Your Questions Answered With Mike Taggart, AICA Executive Director

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed Mike Taggart of Taggart Fund Intelligence, the executive director of the Active Investment Company Alliance. Read the Q & A below as Mike returns to The NAVigator following up on his recent discussion of buying assets rather than discounts by answering some questions from the audience about the persistence of discounts and where discounts fit into the picture once you have purchased a fund.

Mike Taggart

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

CHUCK JAFFE: Mike Taggart, founder of Taggart Fund Intelligence and the executive director of the Active Investment Company Alliance is back and he's answering your questions about closed-end funds and discounts, 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, a unique industry organization that represents all facets of the closed-end fund industry from users and investors to fund sponsors and creators. And if you're looking for excellence beyond indexing, The NAVigator's going to point you in the right direction. Today it is pointing us back in the direction of Mike Taggart, the founder and chief executive officer at Taggart Fund Intelligence, now the executive director for the Active Investment Company Alliance. You can find Mike's research at Substack.com at TaggartFundIntelligence.Substack.com. But to learn more about closed-end funds in general, plus interval funds and business-development companies, go to AICAlliance.org, the website for the Active Investment Company Alliance. And if you have questions about closed-end fund investing, we'd love to get them. Send them to TheNAVigator@AICAlliance.org. Mike Taggart, it's great to chat with you again.

MIKE TAGGART: Thanks for having me back, Chuck. Good to be here.

CHUCK JAFFE: Mike, the last time you were on the show you were talking about "Buy the asset, not the discount", and we have a couple questions that go back at that subject matter.

MIKE TAGGART: Let's hear 'em.

CHUCK JAFFE: Our first question today comes from Morris in Bradenton, Florida. He writes, "I've been trying to introduce my son to closed-end funds, but he seems to think they're complicated. And maybe they are to him because he doesn't understand them, but he has me questioning myself a little. He says that I don't understand discounts, and that because they are based on market sentiment, they can't really narrow until the market sees a full change of mind or heart. So where I look at widening discounts right now and think this is a buying opportunity, he says this is something falling deeper into a hole, it will take longer for it to get up, and it may never get up. And I have looked at some funds and thought that the discount is too big and he might be right. Can we both be right here? How can you tell a discount is really just reading the temperature of the market right now, versus knowing that things are always set at that temperature?"

MIKE TAGGART: Well, there's a lot to unpack there, Chuck, and that's a great question from Morris. It sounds like he's really been doing his homework. I think one, his son doesn't seem to like them because they're complicated, and they are complicated and I think that's what makes closed-end funds so interesting, is that once you can understand the complications, then you can exploit them in a way that can make you money. But it's good that he's being circumspect and not just jumping in. In terms of what Morris is asking and saying here, I think this really gets to what I was trying to say with buy the asset, not the discount. Think of a normal stock. You say, okay well, it looks like it's cheap, let's say on a price to earnings basis or something. The next logical question would be, well, why is it cheap on that price to earnings basis? And that's what a lot of investors don't take the time to stop and think about with discounts when it comes to closed-end funds, right? What is this discount representing? So when I say buy the asset, not the discount, what I mean by that is let's say it's a municipal fund, you want to have more exposure to municipal assets. Okay, fine, you've already made that decision, now you go in and you start looking at the closed-end funds. And you can kind of see, okay well, they're all relatively discounted the same way, why would this one potentially be more discounted than this other one? So you kind of have to lift up the hood a little bit and say, "What is the share price here discounting?" Now his son has it partially correct I would say, closed-end funds are driven in part by market sentiment. So if you see outflows from a certain asset segment in a mutual fund segment say, right? That's probably indicative that the discounts on those same similar assets in a closed-end fund, the discounts are probably widening as well. If you see tremendous inflows into the mutual funds, the discounts are probably narrowing because it does have to do with that investor sentiment. That's not the only thing, though. That would be kind of like back in the day when academics studied this, what the behavioral economists would argue, it was more based on investor sentiment, that sort of thing. Whereas the more fundamental types would say, well, it's really based on fees and expected yield and that sort of thing. So there is kind of a natural level I think for most closed-end funds, and the trick is just to watch them and to kind of get comfortable with if you're looking at a specific fund, you should know that okay this thing usually trades at a 10% discount. But now the market sentiment's blown it out to a 20% discount, now might be a good time to get in because I know long term over time it should go back to the mean. And that's really, when you're investing in closed-end funds based on discounts, that your bet. Your bet is this discount is going to revert to the mean which is narrower, and the way it's going to revert to that mean isn't because the NAV falls the price, it's because the price is going to go up to the NAV. It is complicated, his son's great to point this out to him. Yeah, they can both be right, there's a natural level and then there's sometimes where it gaps out wider.

CHUCK JAFFE: Well, that brings us to our second question which is from Maynard in Phoenix, which kind of talks about wide discounts. He writes, "Chuck, next time somebody comes on to talk about closed-end funds, I have a question. In my example, TYG," and that's the Tortoise Energy Infrastructure closed-end fund, "But TYG is selling at a 20% discount right now even though energy has really come back into favor and prices of the underlying stocks have skyrocketed. Do they expect the premium and discount to narrow on these energy closed-end funds? And more importantly, why is it taking so long?"

MIKE TAGGART: Yeah well, I mean that's a great example right there of what we were just talking about. So TYG, it's a good fund run by, I would argue one of the top firms in the energy space, and the thing to bear in mind is that most funds that are similarly invested are also trading at wide discounts still despite the run up in energy prices. So the natural question, which he's asking, which Maynard's asking is, why is that? And I would argue that investors, they're remembering, they're remembering that this is a very, very volatile sector historically. They remember what happened in March of 2020, and they are a little skeptical to invest, to jump in to such a point that the price would go up and converge with NAV let's say. So let's bear this in mind too, Chuck, TYG could still perform right alongside energy prices, right? It could even potentially outperform energy prices and the discount could still stay at a 20% discount. And that's what we're seeing throughout the space, is that these closed-end funds that are related to real assets and to energy specifically, they're having great runs but the discounts aren't narrowing because the NAVs are going up steadily as well. What I tell people is once you're invested in a closed-end fund, you really don't care about the discount, all you care about is your underlying return; your total return of the capital you invested. And I tell people, I've never in all my years ever heard somebody say, "Well you know, I invested in this fund at a 10% discount and it turned out great, I lost 50% of my invested capital but the discount narrowed to 2%." That's ridiculous, right? Usually what you hear is somebody says, "I bought this thing at a 20% discount. I've had great returns and it went up 30%." And they never mentioned what happened to the discount because once you're in it doesn't really matter what happens to the discount as long as you're happy with your return. For instance, let's just use a 10% discount to keep it easy. You buy a fund, it's trading at 9, it's share price is 10. The share price goes up 100% to 18 and the NAV goes up 100% to 20. You're still at a 10% discount, but you've made 100% return on the investment. That might be a very clear-cut way of showing what I'm trying to say.

CHUCK JAFFE: Yeah, absolutely. And again, in the case of TYG, well, we've got a fund that the long-term discount hasn't been much better than the 20% where it stands now, it's been 15-16%. And in spite of that, or maybe irrelevant to that, the fund was up almost 50% in 2021, and the fund by the way was down about 70% in 2020, that's part of how it all comes together. Mike, great stuff as always. We'll talk to you again soon.

MIKE TAGGART: Thanks Chuck. Thanks for having me. Great questions.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. That's me, and you can check out my show on your favorite podcast app or by going to 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 Mike Taggart, who is the executive director of the Active Investment Company Alliance, but he's also the founder and chief executive at Taggart Fund Intelligence. And you can check out his research on Substack at TaggartFundIntelligence.Substack.com. The NAVigator podcast is new every Friday, ensure you don't miss anything by subscribing via your favorite podcast app, and until we do this again next week, happy investing everybody

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