# Closed-End Funds Aren't Just For Retirees Any More

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed John Cole Scott, chief investment officer at Closed-End Fund Advisors and executive chairman of the Active Investment Company Alliance. Read the Q & A below as John dispels the notion that closed-end funds are only suited for individuals in or near retirement age, investing in tax-advantaged accounts, helping host Chuck Jaffe answer a listener's question. He offers suggestions and creative ways that a younger investor can enhance an established taxable portfolio with a few well-chosen closed-end funds.

John Cole Scott

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, and when I'm not hosting The NAVigator, I host Money Life, my own one-hour show that's available every weekday. We frequently take questions from listeners and often bring in experts to answer them, and this week we were joined by John Cole Scott, chief investment officer at Closed-End Fund Advisors and the executive chairman of the Active Investment Company Alliance to answer an audience question about closed-end funds. We didn't want you to miss it, so here it is as a bonus episode of The NAVigator. Enjoy! Well actually, it won't be me that has the answers for you today. No, no, no, you have questions, we have answers for you here on Money Life. But today I'm bringing in a fabulous resource because the question is about closed-end funds. We get a few of those here on the show, and so I'm turning to John Cole Scott. Now a little bit of my history, when I was a much younger reporter and columnist getting into the mutual fund space, if there was a question on closed-end funds that I needed answered, I called George Cole Scott, John's father. Who started Closed-End Fund Advisors, the firm that John is chief investment officer of. But you also know John because he is the executive chairman of the Active Investment Company Alliance, so he's into all things closed-end fund. You can learn more at CEFadvisors.com and CEFdata.com. He's on Twitter @JohnColeScott, but right now he's back on Money Life. John, Great to have you back on the show.

**JOHN COLE SCOTT:** Always happy to help, Chuck.

**CHUCK JAFFE:** Today we have a question that comes from Ryan in Anchorage. He writes, Chuck, greetings from Anchorage. I'm 39 years old and I'm intrigued by closed-end fund investing but I have the impression that closed-end funds are better suited for individuals very near or in retirement. Would you discuss the potential benefits and downsides of closed-end fund investing in a taxable account for someone with a 10 to 15 year time horizon before retirement? For more context, I do all the right things with respect to funding my 401(k), and my health savings account, 529's and the rest. And I have a high-paying job in a volatile industry that leaves me with significant excess monthly income to invest in my taxable account. My tax rate is roughly 35% and nearly all of my current taxable investments are dividend growth stocks. My primary goal for our taxable account is to generate consistent dividend income that grows at a higher rate than inflation. At our current savings rate, without a change in investment method, I expect the dividends from our taxable account to cover our current monthly spending in roughly 10 to 15 years. At that point I'll consider early retirement or a career change. So I'm wondering what role closed-end funds might play in our taxable portfolio. Well, there you go, John. It's an interesting question because I think it's something faced by a lot of folks since we started The NAVigator. They've learned a lot more about closed-end funds, they like them but they don't quite know where to start and if they're missing something. So would you be adding closed-end funds to that portfolio? I think that's kind of a softball.

**JOHN COLE SCOTT:** It is. Again, I'm biased in a way but I'd say yes. But the reason I'd say yes is because what I'm hearing with my advisor hat on, it is heavily focused in US large and mid-cap stocks and is a diversification goal that I would see beneficial for the next 10 to 15 years of accumulation and obviously beyond when and if he retires. The sectors, as you know from senior loans to real assets to covered call funds, which are equity based, and international funds. You can buy a really good international fund at a discount and just wait 10-15 years if you like the sector and like the manager, and the cashflows to me tend to be at or bigger than you're getting from dividend stocks. Also can't forget the closed-end fund structure, like Eric mentioned last week on The NAVigator, can hold level three and illiquid assets. Huge benefit if you don't have access to hedge funds or private funds to get that through the closed-end fund wrapper. And then as I really think about it, the fact that there's the ebb and flow, that he's a patient, diligent, ongoing buyer, every month he can choose what sector, what fund to buy as part of his mix. He can look for beat up sectors, beat up discounts, have opinions of a 10-year recovery rate that I think can be very, very useful. And then of course we have general tax-loss selling season and proxy discount season where you can add a little flavor by just learning a little more. This is a lot to cover but there's even simple things. Like there's some ETFs in the space where you just buy and ETF and it has the kind of exposure you want, and you let the ETF do the work for you. And the other thing, I'm 43 years old, I save closed-end funds in a taxable account. One of my favorite things is for every dollar I have in my account is $1.25 to $1.40 because of discounts and leverage. And I'm a long-term investor, I love that extra exposure to assets that I couldn't get on my own through other wrappers.

**CHUCK JAFFE:** Well, and in fact that was what I was thinking. Where he's looking for income, you can of course look at tax-advantaged closed-end funds when it comes to bonds, but the issue that an investor like him has is that bonds right now are wholly unsatisfying pretty much any place. But at least in closed-end funds, because there's going to be some leverage behind it, because you may be able to get a discount, not a guarantee on that given where discounts have narrowed and premiums have come into play, you can basically buy an income stream on sale. So when there's not much income to go around, you're effectively getting more yield.

**JOHN COLE SCOTT:** And you're not buying Lehman Agg, you're buying more interesting things. Even as much as CLOs and BDCs and other just less duration or investment-grade focused bonds. Because I see no reason for almost anyone to own duration bonds with low yield.

**CHUCK JAFFE:** Okay, now let's go back to something he said. He says that nearly all of his current taxable investments are dividend growth stocks, so help him out. You're an advisor, where would you start him and have him looking in these market conditions to say, if you're going to add a closed-end fund, obviously not knowing his full portfolio but knowing that you want to get some diversification but you also want to be able to meet his income target of doing better, generating cash that inflation's going to take away from.

**JOHN COLE SCOTT:** I'd say focus on the real assets because that's rather great in this sector, lots of funds to choose from across infrastructure from real estate, from pipelines and that area. Also focus on multi-sector bond funds, let the managers do the tilting for you. And again, if you want to go back to it, you can buy, there's a couple ETFs in this space and you can look for that to be a starting point as you learn. And then you can always sell down the ETF to buy the things you're researching as you gain some comfort. And remember, when he retires he's going to need closed-end funds even more than he does now, and think if works on them as a piece of his portfolio for 15 years, he'll be even smarter then.

**CHUCK JAFFE:** So why is he going to need them more than now? Because that's part of his initial perception, is that closed-end funds are better suited for people who are in retirement or near retirement. We wanted to disabuse him of that, but it also sounds like there is a little bit of truth there.

**JOHN COLE SCOTT:** It is because they tend to yield 6-8% in different market environments. There's obviously no guarantees with any dividends, whether they're stocks or closed-end funds, but you get a diverse income stream that you can have a lot more control over. And like for our clients we love telling them that we're covering their monthly check plus some extra to reinvest, and not have to sell anything even in March of 2020.

**CHUCK JAFFE:** Quickly because you talked about diversifying, but because he's buying closed-end funds, even if he's just saying I'm going to buy individual funds rather than doing the ETF thing he's getting some measure of diversification. So it can be one closed-end fund per asset sleeve or asset space, yes?

**JOHN COLE SCOTT:** Definitely could be when you're doing what he's doing because he also needs to learn along the way. He sounds like he has a very good, demanding job, he's not spending the time we do for our clients on the portfolio.

**CHUCK JAFFE:** So Ryan in Anchorage, A, thanks for the question, B, yeah, you now know a lot more about the role that they play. And that is thanks to my guest, John Cole Scott, he's the founder and executive chairman of the Active Investment Company Alliance, the chief investment officer at Closed-End Fund Advisors. Go to CEFadvisors.com or CEFdata.com for more information, and he's on Twitter @JohnColeScott. John, we'll do this again soon, thanks for joining me.

**JOHN COLE SCOTT:** Always my pleasure, Chuck.

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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/

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