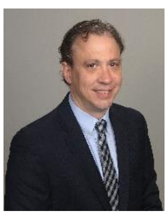
A 'Wall Of Meh' In Sentiment Is An Opportunity For Closed-End Fund Investors

Friday, June 2, 2023

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 economic conditions – the debt-ceiling debate, troubled banks, higher interest rates and persistent inflation – have created a situation where the market isn't climbing the proverbial wall of worry, but rather a 'Wall of Meh,' and says that there is opportunity in the unimpressive current conditions, noting that long-term investors in closed-end funds can use lagging investor sentiment to capture discounts as early as the second half of this year, when he expects a 'generalized recovery' from today's worrisome issues.



Rob Shaker

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

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CHUCK JAFFE: Rob Shaker of Shaker Financial Services is here, and we're talking about the state of equity and bond discounts in closed-end funds as we start the summer, 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 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 will point you in the right direction. And today we're pointed squarely at discounts and chatting with Rob Shaker, portfolio manager at Shaker Financial Services, which makes closed-end funds its primary investment tool, and which you can learn about online at ShakerFinancial.com. And to learn more generally about closed-end funds, interval funds, and business-development companies go to AICAlliance.org, the website for the Active Investment Company Alliance. Rob Shaker, welcome back to The NAVigator.

ROB SHAKER: Thanks. Thanks, nice to be back.

CHUCK JAFFE: We have seen the market rally much more than almost anybody thought to this point. We have not seen a recession yet by most measures, some people think we're maybe getting there or have seen it in some ways, but the discount action has been really interesting in closed-end funds. Let's talk about where we are and what that's doing for your outlook for the rest of the year.

ROB SHAKER: Yeah, so 2023 has been a very interesting year for discounts in general. At Shaker Financial we tend to, for the most part, stick to individual stocks, and individual funds as they move back and forth and have these discount movements, but from time to time we'll see these wide, broader, what we call general widening or narrowing. In 2023 we've actually had two different types of these things, which we find to be particularly interesting. We started the year with a very nice, what we would call extended narrowing, strengthened to the January Effect and everything was going smoothly. That also corresponded with, as you said, a very broad ding to the market. Then around March we had a change of atmosphere, starting with the Silicon Valley Bank crisis and we've entered into a more of malaised type of environment.

CHUCK JAFFE: And is that in part because we have seen a market that has been up but not broad? In other words, with an index you can make it that the index is carried by those couple of names that are lifting it higher, but in a closed-end fund where people are doing an evaluation, you don't have those couple of names in there, you maybe aren't getting the same kind of play. So is that the dichotomy here, that the market's going up but because it's narrow that's why you have that kind of action?

ROB SHAKER: Right, it does completely correspond, so that is something that's definitely affecting the net asset value side of things. As for the discounts themselves, it's a very interesting thing to look at in terms of exactly why would this be occurring? We have seen from time to time what we would call, and when we have a widening we would call it an acute widening, and that typically manifests in a period of fear-based selling. Something really bad happens, everybody sells everything, and that typically hits the bonds the worst because the NAVs of the bonds aren't as getting beat up as the equities are and so they widen more in a short temporal type of thing. This, what we have starting from March, we call it an extended widening, and this is one is mainly in equity funds. And I think it does have to do a little bit with that breath, but I think it's not as much as the breath is moving the discounts as it's moving sentiment, and so what you have is you have a general trading environment. And while the S&P is posting gains and there's this AI and Invidia headlines from time to time, you basically have this, not really a wall of worry, what we call a 'Wall of Meh' in investor sentiment.

CHUCK JAFFE: A wall of meh, yeah, like it. I should use that term more often. How do you respond to a wall of meh? Do you load up and go, "Meh, is opportunity"?

ROB SHAKER: In a sense, yes, and I think it's actually one of the times in which it's really favorable for the more typical retail investor in closed-end funds. As I said, at Shaker Financial, we track these things daily, we have these algorithms, there's real-time reportings, and what we're doing is we're trying to capitalize on that one-day movement, two-day movement, but when you have these periods in which you have these extended declines, it creates a really nice period in which you have an extended timeframe not only to enter into your position, but then if you plan to hold for a significant period of time, and by significant I only mean three, four months, you should be able to get that discount capture yourself as these come back. The wall of meh, banks, debt ceiling, interest rates rising, inflation, all of these things seem to sort of be coming to fruition, you can really picture that possibly three months from now these aren't the same types of things, that people get back to, "Okay, let's just invest." And so we would expect that as we enter into the second half of the year, we get this generalized recovery back, particularly in the equity funds this time.

CHUCK JAFFE: Let's talk about the difference, I don't know if we go all the way to dichotomy, between equity and bond funds. What have you been seeing on bond fund discounts? Because fixed income has been fixed in terms of it's got a return again, but the emotions around it have been interesting. So is there a big discrepancy, and is one side of the market that much more attractive to you right now because of the discount picture?

ROB SHAKER: We actually are pretty bullish on both sides but they do have different patterns for the year. So the main extended widening that we had over the past three months, that's mainly been on the equity side, with the bond side we had something a little bit more interesting in which we had a really sharp narrowing to start the year. But then actually in a very what we would call an acute widening, we had the bonds basically give up all of their year narrowing right after the first Silicon Valley Bank news broke. There was this panic in bond funds, I think partly because a lot of bank players are actually the investors in these bond funds for the long run, but it was this one-time hit. Since then, so since March bonds have been much more steady. So even though there still hasn't really been that excitement about investing again, they've been a little bit more steady, but I would think that with the general recovery that we would expect to see in investor sentiment, that that will push higher. And particularly for exactly the reason that you say, that these bond funds now after a decade of being under pressure about, "Oh, what's going to happen when rates rise?" "What will happen when rates rise?" Now we're in a situation in which not only do they not have that overhang, a one-time hit from a rising rate environment, but they actually have underlying coupons that are pretty significant.

CHUCK JAFFE: Yeah, that's the particularly attractive thing. It's been interesting to watch, that with all of the headlines coming out of Washington, that the market on the stock side, it's been driven much more by the activity in the AI sector than it has been by any sort of broad activity. And then on the bond sector it hasn't been scared off in spite of the fact that we were looking at the potential for a ratings cut, if nothing worse. So do you think that we'll wind up, as we head into summer and we see some resolution on the government issues, and we see the market kind of decide is it going to keep going with AI and turn it into a bubble or is it going to pull back from it, do you think that the discount picture if you and I talk again near the end of the year will be dramatically different than what we're heading into now?

ROB SHAKER: On a trajectory basis, yes, as you move through this year things are going to start recovering and pushing back higher. There's always the question, depending on your timing as you get closer to year-end, whether or not that real burst in discount narrowing holds off until January when it loves to take off. But you get the feeling that if you ask pundit what's going to happen next week or this or the other, "Oh, they're going to cut," "They're going to pause," "They're going to skip," there's all these short-termisms that will make things maybe a little bit sentiment-volatile. But if you really take a step back and ask people, "Where are we going to be three, four months from now?" almost everyone's the same, you have that same terminal rate, you have the same general feeling about what the inflation picture is going to be mathematically at the end of the summer, the debt ceiling and that resolution. And so I feel as if the most likely case scenario is that we're going to have this steady narrowing back in the same extended way that we've had the last three months.

CHUCK JAFFE: The takeaway I would get from that, but I want to make sure that I'm not somehow misinterpreting something is now's your time. Get in now before the narrowing because you'll profit from the narrowing, right?

ROB SHAKER: Right, and I would say now is a good time. I'm not saying that this is necessarily the complete bottom, now or never! But now is certainly a time in which valuations are attractive, especially if you're a long-term holder, and it's a nice one in which it's more of a broad level, so you don't need to really bring in specific expertise, be looking for a specific entry point based on a liquidation seller or anything like this, it's more of just this is a good time. We're at a period in which, with the sentiment expected turn, we should be able to push higher and be a little bit added value above and beyond what you typically get in added value from a closed-end fund.

CHUCK JAFFE: You know, Rob, it is always a good time no matter what the market is doing to catch up with you and find out what's going on in closed-end funds. Thanks so much for joining me on The NAVigator.

ROB SHAKER: Thank you, you have a good one.

CHUCK JAFFE: That's Rob Shaker, portfolio manager for Shaker Financial Services, which you can learn about online at ShakerFinancial.com. To learn more generally 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.

Recorded on June 1, 2023

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