are so excited to have launched this fund is it really fit perfectly with what we demand to see when we launch a new product. What we demand to see are two things. One, an opportunity in the capital markets where we feel we have a differentiated edge and we can add alpha and a really good risk-return exposure for clients. And then two, something that investors really truly need. And of course income is probably chief on the list of investor needs, especially for the last decade, especially over the last many months as low interest rates have seemed to be almost a permanent feature of capital markets post-'08 and any kind of rise in interest rates has eventually been fleeting. So investors need income, that was the need we were looking to address, and we have an edge in global fixed-income. We're one of the largest most widely utilized active managers in fixed-income globally by financial advisors and their clients in the U.S. retail wealth management market. So those two things lined up pretty well for us, so we decided to launch what is our Credit Opportunities Fund, and we decided to interval fund structure for a couple reasons. First, from an investment standpoint, we wanted to be able to invest in the hundred or so best ideas that our investment teams saw across global fixed-income markets. And best here would really be best bang for our buck, best return per unit of our risk in our estimation. And it happens to be the case that a lot of times those ideas that offer the real excess return opportunity are smaller issues, or more idiosyncratic issues, or more complex issues that happen to be less liquid. And you can own some of these in mutual funds, some of these you can't own in mutual funds. But the challenge in building a mutual fund focused exclusively on these ideas is that a focus exclusively on these ideas is not appropriate for a daily liquid structure, where we offer investors the ability to redeem in full every single day. So to access those opportunities, our hundred best ideas and focus exclusively on them, we needed to have more certainty around what type of liquidity we could provide to investors, and interval fund does that. We know that we can cap repurchases, aka redemptions out of the fund, as low as %5 on a quarterly basis. That allows our portfolio managers to have a lot of clarity into the liquidity needs they'll need to meet with our assets in the portfolio, which that allows them to invest in their hundred best ideas and structure for that specific clear liquidity need.

**CHUCK JAFFE:** Let me jump in here for a second because what could happen for anybody who doesn't quite get it, an interval fund, and again Lord, Abbett Credit Opportunities Fund which was started in 2019 is the specific fund we're talking about, and it's ticker symbol LCRDX, if you had a traditional open-ended mutual fund and there was any sort of rush of investors wanting money out, etcetera, you could face a liquidity crunch. And the big problem with a traditional fund trying to invest in these things is if they get caught, that's how you have one of those days where your fund that was trading at $10 a share for the last God knows how long, is suddenly trading at six dollars a share because they had to sell something illiquid at the wrong time. It's the securities that lets you get, without having the volatility that you would get from having to somehow unload something in any kind of rush on the fund, right?

**MICHAEL NAUGHTON:** Exactly. We've built a $200 billion mutual fund business by earning investors trust that when we say you can get your money out, you can get your money out. And that is the case for all of our mutual funds, always has been, always will be. So the mandate for those funds becomes deliver on your investment objective while maintaining the ability to meet redemptions in full every single day, and that is a constraint. Now it's one we've handled quite well in our open-end fund lineup, actively managing versus different benchmarks and investment objectives, and trying to deliver alpha, but it is a constraint. That constraint is removed to a large degree with an interval fund, and your mandate becomes maximize return per unit of risk, maximize your investment objective for investors who are comfortable knowing that they may not be able to get all of their money out on any given day. That we have the ability to cap their redemption request at as low as 5% per quarter. And that is a restraint for many investors, but that's okay, we didn't design this fund for every investor.

**CHUCK JAFFE:** Yeah.

**MICHAEL NAUGHTON:** We designed this fund for investors that said, "The options out there aren't good. I need more income than I can get right now, and I'm willing to give up some liquidity to do it." And that's who we're targeting with this product.

**CHUCK JAFFE:** This is not a fund that is investing in plain vanilla treasury securities, that's why you need the interval fund structure. You are looking at high-yield kinds of things. And we are in an environment where, well, we're seeing inflation tick up a little bit and people are worried about it. We are hearing talk about, well, rates are lower for longer but when will they go up? And we have definitely seen investors trying to stretch for yield. So in this environment, when they're giving up the flexibility of, "Hey, I can get out anytime I want," what they're really doing is giving the managers the flexibility to say, "Go get it." Right?

**MICHAEL NAUGHTON:** That's exactly right. That's exactly right. Look, there's only so many dials you can turn to get more income, right? You can take on more rate risk. With as flat as the yield curve is, that doesn't really work and it's not a risk that you're getting paid for certainly. Whether or not rates go up, that's uncertain. What is certain is you're not getting paid a heck of a lot to go out in maturity. So then the choice investors make is, I can dip down in credit quality and take on more credit risk, and we prefer that risk to interest rate risk, you get paid better for it. In general credit yield out covers credit losses, and active managers can really out-cover credit losses with yield and total return. But you only want to turn that dial so far. For many investors, those are the two primary dials that they turn. Now a third one could be leverage, and with the right assets leverage can be an effective tool. But there's one that is less turned by retail wealth management investors, and that's the ability to turn the liquidity lever. I'll take on some illiquidity risk because it's appropriate for me if I'm compensated for it. And institutional investors, LPs like pension funds have long seen that premium as something that is well worth achieving because they can do it. It is our belief that many high net worth, ultra-net worth and wealth management retail U.S. investors have the ability to give up liquidity if they are paid for that give-up, and that's who we designed this product for. Our managers can go it, they can buy our best ideas that not only provide more income, but substantially more total return opportunity than a vanilla fixed-income investment. And you've seen that in the results of this product certainly over the last 12 and 24 months.

**CHUCK JAFFE:** It's a really interesting strategy, and again, it helps people understand the use of the interval fund because there are a lot of ways that you can set it up. I mean, Lord Abbett, you're not quite a 100-year-old company, it's like a 90-year-old company, but you guys have been around for a long time, this is a really interesting take. And again, it puts you into the interval fund space, that's why we wanted to chat with you. Michael Naughton, this has been fun, thanks so much for joining me.

**MICHAEL NAUGHTON:** Yeah, thanks for having us. It's a great show, Chuck. Glad to be a part of it.

**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 interval funds, 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, Michael Naughton, chief operating officer for U.S. retail at Lord, Abbett and Co. Learn more about the firm and Lord Abbett Credit Opportunities Fund that we've been discussing at LordAbbett.com. The NAVigator podcast is new every Friday, 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.

*Recorded on April 1st, 2021*

To request a particular topic for The NAVigator podcast please send an email to: TheNAVigator@AICalliance.org

Click the link below to go to the home page of Active Investment Company Alliance to learn more: https://AICalliance.org/

**Disclosure:** *Listed closed-end funds and business development companies trade on exchanges at prices that may be above or bellow their NAVs. There is no guarantee that an investor can sell shares at a price greater than or equal to the purchase price, or that a CEF's discount will narrow or be eliminated. Nonlisted closed-end funds and business development companies do not offer investors daily lliqudity: often on a small percentage of share on a quarterly or semi-annual basis. CEFs often use leverage, which can increases a fund's risk or volatility. The actual amount of distributions may vary with fund performance and other conditions. Past performance is no guarantee for future results.*