# How Closed-End Funds Can Be An Investor's 'Paycheck-Replacement System'

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed Mark Asaro, director of investments for Noble Wealth Management. Read the Q & A below as Mark says that investors who are staring down low interest rates that have them questioning the classic, traditional 4 percent 'safe withdrawal rule' should be looking at closed-end funds to bolster returns and to act as a paycheck-replacement, providing steady income that – when applied tactically – should weather changing inflation and interest-rate conditions.

Mark Asaro

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

**CHUCK JAFFE:** Mark Asaro, director of investments for Noble Wealth Management is here, and we're talking about closed-end funds can be something of a paycheck replacement system for your portfolio, this is 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, 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's going to point you in the right direction. And today it's pointing us in the direction of Mark Asaro, he is director of investments for Noble Wealth Management, and if you want to learn more about the firm, it's NobleWMA.com. If you want to learn more generally about investing in closed-end funds, business-development companies, interval funds and more, go to AICAlliance.org, the website for the Active Investment Company Alliance. Mark Asaro, thanks for joining me on The NAVigator.

**MARK ASARO:** Great to be here, Chuck.

**CHUCK JAFFE:** So a paycheck replacement system, that sounds fabulous for a lot of folks. But they have to understand, I think our audience, well they know when they like closed-end funds or they wouldn't be listening to us. But I don't think that's normally how they think of them. So in your financial planning practice, how is it that you're positioning closed-end funds in these tricky economic times with inflation potentially on the rise and some people worrying about what could happen next? How are you positioning this, and if it is indeed as a paycheck replacement system, how does that work?

**MARK ASARO:** Well Chuck, a lot of these people, a lot of these retirees are coming to us and they're looking for income. And as you know, interest rates are rock bottom today, 13 years ago you could have bought a six month CD and earned 5.25%. Essentially no duration, almost no credit risk, and you're getting 5.25%. Today that sounds like a pipedream, most CDs today are less than half a percent. At the same time, we're having all these baby boomers retiring, 10,000 per day, and they're looking for income. They're looking for a way to continue to earn money on their investments without having to take excessive stock market risks. One of the things that they're coming to us and they're saying is, most advisors are telling them you can't earn anything from bonds. So to fix that problem all they're doing is saying, "Well, instead of being a 60-40 portfolio, meaning 60% stocks, 40% bonds, we're going to shift you to an 80-20 or even a 90-10." Now remember, these are retirees in their 60s and 70s, most of these people do not want more equity risk, they want less. So what we're offering them is something else, we're offering them a way to generate income in a yieldless world through closed-end funds. And we're able to marry them with income annuities and other tools today to dampen the volatility but earn a total portfolio yield somewhere north of 4.5%. That's just not possible if you're going to use mutual funds or individual bonds today.

**CHUCK JAFFE:** Right, obviously that's a heck of a selling pitch. How much do you have to rejigger portfolios to do that? Is it full overhaul, let's go mostly into closed-end funds? When somebody comes to you and says, "Okay, I'm looking for income stability that's going to last me for the rest of my life," and you're not saying, "Hey, let's do this classically by owning bonds," or what have you. You're going, "Let's do this with closed-end funds." How much overhaul not only of mindset but of portfolio does it take?

**MARK ASARO:** Usually pretty significant. So we're typically building a financial plan for them to ascertain basically how much income they need per year and basically what their withdrawal rate is from the portfolio. And if you can remember the Bengen 4% rule from the early 90s, that rule has basically been thrown out the window because interest rates are so low today. So we're basically backtracking and figuring out what is this individual person's withdrawal rate or what their actual percentage that they can pull from the portfolio each year, and then creating a portfolio based on that number. So for example, if a client comes to us and says, "I need X amount of dollars on Y sized portfolio," and that amounts to a 4.5% withdrawal rate, we're creating a portfolio that's going to meet that need. In other words, generate income of 4.5% off that portfolio. There's going to be volatility in the markets as we all know, that way we're just pulling off the income, they're never selling into that principal. If they can maintain that portfolio, then it's almost like a perpetual income stream for the rest of their lives and they're not having to cannibalize their assets, meaning drawdown their assets in order to meet their standard of living needs. One of the things that we're seeing a lot of is advisors out there are building individual bond portfolios with coupons that have 5%+ some yields on them. But what they're not telling the client is, yeah, they're getting a 5% yield, but the prices of those bonds are 110, 115, sometimes even in the 120s. Meaning that their yield to worst is somewhere around 1% taxable. So yeah, they're generating this 5% income, but their principal is going down. I can't tell you how many clients who have come to us are showing me these portfolios with this kind of income stream, but in reality I tell them you're going to lose money on these, especially once you calculate your taxes and advisory fees. So there's a lot of things going on out there that are just a little troubling, but if you can look past that and get to a position where you utilize closed-end funds and other tools out there, you can actually build a portfolio where you're not cannibalizing assets and you can meet your spending needs in retirement, not having to sacrifice your lifestyle during retirement just because interest rates are low.

**CHUCK JAFFE:** Do you believe that that can hold going forward in an environment that's going to see rising inflation, changes in interest rates, and an economy that some folks would suggest has got to slow down after we digest this upcoming summer and the push to get back to normal?

**MARK ASARO:** Inflation's probably the biggest worry right now, just because if there is going to be higher inflation the Fed is going to react to that eventually. Now, they've stated they want inflation to run a little hot, et cetera, et cetera. But once they start raising that short-term benchmark rate these closed-end funds are going to have to pay more to borrow for their leverage. That is probably the number one key ingredient into discounts today. I'm not so concerned about long-term interest rates rising as I am short-term interest rates rising. If that is the case where interest rates on the short end rise, you're going to see closed-end discounts widen very dramatically, and it's going to look a lot like it did in 2015 and 2016 when you saw some of the widest discounts in history. So right now we are in this environment pairing back our taxable closed-end fund exposure. You kind of alluded to earlier, how do we manage that with clients? Well, we're tactical. So we were buying heavily in most of 2020, including up through October, and basically starting in February we started reducing our closed-end fund exposure. We'll never get out but we're tactical in terms of the actual percentage within the mix for the portfolios of how much is exposed to closed-end funds. We're still going to need that yield and we're still making swaps and other things to take advantage of the idiosyncrasies in the market, but for the most part our exposure has come down pretty significantly, and eventually we're going to get back in, hopefully later this year when discounts widen back out again.

**CHUCK JAFFE:** You're talking about how you have to be tactical. Most folks when they're looking for income are looking for, "How can I set it and forget it?" So if they're looking to use closed-end funds as an income or a paycheck replacement, how much is it set it and forget it, how much is it, "Hey, there's a little more work here than you might think if you're normally a buy and holder"?

**MARK ASARO:** There's definitely more work involved here, and obviously that's why our clients pay me, or pay our firm, is so that I can take care of that work for them. Now of course there's a lot of individual investors listening today who have to do it themselves, and I always say that closed-end funds are more of a buy and rent as opposed to a buy and hold type of investment. Simple because, yeah, they're going to produce that annuity-like income, they're going to produce fairly stable income streams for pretty long durations, but you do need to be vigilant and you do need to keep track on the funds on a day-to-day, week-to-week, year-to-year, month-to-month basis. So while some funds are buy and hold in my mind, most are not. And so for the do-it-yourself clients, you do need to have some work involved to stay on top of what's going on in the marketplace or you need to hire an advisor to do it for you.

**CHUCK JAFFE:** Well Mark, thanks for helping us figure out what the workload is going to be. I appreciate you joining me on The NAVigator.

**MARK ASARO:** It was great to be on, Chuck.

**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, that's the website for the Active Investment Company Alliance. They're on Facebook and LinkedIn @AICAlliance. Thanks to my guest, Mark Asaro, he's director of investments for Noble Wealth Management in Colorado, the firm is online at NobleWMA.com. The NAVigator podcast is new every Friday, follow along on your favorite podcast app and come back next week to learn more about investing with closed-end funds. Until that time, happy investing.

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

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