Bonus Episode: Rate And Inflation Picture Are Triggering Rotation

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Chuck Jaffe, in this episode of 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 have been impacted by headlines about rising rates and inflation, along with the stock market's heightened volatility and January losses. Fertig says that current conditions have changed some of his focus, moving him away from floating-rate funds – which were trading at a significant discount a year ago, but which are close to net asset value now – while convincing him to 'nibble' on some credit and mortgage funds that have fallen off in recent months, becoming more-attractive bargains as a result.

Maury Fertig

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

ROB FLOYD: Hi, this is Rob Floyd, part of the team that brings you The NAVigator podcast, and the executive producer of Money Life with Chuck Jaffe. On Monday's edition of Money Life, Chuck talked in our Market Call segment about investing in closed-end funds with Maury Fertig of Relative Value Partners. Knowing that NAVigator listeners love closed-end funds, we didn't want you to miss it. So here is that interview as a bonus episode of The NAVigator, we hope you enjoy it.

CHUCK JAFFE: Maury Fertig, chief investment officer at Relative Value Partners is here, we're talking closed-end fund investing and this is 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, what they look for that determines their buys and sells, what they see happening broadly in the market right now, and how they put it all together. And my guest, he's been here many times before, we love chatting with him about closed-end fund investing, Maury Fertig is chief investment officer at Relative Value Partners. To learn more about the firm go to RVPLLC.com. Maury Fertig, thanks so much for coming back to the show.

MAURY FERTIG: Thanks for having me.

CHUCK JAFFE: Maury, we always start with methodology, and yours as I said focuses around closed-end funds. But these are super interesting times for closed-end funds because, well, we saw the market take it on the chin, we've got a rising rate environment, there's a lot of stuff that goes on with closed-end funds that's maybe a little different than ordinary investments. So help us understand why closed-end funds and what you look for that determines which closed-end funds you're buying and not.

MAURY FERTIG: Yeah, so just to start off in a market that's very volatile and particularly in the interest rate rising environment, one of the attributes of closed-end funds, and ultimately it's a positive for them but it can be a negative at times, is the majority of them employ leverage and it magnifies your returns in both directions. So that's just one caveat up front that makes it an interesting space but makes it a little bit dangerous if you're not paying attention to that. So our methodology really boils down to looking at what assets we're trying to put in a portfolio, and can we find closed-end funds that meet a number of criteria that look like interesting ways to capture those investments? So I'll give you an example. If you're looking at the fixed-income universe and you're concerned about rising rates, so maybe there you'd want to say, "Okay, let's look at something that has a very low duration, floating-rate asset." Then you might look at what are the underlying fees to this? What's the cost of leverage? How's the performance been in different types of environments? And what's the distribution level? And then ultimately, if there's a discount, which in terms of new funds we buy, we typically only buy funds at discount, then it's like is the discount greater than average? And is there potentially some catalyst for that discount to tighten up to enhance the returns? So those are just some, there's a little more to that, but that's just a broad overview of how we basically look at these investments. When we first start, do we want to own the asset class before deciding? The fund comes after knowing what's in it. That's the bigger issue, what are we really getting?

CHUCK JAFFE: So are there certain asset classes that right now you don't want to own? Or certain ones that you particularly do want to own? Because a rising rate environment does change the calculus.

MAURY FERTIG: Yeah, two things. One asset class we had owned for the last couple of years and it's treated us very well were floating-rate loans. But what's happened recently is with the bit of panic in the bond market and the selloff, there's been increased demand in the floating-rate loan sector. Not only have the loans remained fairly expensive, the underlying loans, the closed-end funds in that universe are trading pretty expensive, most of them are trading at near or at net asset value. These funds a year ago, there were many funds at eight and 10% discounts to net asset value. So we think that's an area that maybe it's played itself out for the time being, and we've generally been selling off the remaining funds we have that are trading near net asset value. As far as things we're looking to buy, we're starting to nibble on some credit funds, some mortgage funds that have really fallen off a lot in the wake of the recent bond market selloff. That would include, give you a couple examples here, a fund like JLS, that's the Nuveen Mortgage and Income Fund, and it's trading at 11% discount. So not only has the net asset value dropped, the share price has dropped considerably in the start of the year. Another area to look at that's interesting, and there's a whole basket of these, if you look at all the funds that have come in the last 12 to 18 months that have been new issues, most of those are trading well under their offering price when they came, and there's been a lot of tax-loss selling. In periods of extreme volatility those funds tend to get hurt a little more. A good example of that is the Western Asset Diversified Income Fund, WDI came last July at $20 a share and now it's trading at $17.50, because it's a bond fund and rates are higher. So those have become interesting assets, interesting ways to add fixed income in a manner that you may actually capture more upside than a normal bond, just a normal bond fund.

CHUCK JAFFE: You know, you talked about some of the things that you're doing in your analysis, and I'm curious, do you have strong feelings or favorite or dislike certain structures? Because when we're talking closed-end funds, well of course, that can include interval funds. Realistically that includes business-development companies, even though they're not necessarily a classic closed-end fund. So for you are the structures the same? Let's look at the assets first and figure out everything else that we want? Or do you favor one structure against another?

MAURY FERTIG: Yeah, good question about BDCs. For instance, we have a particular strategy that does focus on BDCs. There the ultimate question is the underwriting, because that's a series of loans that the business-development company's writing, and how are they at that process? Do they have the due diligence? What's the track record? But those funds also at times can trade at premiums and discounts, so that's an area we have been involved in as well. Interval funds, anything that's not liquid, doesn't trade on the exchange, we typically stay away from just in terms of some of those are not actually don't have regular trading on the stock exchange.

CHUCK JAFFE: So in terms of some of the things that you are looking at right now, when you're talking about various asset classes, an investor who's a do-it-yourselfer's going, "I need to have fixed income," and they're looking at bonds generally.

MAURY FERTIG: Yeah.

CHUCK JAFFE: For you, how much do you dial down, or in times like this kind of make it that, "Yeah, we're going to get granular"? Because we're now getting to where in closed-end funds you can be granular. You can say, "Oh, here's a senior loan fund," "Here's a floating-rate credit fund", "Here's something doing munis" or what have you. And generally they're all fixed income, but how much are you dialing down? And is that where a lot of the management is taking place, is tilting portfolios in those directions?

MAURY FERTIG: Well, generally speaking there is some tilting within the closed-end fund, but very often we'll have a specific strategy, meaning we'll own up to 40% high yield or typically the muni funds will be all munis, it'll just be a question of what the duration is. So we're very granular in terms of looking through the quarterly statements, in terms of what the portfolio characteristics are, some issue monthly updates. So that we can ultimately look at all of our fixed income, this goes for the equities as well, and know exactly what we got with pretty good certainty. For instance, we will know how much within closed-end equity funds, we will know what percentage we have invested in China for instance. We can get a sense of that and make sure we're comfortable with that and how it fits in within the portfolio. So we're pretty granular, and I think it's important for investors, particularly individual investors, to look through at what's in the fund and make sure they're comfortable with it. The tendency to just jump into funds with big discounts and hope for the best—

CHUCK JAFFE: Is there a term for that? I ask like we have, you don't want to catch a falling knife or that's a value trap or what have you. Is there a closed-end fund term for that, it's a faux-discount, or where you're going, don't be fooled or it's fool's gold or something. Is there?

MAURY FERTIG: I don't know of one but we can certainly think about coming up with one. But I would tell you one funny, just one anecdote about all this in discounts. In times of intense stress, sometimes yeah, just buying everything with the biggest discount for that initial pop tends to be the best strategy in the short term. Maybe not work in the long term, but there does tend to be this snap back. Because we always say about closed-end funds that when things are really bad they take the elevator down and the escalator up. They can drop, the funds drop 5-7% in a heartbeat, and it might take a month to return, to make that back. So anyway, that's a good one, I'll think of a term for that for the next time we're on.

CHUCK JAFFE: There you go. Fool's gold is a possibility. Let's go back to one more example of something that you like. You mentioned a couple of things, but is there one more that's kind of a poster child for, "This is the kind of fund that we like"?

MAURY FERTIG: You know, I still like a fund we've had for a while in the portfolios. I still like it because I think it's trading attractive to the asset class. NFJ is the ticker, it's Virtus Dividend, Interest & Premium Strategy Fund. It's a combination, it's generally an equity fund with some convertible bonds and some covered-call writings, so it generates some income, the yield is a little under 7%, it's trading about a 10% discount. So that's a fund that we still like and I think has the ability for some discount tightening as well.

CHUCK JAFFE: And again, that's ticker symbol NFJ.

MAURY FERTIG: Correct.

CHUCK JAFFE: Well, now we're going to get your quick and dirty take on some closed-end funds my audience is particularly interested in. "Just go slow and be smart." Well, that's typically what you're doing when you're pursuing closed-end funds, you're trying to go slow and be smart. We're, well, not going slow because we're picking up speed with Maury Fertig, it's time for Quick and Dirty. Maury is chief investment officer at Relative Value Partners, RVPLLC.com if you want to learn more about him and the firm. And of course Quick and Dirty is where we put our guests to your test. So to test our guests send your name, your hometown, ticker symbols you're interested in. Could be for closed-end funds, ETFs, mutual funds, and of course stocks to Chuck@MoneyLifeShow.com. We're going to start with two requests over PIMCO funds. The first comes from Morris in Bradenton, Florida who wants to know about PHK, that's PIMCO High Income.

MAURY FERTIG: So PIMCO High Income, look, they've done a nice job at generating solid return in this fund over the years, but the one big negative is it trades at premiums because it has such a nice high yield to it. I think it's a yield in the upper nines. And inherently I am just against it. They do take a lot of risk in this portfolio and I'm against funds that are trading at premiums to begin with because you're sort of on the opposite side, you're paying more for a group of assets that are worth less. So I'd be a seller of PHK. Something I'd like if somebody's looking for something else instead as an alternative, a fund that's been taken over by an activist, is BRW is the ticker, Saba Capital Income Fund. Might have similar return characteristic, trading at a discount of about 5% and has a distribution of a 12% yield. So I think that's a better way, a better fund than owning PHK at this point.

CHUCK JAFFE: So PIMCO High Income, PHK, well, the major malfunction is that that premium that you're talking about. But if you want to look in the same space, BRW, Saba Capital Income & Opportunities Fund, that was a buy. Our other PIMCO request comes from Javier in Wilmington, North Carolina who wants to know about PIMCO Energy & Tactical Credit Opportunities, NRGX.

MAURY FERTIG: Yeah, so NRGX, we happen to own this in some of our portfolios, and I like this fund. It came a couple years ago at $20 a share, it's trading around $14 and the discounts are at 16%. It's in the energy space and people have been just negative on this asset class even though really it's been taking off this year and really had a nice end to last year. And I think this fund has a fair amount of upside if you can handle a little more of the underlying volatility of the asset.

CHUCK JAFFE: That's a buy on NRGX, PIMCO Energy & Tactical Credit Opportunities Fund. Maynard in Phoenix wants to know about Neuberger Berman MLP Income Fund, NML.

MAURY FERTIG: So this falls in very similar respects to the PIMCO fund, it's energy and MLPs, that has been out of favor for years, the asset. MLPs were all the rage seven, eight years ago, and then with the drop in energy prices a lot of these funds did poorly and people left the asset class. This one's trading around a 20% discount and I think really has some nice upside, especially when the people, when the [inaudible] get even more favorably disposed towards energy and MLPs in particular. So I do like this fund and I'd be a buyer at this price.

CHUCK JAFFE: So it's a buy on NML, Neuberger Berman MLP Income. We finish with two requests from Rich in Orchard Beach, Maryland. The first is for Guggenheim Strategic Opportunities Fund, GOF.

MAURY FERTIG: So this is a fund we had owned indirectly through a merger of another Guggenheim fund that was trading at a discount. This fund's been trading around a 20% premium, and as I mentioned about the PIMCO funds, I think that is really a fool's game owning these funds at their premium, because ultimately I think you're going to see an erosion of that premium and that really results in capital loss. So I would be a seller of this fund. Something as an alternative if you're looking for something else with a good level, a steady level of income, would be the Special Opportunities Fund, SPE is the ticker, trading on an 8% discount, a yield of just about 9%. I just think it's a much safer way if you're looking for income in this environment.

CHUCK JAFFE: So it's a sell on GOF, Guggenheim Strategic Opportunities. "So much crap they had to start a second pile." Well, it might not be a second pile, it's the second time we've had something that was sold because big premium. And instead, if you're looking for something in that space, Special Opportunities Fund, SPE. And last again for Rich in Orchard Beach, MFS Intermediate Income, ticker MIN.

MAURY FERTIG: Well, MIN has a soft spot for me because this is one of the early funds we bought when we started the company 17 years ago, and we've owned it at various times when it's gotten very cheap. It's been trading about a 4% discount, it's just an investment-grade bond fund with a very high distribution rate, so it eats into principal. I think ultimately it has traded at net asset value as recently as a month ago. I think it's a hold right now, and I'd be looking for an opportunity if it gets back to net asset value, I would exit this fund at that point.

CHUCK JAFFE: So it's a hold on MIN, MFS Intermediate Income Fund, and again you're looking for that better opportunity to buy it or sell it in case it gets back to net asset value. And while I wish we could take more time with Maury Fertig, we can't, so we have to make our move. But Maury, it's always great to chat with you, thanks for coming on the show.

MAURY FERTIG: Thanks for having me, it's been fun.

CHUCK JAFFE: Maury Fertig is chief investment officer at Relative Value Partners, RVPLLC.com for more information.

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