John Cole Scott provides welcoming remarks to the February AICA Virtual Event “Passive Access to CEFs/BDCs via ETFs and UITs”.

Thursday, February 3, 2022

John Cole Scott, Founder and Executive Chairman of the Active Investment Company Alliance opens the February 2022 AICA virtual event with opening remarks and with an introductory educational presentation on the topic of the event. Read the transcript below to hear what Mr. Scott had to say.

John Cole Scott

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https://aicalliance.org/aica-event/passiveaccesstocefs-bdcsviaetfanduits/

John Cole Scott: Good afternoon everyone, John Cole Scott, executive chairman, founder of the Active Investment Company Alliance. I want to really welcome you to this live session, or if you’re watching the replay, thank you for doing that as well.

Want to give a quick overview of what AICA is for those that might be new to the organization. It’s a nonprofit trade association that I decided to start in the summer of 2019, really with two primary concepts in mind. We wanted to focus on the universe of listed closed-end funds, business-development companies, and interval funds, and then also including tender offer funds which are even less known than interval funds.

And in that framework we wanted to not just go after membership and involvement with the fund sponsors that create these investments that we all can use for our portfolios, we also want to engage those that I call product sponsors like my firm, Closed-End Fund Advisors does customized separate accounts of these structures for clients. But there's also active ETFs, passive ETFs, there's UITs, there's hedge funds, there's a whole gamut of people that use these funds to build products for advisors and investors.

But even beyond the product category, we wanted to involve the service providers. Because those are the entities from accountants to lawyers to proxy firms to exchanges that are in the business of allowing us to have access to and support of the closed-end fund, BDC, and interval fund universe. It even includes the involvement of the SEC, where we try to engage them from perspective as well as to chat about ways we might improve the experience both for fund sponsors and in our opinions for investors.

We are in our third fiscal year. We have 16 members. We are looking to grow actively this year. We are very excited, February 1st we hired Mike Taggart to become executive director in a part-time role to help with the day-to-day executive management of AICA. Helping to increase the quality and depth of the content we create, help improve and grow the website that we maintain for investors, advisors, and members. As well as to help us increase our revenue model by getting new members and sponsorships to help drive the financial resources to fuel our events.

You may notice that you get to attend this event at no cost, and we actually have an invite-to-speak model, nobody was paid to speak on any of our events or our weekly podcast *The NAVigator*. To me that was very important to make sure we had choice in who was on stage for the best access to the best presenters on any topic. And while we always like to encourage people to visit our members and support them, we are not a member-only organization.

Why this event? And this is actually interesting, and you'll learn on the second panel where I'm participating, I had to go outside my comfort zone to think about this event because I don't really use UITs and ETFs for my clients. I'm more focused on the closed-end fund wrapper than the open-end fund wrapper of a UIT or ETF. But in full disclosure, we do have a UIT with SmartTrust in the BDC space, it may come up in panel one. I'm sure I'll reference it to some degree in panel two in relation to the ETFs in the space.

But I really wanted to think of those that needed not active, not self-selected, but the other ways to engage in this sector through different options for their portfolios. And there's a lot of good resources out there. And I hope that this session helps you know where to find information, think of the questions to ask as you build out the closed-end fund experience and BDC experience for your needs.

So with that I do have a couple slides I'll share in a minute. I would like to say, in the weekly email this week which you should all get if you're in this meeting, we are going to highlight a research paper that Mike Taggart did through his own resources on the rising interest rates and how it impacts traditional closed-end funds. It's quite a good read. It's detailed but not too technical. We'll make sure you get access to it also in the replay email for this session, but be sure to sign up for the AICA weekly emails to be able to gain that access.

I mentioned we have *The NAVigator* podcast. We have 134 recorded episodes so far. It's with a wonderful host, Chuck Jaffe, who many of you have listened to his podcast interviews. He's been doing his *Money Life Show* for almost 10 years and we've been with him now for almost three years as a partner in sponsored content to create an opportunity for more knowledge to be given to you through the audio. And we also transcribe it, for those that prefer to read, each of those timely interviews that drop every Friday on the AICA website.

We also, because remember AICA has service providers as part of our ecosystem, you'll learn a little bit, not too much detail we promise, about the fund of fund rules that recently changed and how it actually impacts UITs and ETFs of closed-end funds and BDCs. So one of our member companies Skadden, one of their attorneys gave me some bullet points that I'll share with you because we thought it might be useful to understand about that part of what's going on. It really remind me the reason we built this nonprofit trade association in the way we did and how we have.

Well, with that I'm going to go ahead and share my screen. And just share a couple of slides and chat a little bit about what the universe is like for what we're doing.

So when we look at the ETF wrapper there are really five that have focused exposure in this space. And I try to put some high-level data here, there's a lot more data on each of the, whether you go to an ETF database website, you go to the fund sponsor's website. One thing we do at my data business, at CEFdata.com, is we load in the holdings. Because once again, one thing that's nice about passive ETFs is every day we know the holdings. So every day I can load their holdings into my data business and look at all of the closed-end funded-ness that I'm curious about, and we have a lot of data there that you'll get some perspective on panel two for the BDC side.

But I tried to look at not just what you would see as the indicated yield or SEC yield, we actually loaded as of yesterday's close what the current holdings underlying yield are. And I would reference that generally speaking in my experience, the yield is reduced at the ETF level by the fee at the wrapper level. I do want to note that because of the acquired funds fee rule, you do have to show the weighted exposure of the underlying closed-end fund expenses with the expenses of the ETF wrapper. And I'd say that a lot of people think that doesn't make a lot of sense, obviously some people think it makes sense or the rule wouldn't exist. I feel like you're going to have that fee no matter what you do, the wrapper, their cost is really the only expense you are truly paying for out of the performance of the underlying investments.

And so when you see the yields here, we'll look at the muni CEF center with XMPT. Again, it is over 10 years old, it basically has an underlying yield of 4.63% which is roughly in line with an index we have that covers national muni bond funds, it has 60 muni bond funds and about $200 million in assets. And it's a great way with one ticker symbol to gain access, as you'll learn about on panel two, to that sector in a perpetual way. As we think about ETFs and UITs, really one difference is the UITs are typically termed 15 or 24 months and ETFs are considered to be perpetual, they're in existence until they for some reason choose to close by either some sort of decision at the structural level or for some reason the shareholders could vote for it.

For those that remember March of 2020, there were two levered ETFs, or ETNs to be correct, one of closed-end funds and one of BDCs. The volatility was so intense there that they actually triggered a rule that required liquidation during that month which was not added to the carnage of that month's downside. I would argue my opinion, this is only mine as all my comments are you might imagine today, that I just don't think that a levered fund, an ETN of closed-end funds or BDCs make sense to me at that 2x level. But again, that's my opinion.

Then another older exposure vehicle, more taxable closed-end fund is actually a mix of equity fund and bond funds, been around since 2010, has an underlying yield about 7.4% with a fee of 50 basis points. And this one is very diverse with 124 positions and almost a billion dollars in assets. And possibly I think the closed-end fund peak was in November, I'd have to check, maybe they were a billion dollars at the closed-end fund premium peak before we had a slight decline into year-end.

Few years later there's another taxable fund that came to existence, YYY. Again, it's underlying yield is designed to be a little bit higher as you'll learn about more in panel two, about an 8.08% underlying yield. It's fee structure is very common at that 50 basis points and has 45 holdings. That's about half the size of PCEF and is really considered more of a focused exposure to closed-end funds.

Switching to BDCs, there's really only one passive play, we've got BIZD. Its underlying yield is about 8.25% for the weighted exposure to the funds. We'll discuss it a little bit on panel two in more depth, but I want to let you know it's fee is 40 basis points, there's 25 BDCs in it and again just over a half billion dollars in assets.

There's the version 2.0 of another strategy, so actually the concept behind it goes back longer than its inception of February of 2019, but that's the current inception for the index that's driving this portfolio. This was really going after trying to have more positions and less of a market weight feel, and find the parts of the closed-end fund fixed-income universe that were good companions to the BDC sector. And so think loan-focused funds like listed loans from companies you've heard of, as well as CLO exposure, which again is, I hate to say it's BDC-like, but it tends to have that alt less common than a regular fixed-income fund exposure and it was the way they brought that portfolio together. It's underlying yields are around 8.2%, has 56 holdings, and has been growing for the last couple years with $35 million in assets.

The next slide is very basic, I tried thinking of how to organize. I count about 30 UITs of closed-end funds with over half exposure to closed-end funds. There's probably 22 to 24 that are more pure play in this space. One of our moderators today on the first panel actually created a UIT investing website that he later sold to NASDAQ, so it forwards the NASDAQ system. And it really is meant to cover in a really granular way the connected performance of UITs over time, something you couldn't do before Randy and his team developed that system.

There's about five sponsors in the UIT space that are active right now. We have three of them, so over half of the industry here today. We really are glad to have them here, and we just like to make sure that you get to hear their story about why they use closed-end funds to build the products they do for the investors and advisors that serve them.

There really is muni bond exposure, there's about eight strategies there. There's about, I guess the best way I count it really, I call it seven equity strategies, the tactical ones tend to have an equity overhang to it. There are two BDC strategies, there's the one we do with Smart Trust and one that an Advisors Asset Management does as well. And there's five more focused fixed-income UIT strategies, so you'll hear about those from the speakers on panel one.

We hope to find a way to present the unified universe of UITs of these funds better. I was chatting with Randy yesterday about how we can partner with our data business, AICA as a platform, and his experience in the structure and his partnership, his working with NASDAQ, to really help bring transparency, granularity, and information in a timely way to advisors and investors. And so pretty much that's it. I'm going to un-share my screen and I hope that you enjoy today's presentation. We're going to invite the next panel to come up on stage.

Recorded on February 3, 2022.

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https://AICalliance.org/