John Cole Scott provides welcoming remarks to the Second Day of the 2022 Interval Fund Spring Manager Spotlight.

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John Cole Scott, Founder and Executive Chairman of the Active Investment Company Alliance opens Day 2 of the April 2022 AICA virtual event. Read the transcript below to hear what Mr. Scott had to say.

John Cole Scott

To view the rest of the conference events and panels go to: https://aicalliance.org/aica-event/2022intervalfundspringmanagerspotlight/

John Cole Scott: Good afternoon, John Cole Scott, the founder and executive chairman of the Active Investment Company Alliance. Want to welcome you to another day of our Interval Fund Manager Spotlight here in 2022. Want to do a couple of opening remarks to make sure you're aware of who AICA is, and where we are and where we're going. We are just finishing up our third fiscal year. We are a nonprofit trade association focused on closed-end funds, interval funds, business-development companies, so essentially the entire universe of listed and nonlisted closed-ended management companies.

My regular business is running the firm Closed-End Fund Advisors, a 33-year-old investment advisory firm that my father was involved with up until recently, and his work in closed-end funds was over 50 years. The content model for AICA is an invitation to speak, and we work

with Mike Taggart our executive director, to try to pick out the best panels for you our audience. We both work for tremendously high quality day-of event work as well as replay content that is accessible, timely, and durable over many months to come.

In that we are an invite-to-speak model, we are a membership-based financial services support nonprofit. What that means is that our financial model is primarily from the annual dues of our member organizes from across the landscape, and we could not do this without the membership of those entities. If you're an individual investor or financial advisor and you like what you're doing and want to give us a vote, there are suggested donation options on the website and during the event. If you think this content is viable, we always appreciate feedback as well as any sort of vote from you as well.

It's great, an opportunity for us to remind folks that we are in the third month of having Mike Taggart being an executive director for AICA, really helping to run the day-to-day executive functions. While I'm still heavily involved in the content creation and obviously the vision I put forth three years ago.

We are able to power a lot of our work with my data business, CEFdata.com, which fully covers the entire ecosystem, the last bucket we're firming up is all of the nonlisted and private BDCs. We will have all that data, which is available in a light format on the AICA website in the fund screener by June 1st of 2022.

We are excited this quarter, we were able to forge a building and growing partnership with CAIA. Mike wrote an article, we updated and refocused an article on the interval fund basics, and we got that posted on the CAIA website. You can get to that as I said earlier in the announcement by clicking either the link on the agenda page of the AICA website or the CAIA logo on the floorplan of this day-of event.

We also want to remind people that may have missed it, my firm Closed-End Fund Advisors had their quarterly research call for the ecosystem last week, and the slide deck and replay video are posted on CEFadvisors.com's main website on the left-hand side about a third of the way down.

We are excited, next week I'm going to be on our podcast with Chuck Jaffe. Chuck is our next moderator and a long-term friend and partner. He is the podcast host for AICA's weekly podcast, *The NAVigator*, and I'm looking forward to being on our 150th episode, which is the tail end of celebrating his 10 year anniversary of the current iteration of his podcast. Though he's been doing interviews in financial services for decades and decades and is a valuable partner and friend in this space.

We want to give you a couple of save the dates. We've learned at AICA to plan and plan and plan. We're doing a two-day afternoon BDC event, June 7th and 8th on the Remo platform, so it will be virtual like today. If you're interested to become a speaker and want to nominate yourself, if you're interested to become a sponsor, or if you want to be involved in any way, shape or form from the committee that helps organize it, please let Mike or I know.

We are also working to do an in-person event three years after our launch event roughly, 2022, November 16th in New York City. We're again going to time it the day before the ICI Closed-End Fund in-person conference in New York City. And with that we always have a lot to cover, I'd like to keep these opening remarks to about five minutes. I'm going to share my screen, so let's get started.

We like when we frame closed-end funds, interval funds by comparing them to listed funds. So this through quarter end is the landscape. Think about the listed space, where discounts are, where assets are, and high level what I'd like to say is that there's a lot of diversity in both the listed and nonlisted use of the structure. The focus of the interval fund structure is heavily focused on less liquid investments, so what you'll see is a lot more private exposure to the interval fund wrapper, yet still the daily net asset value that's struck for essentially every interval fund.

To me, there's always special exceptions. And we have a couple lawyers in the audience and they always love to point them out, and that's why we have relationships with them for that experience. But the general best use and ongoing use of the interval fund wrapper is the daily net asset value, it has to be approved at a wirehouse, but then you can inflow daily and they typically offer 5% of their shares every quarter as redemption. And so by doing that they can have far less liquid holdings and really maximize that use of the nonlisted structure, and they can decide to do leverage or not do leverage.

The biggest sector of listed funds is municipal bond funds, and yet the newest growing version of interval funds is municipal bond funds. There are two funds in that sector, so there's 120 more listed funds. And when I started my data business 10 and a half years ago I guess at this point, there were I want to say 230 or 240 municipal funds, in the course of the last 10 years a tremendous number of mergers to consolidate state funds, even taking state funds into national funds, and repurpose and reorganize and kind of raise the size of many of these funds.

So that while municipal bond funds may not always be as institutionally of interest because of their tax-free characteristics, they could be. The fact that they're bigger, which typically allows lower leverage cost, lower fixed expense ratio cost, and easier trade liquidity for getting in and out are generally a positive thing. Like I said, the next biggest sector of the ecosystem in the listed space are BDCs, and there's roughly half of the total BDC assets in the listed format in gross assets and half in the nonlisted. And like I said, we'll be having a lot more data to cover that in June event coming up.

In that capacity I'd say the real estate sector is a large, one of the earlier big growth parts of the interval fund space, and an ongoing part for new funds. I think one out of every five new funds recently has been real estate focused. But what we tend to find is that the real estate funds in the interval fund space are far more likely to have bigger chunks of debt and bigger chunks of illiquid exposure, like we talked, to the structures benefit.

When we think about where we are in the discount picture, if you were at our December Interval Fund Manager Spotlight, we talked about discounts being somewhat narrow, that's the recent peak on this screen. And we talked about the fact that if discounts are narrow, then there's an

extra potential reason to use interval funds if you're trying to find the cousin funds or the peer funds because there's less discount pickup to get in the listed funds. And again should there be any volatility or market hiccups, you tend to have downside volatility separate from the manager, sector, or investment volatility just by discounts widening. And that elastic component of discounts widening or narrowing is an ongoing part of the closed-end fund. It's both many people's favorite parts of listed closed-end funds, and some people's least favorite parts. It's why there is a market. Of course remember, every time you buy or sell a listed fund, both sides of the transaction agreed it was a great price and the future is always unknown.

But where we put discounts currently, definitely not the tightness of December of 2021, but I'd like to think that while we're more at an average, so slightly wider than the 20-year average. I would say that, and there's always looking forward to either potentially overweight good news or overweight bad news. I wouldn't say that there's bad news on the horizon, but definitely with inflationary tailwinds to some markets and inflationary headwinds to other, the cost of leverage ticking up a little bit and it takes a little while for many of the credit funds to pick up extra yield as they tend to invest further out than their leverage cost, that maybe it's justified to have a normal discount now, one point wider than the 20-year median.

So why would now be an opportune time to consider interval funds as a piece of your portfolio? And to put my advisor hat back on, about 10-20% of our separate accounts where the investment object allows it, are interval funds. And we tick that up or down a little bit, it takes some effort to swap funds in the interval fund space or potentially redeem some of those assets to buy liquid funds with. The reason why I think this opportunity is now would be that the volatility tends to be less, and if you are in the camp of trying to lower your forward looking volatility in parts of the portfolio, if you don't want to give up active management and you want to be invested, it could be a great time to overweight your interval funds versus a year ago.

When I really think about the history of the structure, there's less than 10 funds with a 10-year track record. And so it really speaks to how there's a reason we didn't have the dataset 10 years ago, we weren't focused on the content 10 years ago. There were very few options and there wasn't a lot of competition. And I feel like one of the best things about capital markets is that intense competition does create value for investors and the advisors that serve them by giving them choices and making fees require to be competitive, holding managers accountable to actual investment results and processes, and really supporting their funds with updates to their website, with fact cards, with commentary, and making the effort to make sure advisors and those advisors are supported.

A decent number of funds now have a five plus year track record, but what I really want to focus on is how many funds have a one to five year track record. Tremendous number of funds, many of which have been on the event today or yesterday or last fall. And even in the last one year, which has been mostly a bumpy year, there's still six live interval funds that have less than that track record. We're still seeing lots of filings for creating new funds. We're seeing new funds seeded with capital to give them the jumpstart into the market, typically that's often with $100 million and to get onto at least one or two of the platforms to improve advisor demand and success.

I touched on it a little bit when I was comparing the listed fund market, but really as we are choosing interval funds for our client portfolios at Closed-End Fund Advisors, I really love the larger, the private illiquid, private equity, private debt, private real estate, the private stuff that I just am not going to find in the listed fund sector, or where there might be often a deep discount to gain access to it and just makes it hard to own it for a long period of time. Because it's hard for a fund to have a pervasive discount over 15% for years and years and years and not get at least some inkling of interest from the activist investors in the space. There are not a large number of activist investors but they're pretty focused in their work for the listed funds.

What I also love with interval funds, because you don't have that market listing, they tend to pay out their real yield. There's always an exception to any rule, but when we review the dividend classifications, when we look at the NAV total returns and we do our work as an analyst in the space, we are finding far more sustainable and pure dividends being paid. And if we're ever talking to a fund sponsor, we definitely tell them that's a very appropriate way to handle this fund structure. And that in fact every quarter the distribution can be a little different because the markets are always a little bit different, and that is far more palatable in the nonlisted space.

You really aren't going to find the manager level distributions, which can be very common, and not always bad but just very common in the listed fund space. Which can often be used as a discount management mechanism to reduce the wider discounts by giving more certainty to monthly or quarterly distributions. When we decide to use these funds we really are taking off the ability to trade intraday for listed funds to reduce our expected volatility. Because A, there's no listing, so no market price, and B, historically as a later slide will show, there are less volatility at the NAV level for cousin funds in our analysis.

I would note that the minimums can sometimes be misleading if you're an advisor looking to allocate to a fund and you feel like you don't meet the minimums at the client level or firm level, I definitely recommend picking up the phone, talking to the fund sponsor of the interval fund or even your custodian, to just confirm what is normal and what can be offered to you. Because I can tell you a lot of these funds, if they find the right advisor, can possibly lower that a little bit to get you active and working with them as an investor.

As I said earlier, leverage is less common and usually lower. I would say that is partially because some of the fund sponsors that come to interval funds come from the open-end fund world where there isn't leverage directly for the funds. And then also because they're not trying to be the most competitive on a yield basis, they're more of a total return vehicle, you'll see that the sometimes will just be more tactical in lowering their leverage because of the way they structure their investment mandate.

If you're having any issues getting your fund or if you're an advisor trying to get a certain fund on your platform, that is one of the many goals of AICA. Beyond content, is to try to advocate and to coordinate and to balance perspective in this sector through all of our members. And I think I said we are fund sponsors, product sponsors like my firm, and service providers like at some level, Chuck Jaffe's a podcast host in the space, he's a partner of AICA, but he's not a fund creator and he's not a product creator. And then Skadden, who moderates a panel for us on this

event, is a law firm in this space that's committed to the structure and supporting AICA, which we could not do without support of members and partners like that.

I would say asset allocation, it's diverse, it's gotten more diverse in the last five years. One of our favorite things, it used to be I want to say 40% real estate funds, I love the growth of the interval fund structure. We have seen the growth lower a little bit from '20 to '21 year-end. We typically see the growth intra-year after March 31st, so our data is waiting for that update. We really can't have an update because most updates aren't done in 2022 by March 31st. But we are looking for some upticks in that data, expecting inflows to really be a powerful growth of the interval fund, and even the newer funds in that sector. But conceptually there's about $325 billion in all of the listed funds, and there's about $65 billion in tender offer funds, which we have one on a panel today, but really less of a focus. Though to me a really good version of the tender offer fund structure and could not be offered as an interval fund, and just under $60 billion in the interval fund space.

We always like to look at the trends of new funds versus funds I would say died, or in the listed fund space we might call it the closed-end fund graveyard. Backdropping to the same growth charts that we're seeing from asset size, every fund structure from ETFs, which we don't cover, to traditional closed-end funds, to BDCs, to interval funds, you're going to have ideas that succeed and some ideas that fail. That is one of the beautiful things about capital markets, is not every fund ever created is required to live forever, only those that make sense and are durable and meet investor demand and service their clients appropriately are there. So losing funds every year is a normal part of the ecosystem. I would say '21 saw a bigger tick up, and I would argue that a lot of that, over half of that was kind of pending transactions changing from the pullback of Covid. This year we have a couple of funds leave the sector. And again, we would expect one to three of those every quarter would be a normal number. One to two every quarter probably more likely.

This was that slide, and we did this about a year ago, sorry, two years ago. Time both goes quickly and slowly when you work from home, way more than it used to pre-Covid. And so what This is I think the last slide, but really want to focus on this slide because it really comes down to show the cousin funds in the space and that we have typically less leverage in interval funds, as we prove that point, but also less volatility. That's the one-year NAV standard deviation. And yet better total returns through a March of 2020 because they didn't rise as high up, and then they fell less and they were able to recover. So I'd say when you're thinking about these funds you can't sell them every day, which some people dislike, but I think you can say with a good manager and a good sector and a good fund you're willing to trade up to that liquidity for less volatility.

This is just a quick look at some of the recent funds in the space. Again, this slide deck will be loaded to the agenda page and sent to you as a follow-up attendee. And these are some of the largest funds in the space, just to make sure we cover that. And with that, that is it.

Recorded on April 27, 2022.

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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