



John Cole Scott Goes Discount Shopping For Black Friday

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With holiday shopping bargains on everyone's mind, Chuck Jaffe, in this episode of The NAVigator podcast interviewed John Cole Scott, chief investment officer at Closed-End Fund Advisors, the chairman of the Active Investment Company Alliance. Read the Q&A below as John sorts through the big discounts in the closed-end fund world to come up with the best bargains, the most meaningful plays now, based not just on current sale prices but the value and



income streams investors can unlock. In his search, he identified two equity and two fixed-income funds that might be a good addition to any investment shopping list.

John Cole Scott

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CHUCK JAFFE: It's Black Friday and John Cole Scott of Closed-End Fund Advisors is here, and we're going discount shopping for closed-end funds now on 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 joining me today, John Cole Scott, chief investment officer at

Closed-End Fund Advisors in Richmond, Virginia, which is online at CEFAdvisors.com, but we're about to dig into funds using their research, and you can do that yourself at CEFData.com. John is also chairman of the Active Investment Company Alliance, which you can learn about at AICAlliance.org, and you can follow John on Twitter @JohnColeScott. John, it's great to have you back on The NAVigator.

JOHN COLE SCOTT: Always enjoy being here, Chuck.

CHUCK JAFFE: This is airing on Black Friday, and in the spirit of Black Friday and Cyber Monday, I thought maybe we should challenge you a little bit. So we went outside of our normal framework and I suggested that, given the fact that people who buy closed-end funds are always interested in being bargain shoppers to one extent or another, we should look at who's got discounts that make them compelling buys as we get into the shopping time. And I know that it wasn't just as easy as you going off and saying, "Well, let's look for the biggest discounts, that's the biggest deal," but I know you have a couple things out there that are maybe on your buy list now. So let's talk about how you dug into the problem, find us the right bargains for the holidays, and what you came up with.

JOHN COLE SCOTT: Sure, happy to. So we pulled up our daily file from CEFData, I said, "First, let's try to avoid some weird funds because I want this to be a simple, useable story for your audience." So we got rid of anything without a daily net asset value, we got rid of anything that didn't pay a monthly or quarterly, because, well, closed-end funds aren't just for income, the bulk of them are, and I wanted to have an income story here. And we also thought that, let's make sure they have a one-year track record, because some of the discount data we use is one-year dependent and I can't have an N/A in the column to find a fund. We then also wanted to make sure these weren't small funds, there's enough liquidity so that we're not going to move the market on the half-day on Black Friday, so it had to be \$200 million in assets, and from there we started to dig into our discount data. I was doing the math, this is our 180th episode with bonuses, this is our 37 month of doing podcasts. Of course we've been doing this off and on for 10 years. Discounts are more than just the NAV is a ton higher than the marketplace. We wanted to make sure that the discount was wider than a peer-group average, we call that a comp discount at CEFData, we wanted to make sure that the discount was low in its range, we call that a discount-relative range. A really complicated name meaning data points we deal with at our firm. And then we also love a negative one-

year relative Z-stat. Now a lot of closed-end fund people know a lot about Z-stats. We said, "Let's not just take a negative number or a positive number, let's benchmark it off a peer group average, looking for the funds wider than their cousins and sisters." And the last one is more of a discount momentum, negative relative discount, the current discount versus the 90-day. We sifted through that really hard and hairy, got to a list of about 10 funds. And then remember, I'm a fundamental investor too, I said, "Which of these funds would I buy for my clients?" And honestly, three of them we already owned.

CHUCK JAFFE: That's a good thing. But having looked at 'em this way, part of this is, let's take a quantitative approach, look at discounts and make sure that what we're seeing isn't just an attractive number. The same way that you don't want to look at yields and go, "Hey, let me get the biggest yield," biggest isn't always best, and that also goes for discounts. So in this case, no offense to phrases like Z-stats, etcetera, which I know the insiders now. Fundamentally what we were looking for here was mainstream funds, things that were not going to be so esoteric that there might be anomalies in there performance and their pricing, that have a discount that have shown an ability to basically narrow it if market conditions change, that are also paying good yields and being consistent. It's really about finding the right level of consistency, correct?

JOHN COLE SCOTT: Correct. Three of the four funds traded at a premium in the last one year alone.

CHUCK JAFFE: That tells you that they have become big bargains, if they have fallen off dramatically. And one last note about the six that made the cut, they made the screening group, but then you cut it down to four, so this is you deciding on the ones that are the real bargains. But just one last word about those six, which is none of them are necessarily bad funds, but in the spirit of Black Friday and Cyber Monday they weren't the compelling bargain, right?

JOHN COLE SCOTT: They weren't, because we really love the story of, "This used to trade above book," versus, "Oh, this is always a discount, JCS." Or people saying, "Well, the net asset value performance has been generally better of all these funds versus their peers." Never a perfect answer but a nice way to think about quality funds.

CHUCK JAFFE: So now let's dig in on the four that made it through that are your picks here as being great holiday bargains where they're priced right now, let's start on the bond fund side. You've got two bond funds, two equity funds, let's start on the bond fund side.

JOHN COLE SCOTT: Unsurprising to all that the two bond funds are muni funds. One is DSM, the Bank of New York Mellon Strategic Muni Bond Fund coming in around a 13% and change discount, paying monthly, about a 4.27% indicated yield, 35% leverage, and a current duration of about 11 and mid-change. This is one of the funds, three of the four funds had a dividend cut in the last year of 20% or more pretty much in the last six weeks, which is driving some of the value, but also again giving you I think some good footing for less risk going forward.

CHUCK JAFFE: DSM was one of your fixed-income funds, the other one was?

JOHN COLE SCOTT: MIY. Now this is a BlackRock fund but it's a Michigan fund. And so sometimes people go, "Why the heck would I buy a Michigan fund, because I live in another other state?" But remember, this fund's liquid enough and it's sporting a 4.69% yield, 41% leverage, but again about a 14 duration. So definitely if you think we're closer to rates not going up, an even better pick versus the other fund. And don't worry, you don't have to live in Michigan to buy a Michigan fund.

CHUCK JAFFE: So on the fixed income side it's the DSM and the MIY. Let's move over to equities, what funds made your screen there?

JOHN COLE SCOTT: So the first one is CPZ, it's relatively new fund, it's a 2.0 fund, the Calamos Long/Short Equity & Dynamic Income Fund. Again, 13% and change discounts, it's a 10.7% yield, but they raised it a bit about 15 months ago and it really has a nice approach to a defensive footing because of the long-short component, and it's got that feature eventually it will come out at NAV. I just really like that it's performing really well on a NAV basis, but people still seem to be angry at it, which is always a fun way to buy a closed-end fund.

CHUCK JAFFE: And then the fourth fund is?

JOHN COLE SCOTT: It's a 1988 fund. Now we're going back in time to older than our firm which was founded the year after. But HQH, it's a perpetual fund, the Tekla Healthcare Investors Fund. Again, around an 11% discount, the current yield is about 8.25%. They just reduced their yield, but they really have this level policy that says we're going to pay X% of net asset value. And this may surprise you but equity funds are down this year, so the funds

that do that reduced their dividends as a matter of policy, eventually they'll go up. And again, a good track record, the Tekla group tends to buy some private exposure, stuff you really won't find in an open end fund or an ETF for healthcare. And going back a second, healthcare is considered a defensive sector, you're going to discount on a fund that used to be at a premium in a defensive sector, diversifying your experience.

CHUCK JAFFE: And I will simply say this is not only an old fund in terms of what it represents to your firm, but I remember writing about it. It was a Hambrecht & Quist fund when it was started if I'm not mistaken, and I remember writing about it in the 1990s when I was covering the fund industry and healthcare, so it has been around for a while. And the three of these that you own are which three?

JOHN COLE SCOTT: We own HQH, DSM, and CPZ.

CHUCK JAFFE: But again, the fourth fund, the MIY, the Michigan Fund, even though it's a Michigan-centric fund you can find reason to go there?

JOHN COLE SCOTT: I would. I wouldn't make it my only muni fund in my portfolio, but remember our clients tend to have, if they're heavy in munis, between eight and 12 positions. We find it's easier to rotate your trades if you have things that can go down, and then you can look for things. Again, the cross trades across closed-end funds, so it's good to have more than one fund in one sector.

CHUCK JAFFE: You know, John, if I had asked you the question slightly differently, if I had said, "Hey, let's treat Black Friday and Cyber Monday for closed-end funds the way shoppers do when they can't get Tickle-Me Elmo, Cabbage Patch Dolls, or whatever it might be," would you have said, "Okay, let's look at premiums and see if we can find something where this is somehow crazy and is justifying the premium"? Or would you have said, "No, if you get a frenzy that's the Tickle-Me Elmo of closed-end funds, yeah, wait, because eventually it's coming back and you don't want to get swept away just because the crowd is lined up to be able to go shopping and get this thing"?

JOHN COLE SCOTT: I mean, really we do, we've covered this numerous times in the past, but there's some funds that maintain a premium over net asset value, and the simplest answer is they've never changed the dividend policy. Very small number of funds, and eventually you either, if you're overpaying, which we'd argue many of these could be, you're going to erode capital or force a large cut later. You can't magically have double-digit manager yields

through bear markets in an equity fund and somehow have capital later to pay your shareholders in my opinion.

CHUCK JAFFE: Well, John, this has been a lot of fun. It's been cool digging in and getting your Black Friday/Cyber Monday "How do you deal with the discount?" advice. Thanks so much for joining me on The NAVigator to talk about it.

JOHN COLE SCOTT: Always happy to be here, Chuck. It's a pleasure.

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 work and my show at MoneyLifeShow.com or on your favorite podcast app. To learn more about closed-end funds, interval funds, and business-development companies go to AICAlliance.org, the website for the Active Investment Company Alliance. They're on Facebook and LinkedIn @AICAlliance. And if you have questions about closed-end funds, send them to TheNAVigator@AICAlliance.org. 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 either CEFAAdvisors.com or CEFData.com, and he's on Twitter @JohnColeScott. The NAVigator podcast is available every Friday, we hope you'll subscribe and join us again next week, and until we do that, happy investing everybody.

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