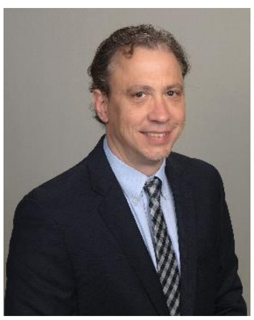
Rob Shaker On What's Next For Closed-End Discounts

Friday, June 25, 2021

Chuck Jaffe, in this episode of The NAVigator podcast interviewed Rob Shaker, portfolio manager at Shaker Financial Services. Read the Q & A below as Rob makes his return to The Navigator. Having been a happy camper when discounts grew massive at the start of the pandemic, and having been more circumspect as they narrowed late in 2020, now he's seeing pockets of opportunity. Looking for relative bargains and watching to see whether closed-end funds now are repeating their pattern from the financial crisis of 2008, when discounts got huge, then tightened up, then struggled during the "taper tantrum" reaction to Federal Reserve efforts in 2013. He's watching the Fed – and the market's reaction to it – now to see if history will repeat for closed-end investments.



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 of Shaker Financial Services is here, and we're talking about discounts and trading in closed-end funds, 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 is pointing us in the direction of a money manager and investor in closed-end funds, Rob Shaker. He is portfolio manager at Shaker Financial Services, learn more at ShakerFinancial.com. And if you want to learn more about closed-end funds generally, check out AICAlliance.org, the website for the Active Investment Company Alliance. Rob Shaker, thanks for joining me again on The NAVigator.

ROB SHAKER: Sure, great to talk to you.

CHUCK JAFFE: Well, I say again because you were on with us in March of 2020, basically two weeks into the shutdown, and closed-end funds, the discounts were massive, and ugly, and you were excited. You were a pig in slop, you could not have been happier. Like, this was my element, great big discounts. And then we had you back on as we got towards the end of last, the market of course had recovered dramatically, closed-end funds discounts had narrowed dramatically, and you were a lot more circumspect. So where are you now? Because discounts have continued to narrow.

ROB SHAKER: Right, so we have continued this narrowing back to sort of where we were back in the teens of 2000, back to a more stable sort of level. It's been a nice, steady claw-back from those low levels around Covid. I don't think it's necessarily too high or too low.

CHUCK JAFFE: What is that doing for you as somebody who wants to look at the discounts? Does it slow down your activity? How does it affect you as an investor?

ROB SHAKER: At Shaker Financial, we're trying to take an individual fund and track it, buy it when it is artificially wide, and then rotate out of it once it narrows. So we're doing this sort of on a fund by fund basis throughout. Now during those types of periods, and during this post-Covid, you'll also have what we'll either call a tailwind or a headwind of CEF discounts overall. So you can have these movements of CEFs overall, but within that as long as things maintain some stability within the discounts and the narrowing, you're able to still do that individual rotation. So nothing from an overall movement point of view is going to prohibit us from doing what we do on a day-to-day basis. That being said, we are always interested in, especially when talking with you, about where we're going and where discounts are. And there's been some talk these days about, are we at a new top? Not unlike the market, and you'll have people discuss that. As our other portfolio manager, Dan Gordon likes to say, whenever you're looking at or discussing the long-term charts and where discounts may or may not be, the answer to your question usually comes down to where you placed your left hand. By that I mean, what periods of time are you covering up on that graph, therefore creating the new analytical starting point? So if you took a graph of discounts, it really depends on where you put your hand. If you cover up the last couple of years and so you're starting there, or you cover up right after the Great Recession, you might look at the chart and say, "Hey, we're kind of topped out here." But if you move your hand in different places, such as move it to the 2010-2013 period, to a nice steady period of discounts right where we are now. And if you actually take out pre-Great Recession, discounts were narrower. In fact, equities were actually at a premium for a bit of the time. So there's different ways to look at it, but within it as long as they maintain that stability you can still take advantage of individual funds.

CHUCK JAFFE: Do you also have to change maybe a little bit of the relative level that you're looking for? In other words, if you are normally looking for a big discount and a big discount now is not as big a discount as it was a year and a half ago, are you willing to settle for what amounts to a smaller discount? It's not as big as it was, it's not as broad as it was, it's not as badly priced as it was at the height of the market being a little crazy. Relatively speaking, what's a more typical discount that you're pursuing now as opposed to the double-digit stuff that had you so happy when the pandemic was starting?

ROB SHAKER: That's a fantastic question, because it actually brings up this other concept of what is an attractive discount? So a lot of people, especially that are familiar with closed-end funds will come in, and naturally speaking you sort of get this feeling that the deeper the discount, the better it is and the more attractive it is. But that's not what we really do at Shaker Financial, because it's more about the relative discount. The discount per fund to its relative average. And there are many deep, long-term equity large cap funds that trade down at 12-13% discounts and have always sort of been down there. Where you have others that might trade at a 3 or 4% discount. So if you can get one of these funds that are traditionally trading even or around par down at like a 5% discount, that's a great deal for that particular fund even though it's not a deep discount. Whereas some of these deeper discounts, just because their absolute level is lower doesn't necessarily make it a more attractive purchase, especially considering what we do in terms of our discount capture. So it's really mainly about relative to what you would consider its historical average. And that brings us back to overall where are discounts in general? Talking about how excited we were back post the

Covid decline, everybody was like 10% off their historically averages. So if you bought something then and held it, you could have made 10% extra. Now you have to be a little bit more choosey and do a little bit more analytics to really find the ones that maybe have not recovered all the way, or have recovered and now bounced back because that's the general nature of closed-end funds. Even though they're all moving one direction to the other, intra-day, intra-week, intra-month, whatever the cycle or the reason, you'll find closed-end funds bouncing around that you can take advantage of.

CHUCK JAFFE: How much of it is, "I'm trading out of one and upgrading my portfolio or getting the better opportunity"? How much of it is simply adding to the opportunity set? Are we watching enough things narrow where you want to be more actively trading, capitalizing on the discounts and watching things cycle in and out of the portfolio?

ROB SHAKER: At Shaker Financial we don't really time mark it, so we're always fully invested. To that extent, we are always looking for a rotation. How we rotate and whether or not we're rotating into more of those deeper discounts, in a sense, more of a defensive mechanism from a potential generic widening or sort of pushing the envelope of the lower discounts and trying to get a quicker turnaround and a quicker discount capture will vary from time to time based upon what we're seeing in terms of selling pressures or buying pressures. But really for the last six months while things have been sort of quiet and sort of dripping upwards, we've seen a nice stability and equilibrium between buying and selling pressures across the board. And that allows us to really just focus in on, "Okay, who today is this price?" Who today is getting sold and out of kilter so that we can establish that position more firmly?

CHUCK JAFFE: We've been through during the 2000s some pretty big market changes, and I recognize that the pandemic, from a causation standpoint, unlike anything else. But 2008, the Financial Crisis, a major event that saw closed-end funds get absolutely hammered, and then rebound, and then stabilize. The pandemic, same thing; hammered, rebound, stabilize. So what's next?

ROB SHAKER: You bring in a great comparison to that bounce-back and the bounce-back which we just had, which then leads to the question of what next? And that would be, because the next big thing that happened following the Great Recession was the Taper Tantrum, and so that's really what we should be thinking about moving forward. And that is, okay, this time around when we start talking about rates going back to more normal levels or however you want to talk about it, or we're going to talk about a little bit less of the accommodation, can closed-end funds behave better? Last time we had what I would call an irrational selloff, it was a complete overreaction to bond closed-end funds particularly. But having gone through that once, I think that's sort of the next big question for closed-end funds on the horizon. Okay, when we get to that point, now we've been through it, we've seen it even in a raising rate environment, many closed-end bond funds are going to continue to have steady and positive net asset values over a year to year basis, can we not panic? Can we not have irrationality? And if we do, how do we best take advantage of it?

CHUCK JAFFE: Rob, it's really interesting. I've got more questions, I just don't have more time. So how about we have you back down the line, see how things are playing out, and find out if you're still happy about closed-end funds?

ROB SHAKER: Sounds great. Nice talking to you, buddy.

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 hour-long weekday 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, Rob Shaker, portfolio manager for Shaker Financial Services. You can learn more about him and the firm at ShakerFinancial.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 next time, happy investing everybody!

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