March 2022 Virtual Event-AICA Spring Closed-End Fund Roundtable Day 2 Panel #3; "Institutional Investment Strategies to Navigate Through Market Storms"

Wednesday, March 16, 2022

John Cole Scott, AICA's Founder & Executive Chairman, moderates the third and final panel of Day 2 of the AICA March 15th & 16th, 2022 virtual event; "Institutional Investment Strategies to Navigate Through Market Storms". Read the transcript below to hear the discussion among Mr. Scott and panelists Stephen O'Neill from RiverNorth, Ken Fincher from First Trust Portfolios from Nuveen, and Rob Shaker from Shaker Financial Services.

John Cole Scott

Stephen O'Neill

Ken Fincher

Rob Shaker

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John Cole Scott: Good afternoon, I'd like the panelists for the last panel of today's session to please join me on stage. Wow, Rob Shaker is wearing a tie and I'm not. You could probably say that's not very often.

Rob Shaker: I have my Ukrainian colors today.

John Cole Scott: Ah, much appreciated. With that, we are sure that just like the Nuveen panelist earlier, that Steve will be able to join us shortly and our people are on it. This panel really to me exemplifies a lot of what AICA is. This is not the people who create closed-end funds, these are the people who actually are the secondary market whose professional careers

have been dedicated to closed-end funds. I would not be in this footing if my father hadn't spent 50 years as a close-end fund investor. Rob's father also was a long-term closed-end fund investor. I'm pretty sure Ken's father wasn't, but he's been in the market longer than I think Rob and I combined almost, because he started when he was four years old is what I'm told. And then of course we have RiverNorth coming on as well, another well-known player in the space and Steve's been active there for a large number of years.

So what I'd like to do is we're going to give a detailed discussion of various ways that we look at the sector and use it for different portfolios. And I thought we'd start off with Ken, if you can give an introduction to your firm, yourself, and then any of the products that involve closed-end funds that you're working with.

Ken Fincher: Sure, thanks John. Good afternoon, everyone. As John mentioned, my name is Ken Fincher, I'm with First Trust Portfolios. We're out of the Chicagoland area in Wheaton, Illinois. For those people who might be sports oriented, you think of Red Grange, the Galloping Ghost, University of Illinois, was a Wheaton resident. And if those people a little bit more in tune with current events or who like to follow media and celebrities, think of the Belushi brothers. The Belushi brothers also originally from Wheaton, Illinois.

First Trust is an asset management firm, most notably known for unit investment trusts, which can be a wrapper for any number of investment vehicles, as well as exchange-traded funds. Obviously the latest and greatest, though starting back in the mid-1990s. We are a purveyor of well north of 100 exchange-traded funds in the markets. So those are a few of the things we do. We run north of $100 billion, both in ETFs and unit investment trusts combined we're probably about $160-170 billion. Myself as John mentioned, I've been involved in the industry since the late 80s. Currently I run a few different strategies utilizing closed-end funds. Most notably we run some SMA, separately managed accounts utilizing closed-end funds as well as a couple of listed products that utilize closed-end funds at their core. So that's a little about me. John?

John Cole Scott: Great, and we'll let Steve go next now that you're properly on stage. You didn't have to sweat too much to get there.

Stephen O'Neill: Yeah, I was panicking trying to get on here last minute. Sorry for the delay. Yeah, my name's Steve O'Neill, I'm a portfolio manager at RiverNorth Capital here in Chicago. I've been with the firm since 2007, and the firm was founded in 2000. We manage approximately six billion dollars in capital, about half of that is in closed-end funds where we are the sponsor. We manage private assets, hedge funds, that's about a billion dollars, and the balance is open-end mutual funds. And a common theme across our investment strategies is that we are opportunistic investors in closed-end funds. So it's a little bit hard to follow. We manage closed-end funds and opportunistically buy closed-end funds, but that's the common theme that I have with our panelists today.

Our firm has devoted 20 professionals' time to actively trading closed-end funds. We think about them both fundamentally and technically. And frankly we ask our clients to determine which type of risk they want to take, and we use closed-end funds as an alpha overlay to those strategies. And so if somebody wants a muni bond strategy, we will focus on generating that tax-

exempt income, but we look to trade closed-end funds that generate alpha on top of that. And certainly for our absolute return vehicles, the hedge funds, we're really just going long-short closed-end funds or long closed-end funds, short ETF, and the goal is to really just isolate that alpha. Hopefully through this conversation today the listeners can appreciate some of the inefficiencies that we collectively see in the space. So that's RiverNorth, so thank you. John?

John Cole Scott: Cool. And Rob?

Rob Shaker: Yeah, my name is Rob Shaker, I'm a partner and chief investment strategist over at Shaker Financial Services. We describe ourselves as a boutique investment advisory firm specializing in closed-end funds. What we do is we create, for individual clients in separately managed accounts, balanced portfolios utilizing almost exclusively closed-end funds. And what we do in general, our core strategy we describe as discount capture. And by that we mean that through our algorithms and through our active trading we intend to purchase closed-end funds when they're artificially wide, rotate out of them once they narrow back into something else that's artificially wide. And through this process of discount capturing and discount capturing we create an added value to the client accounts. And that's what we do all day.

John Cole Scott: Sounds good. So now let's see, actually getting into the weeds a little bit, I'd like each of you to take one of the major sectors of closed-end funds. So what's your perspective? How do you analyze this group? Where do you think investors or advisors are focused on the wrong thing or missed something that's really important? And we'll start this conversation with Ken. If you could talk about the equity fund neighborhood of closed-end funds that would be appreciated.

Ken Fincher: Sure, 2021 was a good year for equity-based closed-end funds. If you look on average, the average fund was up over 20%. So that really gives you in terms of talking about underlying economic strength, underlying equity strength in the markets in 2021. The IPO calendar played a significant role. Obviously IPOs in closed-end funds were dominated by equity-based product in 2021. And because of low income they got away from income-only vehicles and were looking for capital appreciation and total return.

Now when I look at the equity space, I really put equity closed-end funds in three real categories. On the far right you have those people who say, "Hey, look, we're an equity fund and it's all about total return." A lot of these are older portfolios that don't have a distribution policy and they really play the total return. They may pay out once a year, maybe twice a year. On the other side, on the far other end of the spectrum you have those equity based funds that try to be quasi-bond. And that is a lot of the more recent portfolios. I say recent, probably last 10-15 years. Where if you walk into a banker, the banker says, "First question, what's your income? What's your yield? What's your distribution rate for the portfolio? Because we need that to get you through and get you sold." And so those people are kind of quasi-bond, though they're equity underlying I view them as kind of quasi-bond. We're giving up some upside in order to give you some income on an ongoing basis.

And really right smack dab in the middle is you have a lot of the older funds that have said, "You know, we're going to adopt a distribution policy. We don't want to lead with a distribution

policy. We're still going to be total return oriented, but we know our investors are looking for a little bit of income so we may go quarterly. We may pay out somewhere between 3-5% in terms of the distribution." And sometimes that's done simply because they're looking to change their strategy or get in front of more advisors. Other times it's done because you have a new breed of dissident investor in the closed-end fund space. Those people who are saying, "Hey, you know what, that big discount just doesn't cut it with us anymore. We want to somehow realize NAV or get closer to that net asset value." And so these can either be reactive or proactive strategies used by the sponsor to get involved.

It's important in the equity space. When you think of distributions in the equity space, it's a little bit more art than it is science. And what I mean by that is unlike the fixed-income side where you typically have a coupon that gets clipped by the sponsor on an ongoing basis. On the equity side income levels in equities tend to be relatively low. Now again people might say, "Well, Ken, what about MLPs, what about preferred stocks, what about banks?" Yeah, those tend to have a little bit higher coupon, or not even coupon, income play. But nonetheless, equities overall don't produce a lot of income, they're total return vehicles.

And so when I say it's an art, is in many instances the sponsor has to come up with a way that they're going to release a distribution or they're going to generate a distribution. In some instances it's option overwrite, which is an inherent form of leverage in the closed-end fund space. Not like the 40 Act leverage we're all used to, but it's something to help generate income. Back about 10 years ago what was a hot dot was dividend capture. That didn't really end too well, but nonetheless it was a way for an equity-based fund to generate some income for that investor. So that's kind of the art that goes with it. Other funds take a little bit different tact, now if I need to move on, and what they do is they try to generate returns on their net asset value before they institute a little bit more of a distribution policy. So it's a little bit more art than it is science.

John Cole Scott: Very helpful, Ken. Do appreciate that. So Rob Shaker, thinking about the taxable fixed-income universe of funds, could you please share the same type of perspective from your role?

Rob Shaker: Sure. Actually going back to 2021 as well, it was a strong year in taxable bond funds as well. Part of the beauty of last year, sort of across the board, was just the slow and steady nature of things without any of these violent hiccups or corrections and such. And so it really was a time in which you could sit back and focus in on what you were looking for in a given fund and a given discount. And as I tell people all the time when they're dealing with closed-end funds, one of the most important things you have to remember in terms of how we analyze things and how you need to analyze things as an advisor, is the discount matters. Now it's not always controlling it and you can have lots of other reasons why you'd want to enter into or leave a particular fund, but it does matter.

Your total return is going to be in large part determined by the change in the NAV, so that sort of depends on which fund you're in and what type of fund it is, but then also plus or minus the change in the discount. And that's just a reality that takes place. So in terms of what you're looking at, you always want to be looking at the discount. And what we had last year with the

slow and steady nature of things, with the increased, I would say demand in closed-end funds, possible shrinkage of supply, you had a general increase or narrowing of discounts to a really firm level by year's end.

Going into things that maybe I think you said sometimes people might miss in terms of investing. I think something that's inherent in closed-end funds that people don't fully understand is that closed-end funds can move as a group in terms of their discounts. They can widen as a group at one given time. And while it seems a little bit strange, it's just sort of mechanical. One of the big differences between closed-end funds and their open-end funds like most people call those mutual funds or ETFs, is what happens when selling pressures intensify? Which is what happens at a basic mechanical level.

If you go into the ETFs, whole bunch of people want to sell this ETF. You go into a mutual fund, a whole bunch of people want to sell this mutual fund. You get redemptions. And they might put a little bit of pressure on themselves, with the ARK funds, everyone heard about how that would spiral a bit. But you get redemptions, that's what happens. You still have a fair NAV value at the end of the day. With closed-end funds, because of the fixed-capital structure, that's not what happens. You don't get redemptions, you get a dislocation of the price. The price goes down. You get the widening if there are more sellers than buyers.

So I think sometimes people take that as some type of indication of negativity beyond the fact that you just have more sellers than buyers. That occurs at times. We all witnessed it across all the markets as of late. And so that's one thing I think that people might miss from time to time, and it's something we can talk a little bit more about. Because the general idea, and we've been experiencing one if not a couple so far this year, is that you do get this general selloff followed by an equilibrium, and then followed by a nice recovery. It's a temporal thing. It's not a systemic thing, it's a temporal thing because of the selling pressures that exist overall, especially when you have sentiment fear-based selling.

John Cole Scott: That's good. We're probably going to need to move on, I'm sorry.

Rob Shaker: No, perfect.

John Cole Scott: Good. So Steve, the other, actually the largest bucket of closed-end fund assets are munis. You guys have a lot of perspective there, so can you share how you look at them and what you find to be most important in muni bond investing?

Stephen O'Neill: Sure. Certainly I think I got the easiest group of funds. I'm going to demystify this a little bit and I'll tell you what we do after what I recommend others do. And I thought of this this morning and I was looking at the munis and the munis are just getting clobbered this year. You would think if we all sat down and did all our research and we picked the best bond portfolio, and the best call profile, and the best over and underweights across the sector, you'd think there's be some room for difference and there really hasn't been. Like I looked at BlackRock's lineup, they've got 17 national bond funds, the average NAV is down 8.5% total return. All but one of them is within 100 basis points of the average. Which means it's the same people doing the same thing across different funds.

And that's kind of how you can boil down most of the muni bond space, in a way that Ken didn't have the luxury of simplifying it this way, BST is a way different animal than CAF. But MYI is really similar to BLE or BYL. And so when you think about muni bonds, you can do all the work. Professionally, you're looking at the financial statements, looking at all the risk stats, thinking about the capital structure, but at the end of the day most of these funds are pretty similar. And so if I was going to do this at home, nonprofessionally, I would find the funds that are homogeneous. And there are certainly some landmines out there where there is alpha managers good or bad that are making calls outside of your single A long duration muni bonds, but for the most part these can be categorized as municipal beta.

And so I would look at it, if I was doing this, I just want to pick one fund a month or one fund for a long-term investment, I would look at which funds are tracking to peer group. Find a fund that's in the herd, look for a liquid fund, liquidity is really important for trading closed-end funds, find an attractive discount, and then dividend coverage is important but they're all going to move the same way to steal Robert's point about just peer group movement. And so I think muni closed-end funds, there is a lot of them but it's overly complicated because many of them are the same. And you know that because the fund sponsors are merging them.

I don't know how many funds Nuveen used to have, but now they have a handful of them and they're really proving the point, which is a bigger liquid fund is better, and the strategies are so similar we might as well merge them together. And so I think my point for the listeners is you know what, it's hard to compete against the three people on this call. We've got people studying every zig and zag on discounts in the market, and we're trying to make as much money as possible trading discounts. But it's important to acknowledge that for the most part we recognize that the group's fairly homogeneous, which is the reason why you can trade in the first place.

But it is a safer place in the market to say, "Hey, how are the big funds doing? What are those discounts? Maybe I'll make a bet there." In a way that you can't really do in the taxable bond space. I mean, PDI is a totally different animal than HYT. BST is a different animal as EXG. But in the closed-end fund muni space, NDMO is a lot different than NEA, but that's about as apples and oranges as you can get in the space. And so although we do manage a lot of muni funds professionally, we're never out there saying, "Hey, we're super sure that this BlackRock fund NAV's going to be way better than that Nuveen fund NAV," because we have a view, and that's just based on history, you have a daily NAV for these funds every day.

If there were meaningful differences you would see it in real time. And that's why I started with that BlackRock example at the beginning of the call. This is a huge year for munis. Whatever it is, the worst since whatever, you would think there would be more movement. But there's not because this is a fairly homogeneous asset class. Happy to be challenged on that but I think is the simplest asset class of the three.

John Cole Scott: It is, and in my intro session I talked about the purest version of the closed-end fund. As you might appreciate, it's good to have at least more than one ticker symbol per sponsor for tax-loss season so you can easily swap and harvest those losses and still maintain exposure. But you're right. And because your question was easier, Steve, I'll let you start the

next answer. So dividend policies, again large, the biggest differences of opinion of it's super important, it's not important. I always talk about it's the board's decision; the managers are guiding the NAV and boards guide the policy. Tell us how you think about them, entering and exiting funds, or ever where they make an important factor for you decision for closed-ends.

Stephen O'Neill: Sure, that's a good question. I guess whether it matters or not, I think let's just set the foundation which is if you're getting a return of capital, that's not return, that's just your money back. And so if a fund is overpaying its distribution and cuts it, it's the same projected total return as it was before. If the total return of the muni strategy's going to be five and they're going to give you 50 basis point of capital back, then it doesn't matter whether they paid the dividend at five and gave you 50 basis points back or just paid you the 4.5 assuming no change in the underlying bond values.

And so for me the total return's the same. But I acknowledge that we have more of a differentiated view, like we know the math is the same but we know that closed-end fund investors rightfully so view these as income vehicles and they don't think about premiums and discounts, they think about monthly payments in their brokerage account. And so when that brokerage account, that value changes, then there's a negative reaction. That goes to Rob's supply and balance. And so from our perspective, and we're going to talk about this a lot, know what you're buying. But the asset class and know what the earnings power of that closed-end fund is.

From there, you should be happy. You should be happy obviously if the dividend's earnings power is increasing, but if it's decreasing do you necessarily move away from that? You have a view on the asset class. I think it's more of how do other people perceive? What will other people do when the dividend's cut? And so what we do is we're always trying to anticipate changes in the distribution rate, and then we say, "If this happens will the closed-end fund discount widen?" And I'd say if you just threw a dart today in the muni land, because I started there, if you're looking at muni funds at 8-10% discounts, if those funds cut their dividends from 4.75 to 4.5, people are going to say, "Well, I kind of saw that coming, and the discounts are wide enough that I don't think they necessarily need to widen further."

Versus if it's a fund that maybe people are misinformed on, it's a high yield that's misleadingly high with a lot of return of capital, if they cut and that fund's trading at a narrow discount, then you go back to, well, what matters? What matters is that other people will be fearful and they will sell that. And so I think fundamentally everyone on this call would say we try to project the distribution power, but we all have a good sense of what a fund should be earning. But the art is, well, how will other people react to what collectively we might think is fairly obvious, but to others it's a negative shock. And so I think discount matters. If you are wondering if your fund has a risk of cutting a dividend, then you probably don't have to worry too much if it's already at a wide discount. But if you own a fund trading a premium or very narrow discount, then you have greater price risk on the market price of the closed-end fund if they cut the dividend. That being said, repeat my first point, the NAV's total return is the same either way.

John Cole Scott: Very good. Thank you so much. So Rob, the other big thing we've already touched on is discounts. And as a quantitative manager, in our prep call you really had a nice

perspective on absolute versus relative in comparable discounts. So give the discount viewpoint some granularity from your experience.

Rob Shaker: So what we look at, I hear a lot of people talk about absolute discount. And okay, "I got this guy, it's a really good deal because he's he a really deep discount." Or also hear people say the opposite and say, "Well, this is a premium so it must be a really good fund because it's trading at a premium. This must be something I should just enter into." At Shaker Financial we don't really care for the most part about absolute discount. What we care about is relative discount, and that relativity based upon some type of historical average that you're looking at.

Some people will use different ways to measure if something is a little bit on sale or compare to groups. There's lots of different ways to go about it, but the idea is it's relative to where it's been before. Because once again, going back to the fundamental concept that part of your investment in a closed-end fund, part of your return is going to be the change in the discount, you want that working for you. So to the extent that you have the ability to buy something where you think it will be a narrower discount in the future, that's an additive to your investment.

Beyond that there is a little bit of a benefit to discounts in general. As opposed to premiums or things that are right around par. The best, simplest way to think of the advantage of a discount is you get an activist put. It's something that comes up sometimes when some of these fixed-income or bond CEFs which typically don't have that much activism in there get wide. If it's very wide you have the ability of an activist to come in and push it back up somehow. Usually through something eventually beginning to tender. Back in the old days they would actually go to open-end. But you have a little bit more of a put the deeper the discount.

Something I was actually just thinking about as I heard Steve talk, another aspect about the recent increase in distributions that funds are giving, which is a lot of times return of capital, if you were at a decent sized discount, the return of capital is actually beneficial to you. In my mind because it's like a tender, you're getting back at par. If it's a premium, you getting back your money at par isn't really what you bargained for since you paid a premium to get in. So just something else to think about.

But that being said, we are not adverse to dipping our toes on funds as they're right around par, small premiums, and especially during periods such as the most recent one. If you see a lot of activity in the closed-end fund space and you see one of these traditional premiums, traditional small premiums, a lot of times they're the PIMCO guys, if you see them dip into a discount territory, that's usually a good buy.

John Cole Scott: Thank you. Very helpful, Rob. Discounts are such a big part of closed-end funds. Ken, on the prep call you really had nice feedback. There's good premiums and bad premiums. There's good discounts and bad discounts. Could you shed a little light on that perspective?

Ken Fincher: Steve mentioned something, and I think we've been using a term interchangeably, I just want to get some clarity for everyone. There's a difference between a

dividend policy and a distribution policy. Just to touch on that, I think it's important for people to understand a dividend policy tends to be natural earnings of the portfolio. A distribution policy I think goes to what Stephen was talking about when he's talking about return of capital, capital gains, other things that may make up the distribution. So I think it's important to keep those terms separated and not mix them together.

[inaudible] discounts. Honestly I believe that, and again Rob this is no offense to I think what you do, but I think too much is given to premiums and discounts. While I think they matter when we look at things, I think one of the reasons people look at them, even advisors and investors, is they're an easy stat to come up with. They're there, everyone publishes them. I think Rob mentioned dissidents talk about big discounts when they file their 13Ds, so it's kind of front and center just like that distribution or dividend rate is front and center. So it's easy for people to grab hold of and touch. I think more people need to do a deeper dive.

And it's similar to everyone says closed-end funds are all about income. We kind of painted ourselves into a corner there [inaudible] income. Well, you know, we have some pretty good total returns in some funds out there that just don't get any credit or any transparency or any pub because people, they don't have an income. People want the income. So I think there's, John as you alluded to, not all discounts are good, not all discounts are bad. I mean, you can have a discount in a fund because the fund's an underperformer, the manager's not doing their job, there's something intrinsic to the fund that isn't going well. And investors have realized this, whether they be retail investors or institutional investors, and they're trying to get out.

Latest case in point, think about what's going on in Russia. Think about what's going on in the emerging market space. I imagine everyone who's a professional investor, the first thing you're looking at when you came in was looking at what's my exposure to Russia? What's my exposure to Ukraine here? And so there's some intrinsic things that can drive discounts. So I don't like to put everything like, hey, discount is a good thing for an investor, because you have to look a little bit deeper. Same thing with a premium. Premiums can be bad as well, they can be good. If you have an actively managed fund in a very hot space, technology, healthcare the last few years, you're okay and probably willing to buy something at a premium because it's hard to get exposure in this somewhere else. You could say, yeah, I could buy it in the ETF, but you may not be able to buy it from an active manager who has a name in the space.

And if you think about closed-end funds, let's not forget that a lot of the sponsor, the bigger sponsors in the space are household names in investments. As Stephen's mentioned, BlackRock, he's mentioned Nuveen, we can talk about PIMCO, it was mentioned earlier. And so these are people who are front and center in a lot of peoples' portfolios whether they do closed-end funds or not. So look a little bit deeper to round this up. Look a little bit deeper than the discount. I think it's important for a lot of people, but we're more fundamental. Discount matters but it's not the only thing we look at.

John Cole Scott: Perfect. Perfect. So again, probably not as deep of a conversation, but Rob, we thought you might touch on there's different leverage ratios in closed-end funds. So when you're looking at movements of NAV or other things as you do your work, maybe just touch on how you think about the leverage of a fund.

Rob Shaker: I think leverage is one of those things that sometimes creates angst amongst investors, and it's something that sort of feels like, okay, well, this is all juiced. The idea of use of leverage I think in general is a good thing. I think it can serve to help smooth out, help create better diversifications if utilized properly by a manager. I think really the only thing you need to do is be aware of it. Be aware of the leverage and factor that into what is your expectations as to the movement of the fund.

But once again, it depends individually. But Ken talking about looking into the things a little bit deeper, how are they utilized? Like for example, we use margin to leverage some of our taxable accounts. But we don't use margin ever to increase the equity risk in the given portfolio. That's not what we're going to be doing with it, so it's not going to increase its movements vis a vis the SPY or anything like that, but we will use it to create a broader bond diversification.

So I think it's something that you should be aware of and build into your expectations as to that's why something might have moved a little bit more during this period or that period, and just know that as part of your thinking. But I wouldn't necessarily seek it out and I wouldn't necessarily for sure avoid it. I think it is just one of the nice aspects of closed-end funds, their ability to do that and utilize it if utilized responsibly. And you'll see, if it's not being utilized responsibly then you get those types of movements that get people out of that fund for a while.

John Cole Scott: Agreed.

Stephen O'Neill: John, can I add something real fast to that?

John Cole Scott: Of course.

Stephen O'Neill: One thing I think March 2020 showed the importance of understanding the leverage amount is important but it's also the structure. It's kind of like closed-end funds 2.0, but there's a big difference between a bank line of credit and repo, tender option bonds versus a preferred. And so I think if you just pick on taxable bonds in March 2020, the funds that had a bank line of credit, they had to sell down assets. But if you were using repos or you had preferred which gives you off-balance leverage in the repos and then just greater flexibility on the preferreds you had better performance.

And so some of the funds that looked conservative, you've got nice bank line of credit to lever these high yield or bank loans, that might on the surface look like, oh, that makes sense. And you might have been a little bit sheepish about the fund that was levering using reverse repos. The reverse repo did better. And so when we see a really volatile market environment, the first thing we do is sort the funds based off what we think the cushion is to their breaking point or the sense where they need to repay assets.

I think it's not reasonable for a do-it-yourself investor, but I think it's easy to look at the balance sheet, see how they're levered, and it's a simple question for the investor resources which is, you know what, what's the leverage limit? Are we talking about 33% until I have to de-lever? Are we 50%? And then you just got a sense of what that risk is. Because maybe it's to Rob's point

talking about closed-end funds. Closed-end funds are a beautiful way of generating excess return over time, the leverage has typically been additive to the return. The only risk I think for permanent loss is the de-leveraging. And so there are better capital structures than others. Not every fund in my view has optimized the structure and found the best source of leverage to protect long-term investors from, which is the risk of de-leveraging.

And the last point I'll make. If you go back in time and you type in "Tender option bonds March 2020", you'll see a headline from *Bloomberg* that says, "These two managers unwinding TOBs in the market," like this really fearful headline. But in reality, all the muni bond managers were just rotating their portfolio, they were re-TOBing it and buying higher yielding securities and then you saw the payoff months later. All these dividends are going up partly because short-term rates came down, but also because all these funds got re-TOBed which is the way muni bond funds lever, and the income that they were able to kick off was really high.

And so it's a little bit scary, nobody likes leverage, I think, that's my general view of retail investors. But when structured appropriately I think it's really advantageous. And again if it goes to picking a fund, know the fund. And to Ken's point, it's not about the discount, it's the asset class, the capital structure, the discount matters but that's a different conversation. But I couldn't resist, I think leverage is one of the only ways investors can really screw it up. And if you think about it up front, then it's something you don't have to worry about in the future.

John Cole Scott: And I agree. I know in our data business we have tremendous granularity in the leverage because like you, the weekend before March 23rd, we were sifting for inferred leverage and leverage breeches in a way that would be hard if you didn't have that sheet in front of you.

And I also agree, people always say these are more volatile because of leverage. The NAVs are a little more volatile because of leverage, they're more volatile because of retail trading. I think the retail trading correlation dislocations are far more than 20-40% leverage of the NAV, again in my opinion. All right, so Steve, we cut into some of that time, we're running a little bit time. But could you just talk a little bit because your firm has experience with more neutral and hedging type products? People always say, "Big premium, let's short it." What's your take on shorting closed-end funds?

Stephen O'Neill: I'll be fast. I think it's too expensive. The negative rebate, meaning the cost you have to pay to borrow is often too high and there's not enough locates, especially at a professional level. For fun, well, not for fun, we always pool closed-end funds just to get temperature on the market. I won't name the ticker, but there's an equity fund at a 20% premium, pretty famous fund sponsor, if you want to short that, it's going to cost you 28% annualized. Like you just can't make money doing that. And then there is 16% premium out there, cost you 17% to short it. Those numbers are high. You have to be right and you have to be right fast. And so I generally would say not worth it, but I know people make money being super tactical. Maybe Rob's one of those.

Rob Shaker: No. Stay away from the shorts.

John Cole Scott: He margins the bonds but doesn't short anything. Good, so Ken, we talked a little about the IPO market, the 30 or so newer fund structures. Sometimes people say, 'How long do you wait to get into an IPO?" Maybe with your perspective talk about how people should look at new funds in the market and when they might want to add them to their portfolio.

Ken Fincher: The IPO market could be a panel in and of itself. We could talk easily for an hour, and I think there's a lot of questions. I'll just say this about the IPO market. It has definitely become more efficient [inaudible] I got into this business. I was just thinking back when I got into this business, the frontend load on a closed-end fund IPO was six and a third. So if it was a $15 stock, 95 cents came out before this thing even hit the market. So the shareholder was paying over 6% load to get involved. Obviously we've come full circle, we went down to 4.5% for a while and a lot of funds got done there. In the last few years, we've gone to really zero.

I mean now look it's not really zero, there is still a fee paid to the advisor. The manager is still going to goose up their management fee a little so they can recover what they pay on the frontend, because they have to pay that advisor to get involved. And so while it's changed, I think it's a little bit more efficient, in the end it's efficient for the end investor. The other efficiency I think you have going on is unlike the go-go days, probably back late 90s, typically it's one deal coming to market a month. The syndicate has definitely been drawn down as firms have merged together. You have typically, I'll say three to five firms that will lead an IPO, or who want to lead, and many of the sponsors focus on them. So getting on a calendar can be difficult.

And John, you talked about it as well, the structure has changed. No longer, at least more recently have you seen these perpetual funds out there. Now everyone has a little bit in their pro that talks about how they can become perpetual, but for the most part we went from doing five and seven-year deals, we bumped it up to 12, and I know there's some talk about 15s. So people are getting more comfortable. The nice thing about that is the big complaint about closed-end funds has always been, "I'll never be able to realize the net asset value unless we have some sort of corporate event that takes place and I get paid out NAV." The fund goes away, a dissident gets involved, the fund decides to open-end.

That's kind of all changed in the sense that now there is an end date in many of these funds, so advisors or their investors can actually get out at a certain point. That's why it's so important to really look at the total return. It's great to get involved going, "Hey, I have an end date, so I'm going to get involved at 15." But in 10 to 12 years, if you're getting back 10, and again a lot of stuff happens in between, but that's kind of a hard pill to swallow for a lot of investors. So if you look at the total return you can understand.

In equities it may be a little sexier in that, "Hey, I got in at 15, maybe I got out at 20-25 and I got 4-6% returns over the year or maybe a little bit better if they had capital gain payouts at the end of the year." And fixed income, it's a little bit tougher pill to swallow. But nonetheless, a lot of managers will manage it to that end date, and so they will keep their portfolio within that 12-year cycle so many of the bonds are actually coming back at par so they can get out and try to realize.

The target dated trusts are kind of great for munis. You're not seeing those anywhere else. They've been done, they haven't been successful in my eyes because too much can go on and things I think outside the slow, boring investment-grade muni world that can impact net asset values. Munis have been able to deliver on target dates in that they're paying out what they're saying they're going to pay out at the start of the fund. A lot of other funds haven't been able to hit that mark.

John Cole Scott: Helpful.

Ken Fincher: So they've gone away. They've gone just to being term funds.

John Cole Scott: Got it. So we had such good commentary we're running shorter on time. We have more questions then we will have time for. I'm looking at some of the questions that have been asked so far. If there's any audience questions, add them now. But really one question for each of you. And so I'll ask you a question, but if you'd rather have a better closing statement you're always welcome to do so, this is your time. So for Rob, really looking at two things you were talking about. The way some days are thinly traded and then there's calendar season for trading, maybe some perspective on how you look because you're trading every day in the market from my knowledge of your work. And then feel free to say if there's any area you'd like to point people. They always love your opinion on a sector or area to look at.

Rob Shaker: Yeah, so a lot of people ask, "Hey, what's the difference between trading during the quiet summer months and the last two weeks where the markets are moving 2% a day?" I think it's pretty interesting in the closed-end fund space because volatility in the general market doesn't always translate to volatility in the closed-end fund market, especially day to day. So I'd say the two big things to do that are different for us is on a day in which there's volatility in the general market but we're calm in closed-end funds, one of the things that we're really looking out for is what we call laggards. Either laggards or stale offers.

Because this market, I was looking over my shoulder here, today the closed-end funds were a great solid day of trading, but the market moved maybe a percent in the last half hour. If somebody had an offer on an equity fund out there, you may have been able to get a great deal on it just because its NAV pushed, its discount widened by a percent just while you were watching. So we look for those. When it's more volatile in the closed-end fund space, then you're looking for what we call the dumps or the pops. More specifically the dumps. And when you get somebody who wants to sell, one way you can check even if you're not really experienced on this, if you have any access to Yahoo and average daily volume, if you see something trading at five times daily volume and it's down 3-4% and it's a bond fund, it's probably a great buy.

It's really just not that much more complicated than that at one level. But with the volatility you get those types of things. Hopefully we get back to a more quiet summer. Hopefully, knock on wood, everyone's allowed to have vacations this summer and get away from the home office. Yeah, that's it. That's the bigger difference. You see a whole bunch of, during the quiet times a lot of clicking to get a lot of little trades done, working really hard. Volatile times, you really just

look for that person who is for some reason unloading a million of something at an artificially low price and being on the other side of it.

John Cole Scott: I know in your daily note you often talk about when margin calls come due and those carnage days of trying to catch the forced selling from brokers, but especially IB that doesn't ask you first from our knowledge. So Steve, the two questions we want you to choose your own adventure on. It's Fed day, interest went up a quarter point, the least boring thing that happened that's been opined for a long time. Talk about the way the movement of the Federal Reserve interest rate changes any of your thinking, if at all. And then if you're willing to talk about a sector that you have interest in or that you think people should consider with the current environment, people always love to hear that as well.

Stephen O'Neill: Sure. I guess I'm going to make sure that Ken's point's well taken here, and I would say first thing that you should do is determine which asset class you like. And so today's meeting should not determine whether or not all of a sudden you want to buy preferred stocks or munis or international equities. You should have a view of what that asset class exposure you want is, and then from there Fed policy or interest rate volatility, that can matter in my view on whether you want to buy an ETF or a closed-end fund, whether you want to buy an open-end fund or closed-end fund.

I think when we think about the volatility in the market today, daily dollar volume's twice what it is than in the summer. And so there's a lot of volatility, there's a lot of wide discounts, and so I'd say almost any asset class which is fairly unique, meaning that if you like short duration, long duration, high quality, low quality, US, international, you can pretty much buy all those funds at an attractive discount. And so you can kind of make both Ken and Rob happy. Rob likes the relative discount, Ken wants you to own the asset class you want, put those together, they're sure better than an iShares ETF.

And so I think this market has got something for anyone. Without being too specific on names, I will go back to Ken's comment on the IPOs, I think the IPO process has changed but you wouldn't be able to tell based on how the funds are trading in the secondary market. I mean, I really think the process of going through the underwriters and the sophistication of the investors today has really raised the bar on the type of managers that can launch closed-end funds, the type of strategies that are employed, and some of the best funds that have been launched period have been launched in the last five years. I really believe that, but you wouldn't be able to tell based on some of the discounts in the secondary market.

I don't know where things closed today but there are two billion dollar-ish funds that are trading near a 16% discount from brand name sponsors. I think that that is really surprising. And that goes back to maybe the history, how long will people wait. Who cares? If you like the asset class and you understand the risk of the fund, get that asset class at a really wide discount, you'll be happy that you did. Maybe not tomorrow, but sometime in the future.

And I think that's the opportunity in closed-end funds, which is you can really access any asset class. You can even access some asset classes that are hard to get, which would justify the premium that Ken was talking about. But if you can get that asset class at a big discount, I think

some of the class of 2021 IPOs is offering you some really rare old school discount which are just an anomaly compared to the field. And so I think there's some really cheap values out there. But again it'd be hard for me to pick a sector because it's really what that investor needs as part of their portfolio.

John Cole Scott: Fair point. And for those that didn't attend either intro session, one of our slides was a quick data dashboard on the 32, I call it, in the last year's version 2.0 closed-end funds. Something that you'll be able to get a download of off the agenda page once our web people get it up, hopefully today or if not tomorrow. I'd say we definitely studied years ago that closed-end fund discounts tend to widen between month four and 11, I would generally say after a semi and before the one-year note. Because there's some investors that just wait for that one year number to even consider it and usually get some sort of discount pullback in the second half of the first year of life. But great points.

So the last person to round out our panel is Ken. So Ken, basically you can chat about how you think about selling a closed-end fund or also talk about where you find things attractive in the current place.

Ken Fincher: Thanks John. I want to make three points, and I want to add onto what Steve just talked about in terms of the IPO market. The IPO market for 2022 will not be robust, okay? So an outlook here is, you're going to see-- we've already seen the March deal get pulled, the March deal's not going to come. I would expect the calendar to really lighten up. Now that's good news for investors in the secondary market. And the reason that's good news is you're not going to see as many deals sloshing around out there. And as Steve mentioned, you already have deals out there that maybe you didn't participate in that are prime opportunities right now. So take a look at those. I think the advisor community with the IPO market lightening up will start to focus more on the secondary market than they do on the IPO market. Two different animals but they'll focus more on that secondary market, which means I think you're going to start to see demand pick up a little as investors realize, hey, there's not a new billion dollar deal coming next month or the month after that. So that's the first point.

The second point I would say is expect long duration funds to continue to undergo some pressure. Just to give you an idea, let's talk about municipals for a minute. If you go back to early part of 2020 when the economy shut down, in a two-week period muni closed-end funds on share price lost 20%. Twenty percent. If you look at 2022 for the first 10 weeks, the average closed-end fund through yesterday, the average one lost 14%. Muni. This is a muni fund. And you think about muni, as I mentioned earlier, boring, investment grade, last year you couldn't buy anything at a discount. Now you're tripping over double-digit discounts in the market. So while I think long duration's going to be under pressure, you can't say there's not opportunities out there right now in the municipal space. So pick your poison, figure out where you want to be as Steve mentioned, and then I think you're going to find things that you'll find appetizing at least as you move forward.

And third and final, a lot of people are using this, we've talked about it, *Bloomberg* has articles nearly every day. Everyone expects because rates are going to move higher, we saw the first iteration of the Fed today, they're implying that every Fed meeting the rest of the year you'll see

six more increases. So where's everybody going? They're going to floating rate stuff, right? In a floating rate environment, guess what? Rates start to go up. The floating rates start to pay out a little bit more, it gets a little bit more attractive to retail investors. What you're finding though is there's a couple things going on.

First of all, a lot of economic uncertainty. Second is many of these loans are priced close to par. And so unlike the last time where we had to cycle higher, which was 2015 to 2018, you don't have these loan funds that are trading at these enormous discounts because everyone's kind of front run that, understanding that they think with the Fed moving higher their loans will do a little bit better. I think you use loans as the parking place for anything else, but don't expect the double-digit total returns this year that you might have received in 2016-2017. Those are kind of three points I'd make before we close the call.

John Cole Scott: All very good. I was just double checking. I saw muni discounts widen 9% from September through this week, and so definitely a big discount change with the mindset. And then also I'm sure you've done your own research, but Mike Taggart's been writing about closed-end funds weekly and did a nice piece on senior loan funds about a month ago that is available on his Substack page and should have been in some of the AICA emails.

So this was again, I guess I can't blame anyone else, it's my fault we went over. I'm the moderator, my job is to keep you on pace. But thank you each of you for the different perspective. Please work with your compliance people to get it approved as fast as possible, we'd love to get this to the replay audience and give you guys a chance to use it in your own way as well. And with that, feel free to stick around a little bit, but thank you so much for your time and for closing out day two of our spring roundtable.

Thank you, everyone. I will note, the person who has a question about FEI and FPL, email me and I'll try to find the better person at First Trust to answer that. I think I know enough about Ken to know that's not his part of the company from my perspective. Is that fair, Ken?

Ken Fincher: That's fair. I do not cover nor do I invest in any First Trust closed-end funds.

John Cole Scott: Perfect. Yeah, you're their secondary arm of buying other peoples' closed-end funds. So reach out to me, I'll be happy to help you there. And thank you everyone for being here. Bye.

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Click the link below to go to the home page of Active Investment Company Alliance to learn more:

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