



Matisse's Boughton: International, Emerging-Market Stocks Are 'Dirt Cheap'

Wednesday, March 23, 2022

Chuck Jaffe, in this episode of The NAVigator podcast interviewed Eric Boughton, chief analyst at Matisse Capital and portfolio manager for the Matisse Discounted Closed-End Fund Strategy. Read the Q & A below as Eric says that the war in Ukraine has been creating deep discounts and bigger buying opportunities for closed-end fund investors, noting that emerging markets and international stocks went into the conflict already at low levels, which now means investors are getting 'a discount on a discount.' He notes that international equity closed-end funds now are



trading at a median discount of 12 percent, compared to a long-term discount of 10 percent; international bond closed-end funds now trade at a median discount of 11 percent, compared to a normal average of 8 percent. Those conditions – and wider discounts – should improve investor confidence that the investments can rebound quickly from the war.

Eric Boughton

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CHUCK JAFFE: Hi, it's Chuck Jaffe, host of The NAVigator podcast from the Active Investment Company Alliance. I also host a weekday podcast called Money Life with Chuck Jaffe, and on Tuesday, March the 22nd we featured Eric Boughton of Matisse Capital in our Money Life Market Call. Because the interview was focused on the Matisse funds, which invest entirely in closed-end funds, we wanted to make sure you got a chance to listen in. So here it is as a

bonus episode of The NAVigator, enjoy! Money Life Nation, you guys are always asking me to get more guests on to talk about closed-end funds. Well, you're in luck because I got one of the best guys around. Eric Boughton, portfolio manager and chief analyst at Matisse Capital is here, and yes, it's time to talk closed-end funds in 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 that's impacting the market now, and how they put it all together. My guest is Eric Boughton, chief analyst at Matisse Capital, which you can learn about at MatisseCap.com and which runs two funds that invest in closed-end funds. It's the Matisse Discounted Closed-End Fund Strategy Fund, which is MDCEX, and the Matisse Discounted Bond Closed-End Fund Strategy Fund which is MDFIX. You can learn about the funds at MatisseFunds.com. Eric Boughton, it's great to have you back on Money Life.

ERIC BOUGHTON: Great to be here, Chuck. Thanks for having me on.

CHUCK JAFFE: Eric, we always start with methodology, and when it comes to closed-end funds and also with your mutual funds, which of course say they're looking for discounted closed-end funds, discounts matter. But there's more to it than just the discounts.

ERIC BOUGHTON: Closed-end funds are awesome vehicles for investors to get extra income, and the thing that we love about them the most as you said, is that they can trade at big discounts to their net asset values. That gives us the opportunity to buy assets on sale. We find cheap asset classes and we buy the funds that own those stocks or bonds at sometimes 10-15% discounts to what they're actually worth.

CHUCK JAFFE: Of course closed-end funds move in the direction of those discounts pretty violently at times based on headlines. And man, have the headlines gotten closed-end funds moving again. So let's talk about this environment, because on the one hand, yeah, there's a lot of stuff that has been put on sale, and on the other hand, sometimes it feels like you're reaching out to catch a falling knife.

ERIC BOUGHTON: Indeed. The closed-end fund market is Putin on a sale, as we might say, with the Russian invasion of Ukraine is leading to some opportunities in emerging market and foreign closed-end funds. So that's something we're really paying attention to right now.

CHUCK JAFFE: Did you catch that in there? Putin on a sale? Yeah, okay. We like it in terms of the thing, we don't necessarily like what's going on in Ukraine. But it has been hitting closed-

end funds particularly hard because of course there are some areas, certain commodities, certain market sectors, closed-end funds that specialize in certain parts of the world. While it's been Putin on that sale, what has it been in terms of buying opportunities versus not? Because it put 'em on sale but it's not like there's resolution that gives you some idea of when the discounts are going to come off, is there?

ERIC BOUGHTON: That's a great point, Chuck. Anytime you're trying to buy things on sale, you have to admit the fact that they could go on bigger sale tomorrow, and so that's something we're definitely aware of. One of the things that we look at here in terms of the discounts and the opportunity is we need to get a handle on the magnitude of the issue. So one of the key things we're looking at for example with foreign closed-end funds is how big is Russia? How big a deal is Russia in the marketplace? Russian stocks are only made up about 4% of the MSCI Emerging Market Index over the past several years, and as we've seen, they've now actually been removed from the index because they're not trading. So investors who are panicking in closed-end funds are really misunderstanding the magnitude of that Russian problem. Another thing that we note about international foreign equity bond and closed-end funds is that relatively few countries are likely to see a long-term negative impact on the profits of their companies that result from Putin's invasion of Ukraine. So that's true for even emerging market countries. And third, international stocks and especially emerging stocks are starting out dirt cheap, they went into this dirt cheap. So the MSCI Emerging Market Index with Russia out of it trades at 13x earnings as compared to the S&P 500 say at 23x. In fact, at last week's low, the primary exchange-traded fund for the space, EEM, was down 25% from, get ready, its October 2007 level. Even when you add in dividends, total return for those 15 years is less than 1%. And finally, in international closed-end funds, and this is often the case in closed-end funds, you're getting a discount on top of the discount. So the international equity closed-end funds today trade at a median discount of 12%, 88 cents on the dollar as compared to a long-term discount of about 10%. Emerging-market bond closed-end funds trade at 11% discount compared to a long-term 8% discount, and we'll talk about some specific tickers there later on.

CHUCK JAFFE: You and I have talked about closed-end fund discounts in the past, and in fact we had a conversation as the global economy was heading into the pandemic. And we had just seen everything start, the market of course was tanking, and you came on and basically

said, "Well, I'm not saying that there's a bottom in here, but I am saying, 'Oh my goodness, look at the bargains I have to buy right now.' Well, now we've got the same situation but not with as much clarity. And I know it's hard to believe there was any clarity at all back in March and April of 2020, but there was, you knew that at some point the virus would pass. Here you're wondering if World War III is on the horizon. Is this buying opportunity better than 2020? Or is this buying opportunity worse than 2020? And of course we're taking out the emotion of buying during war time, we're just talking about the metrics.

ERIC BOUGHTON: Sure. Sure. I mean, I think the metrics aren't quite as attractive certainly as they were March 18th, 2020 at the bottom, but they are very good. I mean, the closed-end fund market today overall trades at an average discount of about 6% to its net asset value, and usually that's more like 3%. And that doesn't sound like a big difference but it's a standard deviation cheap for those who like math terms like that. And those opportunities are sprinkled throughout the closed-end fund universe. There are fairly cheap opportunities in terms of discount compared to history through the space and I would say that today the things that are getting the market concerned are fairly clear to us. There is of course a risk that the situation with Russia turns into World War III, and there is of course the risk that interest rates spike up to 4, 5, 6%. We can't discount that as a possibility but it's pretty clear that those are low-probability scenarios, and it's also pretty clear to us that the closed-end fund market is worrying about those things far too much.

CHUCK JAFFE: Where else are you finding bargains? And then let's flip that around, what are you moving away from where, nope, closed-end fund business has not really responded well?

ERIC BOUGHTON: So I mentioned emerging-market stuff, I think another broad area that we talked about in May of 2021 is MLP closed-end funds. And shockingly, all that's happened since May of 2021 is that even though those closed-end funds have done well for us, they've actually gotten cheaper on a discount basis, and oil prices have spiked to new highs, which ordinarily is good for these companies and their profits. And so the situation has become clearer that MLPs are a good bargain, their fundamental business has improved, and yet the closed-end fund MLPs are still trading at an average discount of 18% at the moment, and five funds are at wider than 20% discounts. But I think that overall, all the things we pointed out in May are still true. MLPs in general are about 12x earnings, they have free cashflow yields in the mid-teens, they have a dividend yield around 8%, they're still 60% below their 2014

highs. It's just a great opportunity and continues to be a good opportunity for new money in our opinion.

CHUCK JAFFE: And what are you staying away from? What are you avoiding?

ERIC BOUGHTON: So one of the things to talk about I think would be utilities. So closed-end funds that own utilities, your typical Duke or Dominion or electric utilities, things like that, these utilities are often valued by investors for their attractive cash distributions and the modest growth they can have in those distributions over time, and so they have many of the same characteristics as long-term bonds. So if you look at the bond market, the bond market is struggling; the long-term rates are up, the 10-year treasury has gone all the way up to 2.2% as the Fed has started to raise rates. So if you look at that you might expect utilities to be on sale, right? Long-term bonds are on sale, so why wouldn't utilities be on sale? But they're not. Utility stocks have performed well, they're up nearly 20% over the past year and that's pushed their indicated yields down to the mid-two's. That may seem like still a good deal compared to the 10-year treasury, but in general utilities have had a much bigger spread compared to the 10-year treasuries. So utilities could be one of those sectors that catch up on the downside if rates stay where they are or continue to rise. And meantime, utilities closed-end funds are trading at a premium on top of a premium in the sense that the average closed-end fund in the space trades about 12-13% above its net asset value. So that's an area that we'd say avoid.

CHUCK JAFFE: Well, now we're going to get your quick and dirty take on some closed-end funds that my audience is particularly interested in. Yes, it might seem like Fantasy Island when you can buy assets on sale, but that is a huge part of why you get interested in closed-end funds. And we're discussing closed-end funds now with Eric Boughton, portfolio manager and chief analyst at Matisse Capital, they run the Matisse funds. So it's MatisseCap.com, and you've heard a lot of the things he's getting into. Remember, if you want to participate yourself, you need to send your name, your hometown, and the ticker symbols you're interested to Chuck@MoneyLifeShow.com. We're going to start with a couple of requests that are internationally oriented but not necessarily all about Russia. Tony in Las Vegas wants to know about MXE, that's the Mexico Equity and Income Fund.

ERIC BOUGHTON: Ah, the Mexico Equity and Income Fund, in our opinion this is a buy. So this is a great example of an emerging-market closed-end fund that has nothing to do with

Russia but which investors seem to be rushin' to sell. In fact, Mexico's probably going to benefit from higher oil prices, and Mexican stocks are cheap at about 14 or 15x earnings, and meanwhile this closed-end fund, MXE, closed this past Friday at a 21% discount to its NAV, 79 cents on the dollar. On average over the past decade it's traded at a 12% discount. The fund's well run, it's beaten its benchmark handily over the long term, and it's a small fund and it's had recent activist involvement, so there's a chance that it might be liquidated at NAV at some point. No guarantee, but a possibility. And when a fund goes from 79 cents on the dollar to a dollar, that's a 27% extra return that happens. So we say MXE is a strong buy.

CHUCK JAFFE: Yeah, it's a strong buy on MXE. Don't be one of those people, who as Eric just said, is rushin' out of it. That's two drum tags for you, Eric. I don't know that we've ever had a guest who's earned three, but we'll see.

ERIC BOUGHTON: Oh, gosh.

CHUCK JAFFE: And we're going to move on to another international fund. Steve in Royal Oak, Michigan wants to know about the Aberdeen Asia-Pacific Income Fund, that's ticker symbol FAX.

ERIC BOUGHTON: Thank you, Steve. Appreciate you listening to the program. Yeah, this is another example on the emerging market theme, this time on the bond side. So this is an Asia-Pacific Income Fund, so as the name suggests, the fund owns bonds issued by Asia-Pacific companies and governments, it doesn't have any Russia. And yet recently investors have not only sold the Asia-Pacific bonds underlying the portfolio somewhat indiscriminately, for example, the underlying portfolio for FAX has fallen 12% over the past year, but they have also sold FAX itself down to a 13.5% discount to that depressed NAV again as of this past Friday. So we're of the opinion that not only will that discount narrow substantially, I mean, considered that since its launch FAX has traded at an average 8% discount, but its portfolio we think will also likely recover as well. And while investors wait, they're likely to collect a monthly cash distribution, again no guarantee, but it's been very stable, a cash distribution that works out to 9.9% on an annual basis. So for us FAX is a strong buy.

CHUCK JAFFE: That's a buy on FAX, Aberdeen Asia-Pacific Income. Our last international request comes from Morris in Bradenton, Florida. He wants to know about the IHD, Voya Emerging Markets High Dividend Equity.

ERIC BOUGHTON: That's another wonderful fund that fits the emerging market theme. Again, it's a fund with less than 2% in Russia, even before the invasion. It's very well run, it focuses on high-dividend stocks and it pays a quarterly cash distribution that works out to 11% on its current stock price. So typically it trades at a 7% discount and as of Friday it closed at a 12% discount. It's a strong buy.

CHUCK JAFFE: That's a strong buy on IHD, Voya Emerging Markets High Dividend Equity. Now we'll come back and go a little more domestic starting with a request from Rich in Orchard Beach, Maryland. He wants to know about the Liberty All-Star Growth Fund, that's ticker ASG.

ERIC BOUGHTON: ASG is a fund that owns growth companies at sky-high valuations. It's median holding trades right now at a PE ratio of 37, not even counting the holdings that aren't profitable right now. Meanwhile ASG itself trades at a 4% premium to its net asset value, when on average over time it's traded at a 5% discount. So premium on top of a premium, for us that's a sell.

CHUCK JAFFE: Yeah, premium on premium probably does smell like rancid rodeo. That's a sell on ASG, Liberty All-Star Growth. And last for Maynard in Phoenix and Rick in York, Pennsylvania, ClearBridge Energy MLP Total Return Fund, ticker CTR.

ERIC BOUGHTON: CTR, again here's a fund that fits our MLP theme well that we discussed. It owns cheap pipeline MLPs, like say MPLX and Energy Transfer. It pays a quarterly cash distribution which was just increased, and that distribution annualized is at about 8%, and it trades at a 21% discount to its net asset value as of Friday. Since its launch, that discount has only been 9%, so this is a buy for us as well.

CHUCK JAFFE: So we finish on a high note with one more buy on the ClearBridge Energy MLP Total Return Fund, ticker symbol CTR. And yes, we've got one more good bye to be concerned about, it's the one where we have to say goodbye to Eric Boughton. But Eric, always great to chat with you, thanks again for making me hit the drum tag a couple of times. Love to hear the notes that you're hitting, we'll talk to you again down the line.

ERIC BOUGHTON: Thanks a lot, Chuck.

Recorded on March 22nd, 2022

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