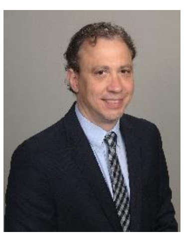
Rob Shaker: 'Sympathy Widening' Could Signal A Bottom For Discounts

Friday, July 8, 2022

Chuck Jaffe, in this episode of The NAVigator podcast interviewed Rob Shaker, portfolio manager at Shaker Financial Services. Read the Q & A below as Rob says that the closed-end fund market showed signs of a "sympathy widening" in mid-June, an event when there is "excessive liquidation selling based on fear," leading to a bad day on the stock markets and bond closed-end fund discounts widening at the same time. Shaker says it can be a sign of a market bottom, which can lead to a bounce-back; still, he says, markets remain fragile and there could be more excessive selling again, though it hasn't happened since June 16. Shaker also noted that the first half of the year saw trouble for closed-end funds, but the behavior of discounts was very different for equity and bond funds, with fixed-income issues seeing a much more dramatic widening than stock funds.



Rob Shaker

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

CHUCK JAFFE: Rob Shaker, portfolio manager at Shaker Financial Services is here, and we're looking at how closed-end funds performed and what happened to discounts during a terrible first half of the year for the stock market, this is The NAVigator. Welcome to The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator's brought to you by the Active Investment Company Alliance, a unique industry organization that represents all facets of the closed-end fund industry. From users and investors to fund sponsors and creators, if you're looking for excellence beyond indexing, The NAVigator is going to point you in the right direction. And today we are looking in the direction of Rob Shaker, portfolio manager at Shaker Financial Services, money manager there who has been on The NAVigator before talking about discounts. And as we hit the middle of this year, well, there certainly has been plenty to talk about in the market, but if you want to learn more about what Rob does go to ShakerFinancial.com. And if you want to learn more about closed-end funds, business-development companies, and interval funds in general, check out AICAlliance.org, the website for the Active Investment Company Alliance. Rob Shaker, great to have you back on The NAVigator.

ROB SHAKER: It's nice to chat with you again.

CHUCK JAFFE: Rob, the first half of the year, there's no sugarcoating it, it pretty much sucked. The market hit its high watermark on January the 3rd, the first trading day, and it was mostly downhill from there. Going downhill as well was discounts, so let's talk about, has the ride for closed-end funds been rougher or as rough, or somehow smoother than what the rest of the market experienced thus far this year?

ROB SHAKER: So the first half of 2022 was rough all around, and CEFs were certainly no exceptions. As we've discussed before, when you're talking about closed-end funds, your total return will stem from two different parts: one is the change in the net asset value and the other is the change in the discount. Change in the net asset value was poor along with the market, particularly in bond funds, which had a strong hit to them in the first half. But at Shaker Financial we focus in more on the discount movements, and the discount movements were a little bit troublesome as well, especially at the start of the year.

CHUCK JAFFE: Well, I know that you don't just focus on the discount movement, but you kind of measure discount separately. In other words, you've got the discounts on equity funds and the discounts on bond funds. How much were they moving in sync or how much were they moving differently during the first half?

ROB SHAKER: That's a great question, because at SFS we generally do bifurcate our focuses of attention on equity funds distinct from bond funds. And we have found that they will typically have different reactions to excessive selling or buying changes in equilibriums throughout a year or a given time period. And in the first half of this year, it certainly was the case that there were lots of periods of excessive selling pressures. And one of the more unique aspects of the fixed-capital structure of closed-end funds is that when you have this excessive selling pressure you can get these large widenings across the board. So in terms of equity funds, this year they were remarkably steady. There were some declines, some periods here and there when we'd see a little bit of a pickup in equity closed-end funds, but for the most part they were actually somewhat benign and the overall level of equity discounts has been relatively steady, and we currently sit at where we started the year.

CHUCK JAFFE: But sitting where we started the year, that's great compared to the rest of the market, but what has it set us up for the rest of this year? I mean, are we looking at closed-end funds being ahead of the curve and with less of a rebound to go as a result? What's the positioning moving forward?

ROB SHAKER: Right, and so once again we bifurcate our analysis. And so on the equity side you can sort of say, well, maybe we're sort of in this status quo where we don't really have a feeling one way or the other moving forward through the rest of the year. However on the bond side things were a lot different this year. Bond funds, we did see the type of declines that you will see sometimes through excessive selling pressures. But as the portfolio manager [inaudible] pointed out to me just recently, we may have actually seen a discernable bottoming out of bond fund discounts in June. And typically why we will find such a thing is we will find a discount bottoming out when we have a very dramatic, what we call, "sympathy widen" in conjunction with a day of large market decline. And we think that we sort of saw such a possible result on June 16th of this year, in the middle of June. Could best explain what I mean by this sympathy widening, and the anatomy of a sympathy widening, we can actually go through the specifics of June 16th. And so coming into that day the market had suffered through a week or so losses, and so many entered the day with forced sells on their books, either because of margin calls or liquidation requests from clients. And then what we had is one of the types of days we've had this year where the market starts going down 3% and all the selling intensified. So what we get is now all of a sudden all the investment managers start selling things. "I've got to sell!" "I've got to sell!" And the first thing they do is they sell their equity funds and they push those down to about 3% as well. Which makes sense because there NAVs are down 3% as well, they're moving with the market. However, what we find is the bond funds, their NAVs aren't going to be moving down 3%

because they’re not tied as tightly to the market. But when the selling gets frenetic, we believe some investors simply look around and say, “Hey, I have a fund that’s down 1.5%, everything else is down 3%. I don’t really care it’s a bond fund, and I’ll sell it down to 3% as well.” And what you get is a very large widening that day, on June 16th when the bond funds were actually down less than 1% on average NAV-wise but the selling had pushed it down to 3%, now all of a sudden you have a 2% widening.

CHUCK JAFFE: I guess the problem is you can’t recognize that a sympathy widening is happening as it’s happening. You can’t quite make it out that way. Because if you did, I would think you’d be able to make it an investable event, couldn’t you?

ROB SHAKER: Well, at Shaker Financial we do have strategies that are based upon that because in a sense you can recognize it. And this occurs not only this year, but it occurs most of the time in which you have what we call “excessive liquidation selling based on fear”. We used to call it the “CNBC is going to have a *Markets in Turmoil* episode indicator”. When you knew things were that fearful that the people were talking about it, the general media is turning to negative stories about the market. And then you see that type of day in which you see a very large move in the equity markets, and then you see bond closed-end funds actually moving in line with that large decline contrary to the NAV movement.

CHUCK JAFFE: Interesting. Now when you have a sympathy widening like this, is there the next signal to be taken or could we have another one? Because we’re still looking at markets that are pretty uncertain, and we’re still not looking at the kind of capitulation on a full-blown basis that you’re talking about happening, at least to some extent, here with the closed-end funds.

ROB SHAKER: Right, and that’s a very great point. And the idea being that when you have a sympathy widening like this, especially when it’s the strong, excessive one, you will have a bounce-back. But the recognition that markets remain fragile is important, because it’s not the bottom if you return back with some equilibrium trading if you have another huge selling wave, if you have more excessive selling coming through. So far on the June 16th, following June 16th we eased a bit and bond fund discounts actually narrowed back every day for 10 straight days because we haven’t had that fear-based selling pressures. It’s one of those times some clients or someone might ask you, “Well, when is it going to end?” When is the selling going to end? And sometimes the answer is, “When it ends.” That’s about as best you can explain it, but you can still take advantage of the idea that there is sort of a temporal tailwind in your favor moving forward. With the possibility that, yes, there could be a couple of little headwinds back at you, but for the most part we're still in that period of which we're moving with the tailwinds.

CHUCK JAFFE: And obviously tailwinds are a good thing wherein this is again I assume sort of that classic situation for closed-end fund investors where for other parts of the market maybe you're going to ride a crest or what have you. But in the case when the closed-end fund discounts get wide, it's almost daring you to buy, but it usually pays off to buy. As you've always said, that you're all about the discounts. Right about now where other people and some folks might be looking at this market being risk-off, I assume you are, "Let's go," right?

ROB SHAKER: Right. We try and remain fully invested, but we will actually increase our allocations time to time for some additional bond funds. And this is exactly the type of time where you'd want to be, for the long term, invested in closed-end funds. We don't take a short-term approach, everything that we do is based on a long-term investment horizon. And the thought that when there is this sort of blood in the water and people are getting nervous, that is a time in which it really does make sense to look around, to find which of the things are babies thrown out with the bathwater, get yourself invested, and know that the longer term tailwind is there for you. And if you can make that right investment and just stay calm, and weather through any type of little bit of choppiness that comes along the way, that you're going to do better than you would outside of a CEF investment.

CHUCK JAFFE: Rob, great stuff as always. I look forward to our next conversation as we see what's happening with discounts in the market and more.

ROB SHAKER: You take care and enjoy your summer.

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, you can check out my hour-long weekday show on your favorite podcast app or by going to MoneyLifeShow.com. To learn more about interval funds, closed-end funds, and business-development companies go to AICAlliance.org, the website for the Active Investment Company Alliance. They're on Facebook and LinkedIn @AICAlliance. Thanks to my guest Rob Shaker, portfolio manager at Shaker Financial Services, learn about him and the firm at ShakerFinancial.com. The NAVigator podcast is new every Friday, ensure you don't miss anything by following us on your favorite podcast app. And if you like us, we'd love to get a review because they really do help. Until we do this again next week, happy investing everybody.

Recorded on July 7, 2022

To request a particular topic for The NAVigator podcast please send an email to: TheNAVigator@AICalliance.org

Click the link below to go to the home page of Active Investment Company Alliance to learn more: https://AICalliance.org/