



The Search For Funds In Today's 'Painful, Ugly, And Shocking' Closed-End Environment

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed John Cole Scott, chief investment officer at Closed-End Fund Advisors and the chairman of the Active Investment Company Alliance. Read the Q & A below as John talks about the search for closed-end funds



that can deliver in rising-rate, high-inflation conditions, talks about five issues from different categories that pass muster now, and explains how in today's business-development company space, "Sometimes discounts are expensive and premiums are cheap."

John Cole Scott

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

CHUCK JAFFE: John Cole Scott from Closed-End Fund Advisors is here and we're talking about digging through the data to find the right closed-end funds for today's changing rate and inflationary environment, welcome to The NAVigator. This is 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 is 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. If you're looking for excellence beyond indexing, The NAVigator's going to point you in the right direction. And

today, well, it's not quite the 150th episode of The NAVigator, but it is for us the end of our 10th anniversary celebration. So we're kind of getting to that spot, where The NAVigator's been with us for about three full years and John Cole Scott has been appearing on the show all the way back to 2012. John Cole Scott is chief investment officer at Closed-End Fund Advisors in Richmond, Virginia, which has helpful research tools online that you can use at CEFdata.com. You can also learn more about the firm at CEFadvisors.com. And John is also chairman of the Active Investment Company Alliance, which you can learn about at AICAlliance.org. John Cole Scott, it is great to have you back with me on The NAVigator.

JOHN COLE SCOTT: I'm so happy to be here with you, Chuck.

CHUCK JAFFE: John, these are conditions that have everybody looking for what's going to be safe, what's going to work. And of course closed-end funds, well, if you get a big enough discount, you've got things on sale, but you're also looking for others ways that you can produce reasonable returns and income streams at a time when inflation is squeezing real returns and interest rates are rising, making bonds, at least temporarily going through the price changes, a place that's difficult. So in these times, when you are looking to be able to match investors to good funds, what are you doing, what are you looking for? What's the analysis that you go through?

JOHN COLE SCOTT: Basically the current environment can be easily described as painful, ugly, and shocking. I had lunch with a consulting client today in New York and the movement of muni bond funds is intense because duration risk is real. But we really go back to what we've always done as a firm from our first podcast with you 10 years ago, it's a balanced approach to looking at what's the dividend analysis, because that's the major total return component of a closed-end fund. What's the next asset value, sector manager analysis? Because while we never own the NAV, the market prices we buy and sell at are connected to and related to the net asset value. And it's doing that discount analysis, which is often the focus for closed-end funds, but shouldn't be your only focus. And when we're really building this portfolio we go back to why are we using closed-end funds? And closed-end funds give you access to active management with a stable share count, so that the manager's never adding at the top and a forced seller at the bottom. In a period like now he's not having to redeem to open-end fund or ETF redemption pressures, and it's a positive thing over time. And we even go back into our data and see the average closed-end fund on a 10-year basis

through the craziness of May 2022 is still up 7.5% total return on a 10-year basis, but the average closed-end fund yields around 7.5%, which is why you can't forget to look at the dividends.

CHUCK JAFFE: In terms of what has survived that rigorous analysis, my audience loves the ideas that you tend to come up with, I'm sure your clients do to. What ideas are you working with right now?

JOHN COLE SCOTT: The bulk of our work, we do highly customized separate accounts for individuals and advisors that we can connect to, and really going down the process, and I thought I'd talk about some of the funds that currently fit that trifecta analysis. We'll start off with a fun sector that's been our positive adding to the year, the MLP sector, and a very attractive fund there across the board is EMO. It's a ClearBridge fund which is now part of the Franklin Templeton family, with a 20% discount, a 6.8% yield, a 31% leverage profile, and 93% of the dividends have historically been tax advantaged, and so they're a nice complement to those muni bond funds which have acted very different this year. We then shift it up a little bit and go into the muni camp. BlackRock has a very attractive fund, MYD, it's about an 8.7% discount, 5.4% yield, its leverage is pretty normal for the sector at 39%. It does have a 13 duration, but it is showing 100% earnings coverage. And if you have a highest federal tax bracket, if you do the math, that's an 8.6% tax-equivalent yield, very compelling as part of a taxable accounts fund portfolio. We then go back to fixed income and we think what's going to do well in the current environment in our opinion? Loan funds are a great opportunity, and there's a Blackstone fund, BGX, it's about an 11% discount, a 6.8% yield, and 38% leverage, its duration is 0.51. A heck of a companion to munis and run by a well-known asset manager that can do well in this environment. We then round out what we're doing, because credit's important but not the only thing, real assets are far from expensive and do well in this environment as we've learned with a lot of our manager interviews, and Nuveen has a great fund, JRI. It's about a 10.5% discount, an 8% yield, 30% leverage, and 50% of the dividends have been tax advantaged, and 40% less beta than the average real estate real asset fund in its sector. So we like that for our clients, lower NAV beta and good attractive entry point. The last thing I'll talk about is basically the granddaddy of BDCs, it's not the biggest but it's Capital Southwest, CSWC. It trades actually at a 46% premium currently, which is cheap in many peoples' opinions, including mine, but has a sustainable

yield of 8.1% with supplemental dividends coming this year. They've been listed in the market since 1960 something, a BDC since the eighties, and they're internally managed, which means they don't get bigger checks for fees as they grow, so they're very good and cautious at raising their equity and debt profile. And we want to highlight that fund because we want to let people know, BDCs, sometimes discounts are expensive and premiums are cheap, and it's a different fund structure than like a senior loan fund.

CHUCK JAFFE: In terms of how you then mix those things and use them properly in a portfolio, whether you're doing it with your clients, you're doing it in separately managed accounts, etcetera, what's the right mix? Because one of the things that closed-end funds seem to have much different than traditional open-ended funds is that open-end funds, you pick two in the same space, you frequently get a lot of overlap. That doesn't seem to happen so much in closed-end funds. So how much do you want to be focused and concentrated? How much do you want to make it that in each of those areas it's one pick and that's enough?

JOHN COLE SCOTT: So our approach has basically been for traditional funds a 2-6% allocation, anything over 4-4.5% is considered a major bet in my world. For MLP funds and BDC funds which historically have more volatility, we have that, so typically 1% to 3% max. And we end up having about 40 to 50 positions in a diversified portfolio, and we do manage our taxable accounts dramatically different than our qualified accounts because you can take tax losses, which are an asset for future tax liability that sometimes doesn't get used appropriately. And if you think about it, the difference between closed-end funds and open-end funds, at least at the basic level, is you can have similar NAVs but different discount ranges. And really you need to balance those two out because the tailwind of discounts take a lot of opportunity if you're patient. I always tell people the risk of closed-end funds, they're going to be volatile because they're listed securities and they're 80% retail owned. But if you take the volatility just as an opportunity to trade and reposition and think of true volatility in the risk of a portfolio being actual loss of income, loss of NAV, destruction of principal, it's a much different answer.

CHUCK JAFFE: Obviously the backbone of all of this is research, and for you it's the CEFdata.com website and all the research that you're doing there. But I'm sure that clients come to you and they're using other research, they're using Morningstar, they're using whatever. There's not a tremendous amount of research available on closed-end funds, so

how do you make sure that folks understand what it is that they're getting and how to properly use the research?

JOHN COLE SCOTT: At a business level, sometimes I run my data business at a loss because I just am curious and I'm hyper-focused on the best answers for whether it's a consulting client or a separate account client. But we really work granularly to go after everything we can find from the filings to press releases, the fact cards, the updates, even thinking of datapoints like implied leverage based on the net asset value move and the dollar of leverage known, something you'll never see at another data provider. Because people buy our data, it has no good frontend interface but it's really granular and it's almost 11 years old, and that's a huge benefit. And then remember, at the basic level, when you buy a 10% discounted closed-end fund portfolio that's leveraged 35% on average, which is not uncommon, you're controlling \$1.50 of assets with 90 cents. It takes that 7.5% yield and a manager that only has to do 5% to meet it. It gives these higher yields less risky consequences because you're not stretching to just be CCC credit and highest sorted yield operating company dividends, it's diversified and the mechanism of the closed-end fund structure is the one doing much of the work for you.

CHUCK JAFFE: John, always great to chat with you, thanks so much for what you've done. Thanks for being part of the first 10 years of my show, and I look forward to Money Life's partnership on The NAVigator continuing for a long time.

JOHN COLE SCOTT: Absolutely. Look forward to the next 10-year anniversary in another 10 years. Thank you, Chuck.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. And yes, that's me, and you can learn more about my work and my show, which just celebrated its 10th anniversary, more than 2,500 shows, by checking out your favorite podcast app or by going to MoneyLifeShow.com. To learn more about closed-end funds, business-development companies, and interval funds go to AICAlliance.org, the website for the Active Investment Company Alliance. They're on Facebook and LinkedIn @AICAlliance. Thanks to my guest John Cole Scott, chief investment officer at Closed-End Fund Advisors in Richmond, Virginia, the chairman of the Active Investment Company Alliance. His firm is online at CEFadvisors.com, and you can check out the data we were discussing at CEFdata.com. He's on Twitter @JohnColeScott. The NAVigator

podcast is available every Friday, please subscribe on your favorite podcast app and join us again next week. And until we do that, happy investing everybody.

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