Five ‘Plain Vanilla’ Closed-End Funds For These Markets

Friday, June 3, 2022

Chuck Jaffe, in this episode of The NAVigator podcast interviewed John Cole Scott, chief investment officer at Closed-End Fund Advisors and chairman of the Active Investment Company Alliance. With the volatility and downward pressure in the market pushing many investors to specialty funds, sector offerings, and alternatives, read the Q & A below as John returns to the NAVigator to talk about some funds that are more basic in strategy, core holdings by nature, and highlights five that represent good values and opportunities now.

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 is here and we’re talking about closed-end funds for the rest of us in today’s challenging investment 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. Joining me today, it’s John Cole Scott, chief investment officer at Closed-End Fund Advisors in Richmond, Virginia, which is online at CEFadvisors.com, and we're going to dig into some funds using the firm's research, which you can dig into yourself by going to CEFdata.com. John is also the chairman of the Active Investment Company Alliance, which you can learn about at AICAlliance.org. John Cole Scott, it's great to have you back on The NAVigator.

JOHN COLE SCOTT: Always enjoy being here, Chuck.

CHUCK JAFFE: Now John, I said we're going to talk about closed-end funds for the rest of us. It's not that interval funds, closed-end funds, BDCs, etcetera are not for all investors. And in fact, I know that we have plenty of folks who really have not only learned about them but have participated in investing. But sometimes here on The NAVigator, when we start to talk about closed-end funds, we really are talking about all of the interesting flavors, we're not really talking about vanilla and chocolate. You know, plain, ordinary growth funds or stock funds or things that are right in the middle. And there's a story there right now, and a couple that stand out to you in this environment for people who say, "Wait, I want closed-end funds, but I want 'em to be very mainstream in what they bring to my portfolio." Right?

JOHN COLE SCOTT: It is, absolutely. We thought it would be really interesting to pick out more of the equity-focused funds. Not the sector, not the bond, not the interval, not the BDC as you said, and where their NAV correlations were all relatively high, typically 91-96% over time. But there's a lot of different features in each fund, both at the guts level, the structure level, the volatility level, or even the distribution level that we thought would help people realize that it's always going to be more than just discounting yield and sector, you've got to dig a little deeper.

CHUCK JAFFE: And that's important, because when we're talking about closed-end funds, for so many people if they like the structure then they go, "Wait, I just want to be able to buy things at a discount." So their reason to go for a plain vanilla fund, one that's mainstream buying just broad equities is, "Ooh, I can buy stuff on sale." So give us an example, because we're going to talk about a handful of funds here, of a fund that shows that off. It's buying mainstream assets but it's maybe more than just a discount story.

JOHN COLE SCOTT: So we'll first start off with AOD, it's an abrdn fund now. It's at a 12 and change discount, because we still love discounts in our world, and it has a relatively stable 8% indicated yield. But what's interesting, the yield has a high amount of qualified dividends, and that's uncommon versus many of the funds we pick for our clients. When we look at what the NAV performance has done over three years, around 35%, so even through the pullback it's had good manager performance. Another nice thing to the dividend stocks, they tend to be lower beta, its NAV beta is a 0.84 versus SPY. And their expense ratio, again it's a little higher than we'd like for a regular equity fund but still reasonable at 1.14. And we really think about the structure of it, its three-year NAV standard deviation is at 21.8, which is kind of middle of the pack for the funds we'll discuss today because there has been some volatility there, but the discount standard deviation is moderately low at 1.6. And I'm pretty sure most of your listeners don't look at discount standard deviation data but we are going to talk about it with a couple of the funds today, I really think it's important. It's only half US equity, half foreign developed equity, but it's still at 94% of big cap stocks. It's a billion dollar fund and it is actively managed 72% turnover, and so that's kind of a starting point for the conversation about where you can look for an interesting fund in the space.

CHUCK JAFFE: And again, that's AOD, the Aberdeen Total Dynamic Dividend Fund, a fund that you have talked about in the past that again used to be an Alpine fund, now part of abrdn. So that kicks us off, but like I said, you've got a handful to talk about.

JOHN COLE SCOTT: There's another kind of tilting direction, so there's a BlackRock fund, the Blackrock Enhanced International Dividend Trust, BGY. Again, coming in at a little lighter discount, 11.8%, a little lower yield, 7.5%. But again, a little bit lower total return, a 23% three-year because it's trying to do a lower beta experience. It's a 0.64 beta versus SPY and the three-year standard deviation is at 16.9, so lower than the other fund. And again, expense ratio pretty much on par for a number we like for equity funds, 99 basis points. The discount's a little more volatile at a 2.2%. It's only 10% US equity, but still 91% big cap and the turnover is 71%. So I think you're getting a lot of value for the expense ratio, but a very different allocation and a very different beta experience for equity funds.

CHUCK JAFFE: This is a fund that if somebody goes to check it out, say at Morningstar, they're going to find out that it's a two-star fund. We've never really talked about things like star ratings as they impact closed-end funds, but my audience has heard me say many, many times that star ratings have a purpose but it's not necessarily use them as a decider. Yet I still have audience members who will say, "Why do I want a fund that's getting a below average star rating?" So if somebody's going to use that to back up the data they're going to get from your site, which is much more comprehensive on closed-end funds, and again it's

CEFdata.com, how does it stack up or how do you take it that I've got a fund and I don't care about the star rating?

JOHN COLE SCOTT: We appreciate your audience, we want to let them know that the star ratings at Morningstar, last we checked, and as you know, our executive director used to work there, doesn't account for discounts or premium, only NAV performance. And in my opinion, doesn't account for lower performance because you're less volatile. So I would argue if I was on the stand, that the Morningstar star rating for closed-end funds is great because it makes people make bad decisions that we'll catch the other side of that trade. But not your audience, we love them.

CHUCK JAFFE: Well, there's a reason why they can't necessarily capture the discount, which is they'd have to have a buying point, right? They'd have to consign to say, "Hey, you bought in here, and here was the discount that you got." And that doesn't really work with their methodology, as I understand it. So again, that was BGY, the Blackrock Enhanced International Dividend Trust. What's another one?

JOHN COLE SCOTT: This is one of the oldest funds in the ecosystem, always fun to talk about, General American Investors. It's at a 17% discount, it does pay dividend at the end of the year, a chunky dividend, you never know what's going on. It happens to have 13% leverage, has a preferred stock as leverage for itself, but it's put together some good performance, 37%, pretty much just slightly off beta versus SPY with a 0.92. If you look at the expense ratio, honestly a little high at 1.36, but it's discount standard deviation is 0.8. Again, as I told you, very low, one kind of interesting point I want to share today. And it's mostly US exposure, but it has a small allocation to convertibles, which is not historically part of the fund, especially because it's General American Investors, they have to be more US equity. But it's a $1.5 billion fund, and a modest 25% turnover, and really a classic fund that survived the 2009 crash.

CHUCK JAFFE: General American Investors, ticker GAM. That's three, the next one on our tour of plain vanilla funds worth looking at right now?

JOHN COLE SCOTT: All these funds are over 15 years old. We wanted to dig to established funds because we hear that comment from some audience members occasionally and in our world as well. But the next fund is the Virtus Dividend Interest and Premium Strategy Fund, NFJ. It comes in at a 12% discount, again a 7.7% quarterly yield, zero leverage, just under

30% three-year NAV performance. A modest beta to SPY at 0.88, a three-year standard deviation of 20, and a discount standard deviation of 1. Its expense ratio again, we think is very appreciative at 0.96%, but it does also have about 70% US exposure, small international of 5%, and convertible funds for the balance. But again, at 63% turnover you're getting active management and you're getting that unexpected convert exposure that you may have thought you wouldn't get other places.

CHUCK JAFFE: NFJ, again, Virtus Dividend Interest and Premium Fund. And our last in our handful of funds that we're exploring today?

JOHN COLE SCOTT: Tri-Continental Corporation, it's TY, it's another 1929 fund. I really think it's interesting to talk about how it's different to General American. Again, a little narrower discount at 12.6%, but only a 3.8% yield, but it does it kind of quarterly, so it does come up a little more consistent for investors. The reason I want to tell this story, and again it's a long-term performing fund, it's a 43% NAV total return and only a 0.80 beta. So just for a moment think about it, better results, less vol, that doesn't guarantee the future but it's a nice story I think to think about in this market. The expense ratio, you're going to love this, Chuck, 46 basis points. Its discount standard deviation is relatively modest at 1.3%. It's again mostly US equity at 70%, it does have a little bit of bond exposure, and it's 60% big cap. Again, 33% turnover, and all these funds are billion dollar funds for the most part. So they're large, they're liquid, they're established, but they're all different and you can use them differently in different accounts for different times in your opinion for the market cycle.

CHUCK JAFFE: Somebody's going to take a look at a Tri-Continental, again it's ticker symbol TY, and they're going to look and go, "It's down significantly this year." Although it's down a heck of a lot less than the broad market. In all of these cases, are we looking at discounts that have widened and the ability to say, you know, look, if you're looking to buy something on sale and you want to get great assets, and you want to take advantage of the downturn and not try to time it, just know that you're buying knowing you've got a bounce back, that this is good timing on buying these funds because they're riding the market wave but maybe not quite as volatile as standard funds?

JOHN COLE SCOTT: Yeah, I would say that it's down about just under 8% NAV year to date, market price 11%. When you're buying all these funds you are buying equity, and equity will be a little more volatile if we get a recession or get wind, they always seem to come. But we want to remind people, the closed-end fund structure doesn't have redemption pressures or forced selling at the bottom, managers aren't being given globs of money at the peak of the market that they have to put the work at irrational levels or have a cash drag. So there are protections for equity investments, but yeah, this is equity-focused investments. It's where you want to grow over time, not worry about the bond side of the market, this is the equity side of your portfolio. But in the closed-end fund structure, even these relatively plain vanilla, more traditional structures, the funds my father used in his career, most of the funds we talk about in the NAVigator didn't exist when he was still trading, are really good opportunities to get that piece. But again, they tend to be better for taxation, they tend to be better performers in a bull market. They'll go down in a bear market the way everything can, but that's why there's different features. Generally the monthly paying funds support the discount levels because people tend to like to get paid monthly.

CHUCK JAFFE: John, great stuff. Thank you so much for joining us, we'll talk to you again down the line.

JOHN COLE SCOTT: Thanks so much, Chuck. Happy to be here.

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 all about my hour-long weekday podcast by going to MoneyLifeShow.com, or you can look for us on your favorite podcast app. 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 John Cole Scott, he's chief investment officer at Closed-End Fund Advisors in Richmond, Virginia, and he's the chairman of the Active Investment Company Alliance. His firm is online at CEFadvisors.com, and their data site, it's CEFdata.com. The NAVigator podcast is available every Friday, please subscribe on your favorite podcast app and join us again next week for more closed-end fun. Until then, happy investing everybody.

Recorded on June 3, 2022

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