John Cole Scott On How The Wild Market Action Is Impacting Closed-End Funds

Friday, April 11, 2025

Chuck Jaffe, in this episode of The NAVigator podcast interviews John Cole Scott, Chief Investment Officer at Closed-End Fund Advisors, Chairman of the Active Investment Company Alliance. John and Chuck check in on how closed-end funds have performed since the government's tariff announcement, particularly in bond funds, where the outlook for yields has put fixed-income markets under pressure; he also discusses discount levels, strategies that closed-end fund investors might use now, and how the current situation compares in closed-end funds to the market decline around the Covid pandemic.

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

Dig deep into business-development companies at the Active Investment Company Alliance 2025 BDC Forum. It's Wednesday, June 11th in New York City, a full day of big names in BDCs at the podium or on informative panels and networking opportunities with fund sponsors, asset managers, institutional investors, and others who are actively involved in business-development companies. Advisors can get seven CE credits for attending. Go to AICAlliance.org/events for the full schedule and details. Use the code NAVIGATOR20 for a 20% discount on your registration fee.

CHUCK JAFFE: How are closed-end funds performing amid the current market volatility? Let's find out with John Cole Scott from Closed-End Fund Advisors, 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 representing 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, John Cole Scott, the president at Closed-End Fund Advisors in Richmond, Virginia, which is online at CEFAdvisors.com, and the firm makes its data and closed-end fund research available, you can dig into it yourself at CEFData.com. Beyond his own firm, John is chairman of the Active Investment Company Alliance, which you can learn about at AICAlliance.org. John Cole Scott, lots to talk about. Great to have you back on The NAVigator.

JOHN COLE SCOTT: Always good to be on the show, Chuck.

CHUCK JAFFE: Everyone has been focused on the stock market, and it's not that closed-end funds don't cover the equity market, they do, but the story that hasn't been told amid all of the market volatility coming out after the tariff announcements has been really on the bond side. As Treasury yields have gone up, there's a lot of talk that that's what convinced President Trump to put a pause in, et cetera, and Treasury yields have gone up, that is big news on the bond side, since so many closed-end funds are focused on fixed-income, muni bonds, et cetera, that's where a lot of the action has been. So help us understand, amid all of this volatility, what's been going on with closed-end funds, specifically the fixed-income closed-end funds and their discount levels and more.

JOHN COLE SCOTT: Yeah, so basically what we're looking at is so far is our 15 sector index, to start the conversation, its discount peak to valley has widened 6-7%, it depends on which day we record this, this is after the close on Thursday, and a total market price pullback of a little over 11% in the last basically six market days. But really digging in, as you said, to munis, which right now they're only down about 4.5% year to date, but their net asset values went down almost 6% in two days simply because the average duration is an 11 and low change and the 10-year moved 50 basis points. Versus taxable fixed-income funds and the net asset values are much more stable because their durations are about a quarter to a third of that in almost all cases.

CHUCK JAFFE: We've lived through market traumas before, but Covid was, I don't know horrific is the right word, but it certainly from the closed-end fund perspective, man, discounts at that point were out of control. How does this time, still being resolved of course, compare to what we saw during Covid?

JOHN COLE SCOTT: Yeah, so peak to valley, that index went down almost 20% from February to March 23rd, there were moves of 7% two days in our database for a diversified basket of closed-end funds. So going back to that, I would say that this is much milder, this situation seems to have at least, we have a better working idea of what could improve it. There's still a lot of questions today, like the questions I had when we recorded a podcast in early March of 2020 talking about the discounts happening then for investors.

CHUCK JAFFE: One of the interesting things that people keep talking about is that the market craves certainty. Closed-end funds trade on sentiment, that's what the discount is all about. Are you at all surprised that given this much uncertainty we haven't seen bigger moves in discounts, a much bigger widening of discounts? Or have we not seen it precisely because there's no certainty, so we can't see that much willingness to move because, hey, they're already at a discount, how much more on sale were they going to get?

JOHN COLE SCOTT: Well, it's important to know that equity discounts really haven't gone that far, those funds have just underperformed the credit funds. If you really think about the questions we've been thinking about, and have even discussed previously this year on the show, is the 10-year trending to four or five? And with all interest rate moves, is it a slow move or a fast move? And that really is going to be driving interest in these funds. If you see the discounts, like there are days when the discount went from a 9 to 12% for muni bond funds, and the next day the data resets and they've narrowed 6% because the net asset values are moving so fast, the market prices can't always keep up. What I think of today's move, the last basically one day over a week, is that there's a lot of investors scared of the equity markets, they're putting money into these closed-end funds because the yields are high, sometimes real, sometimes overpayment, and these discounts are wide, and it's a relatively benign place to be as a retail investor because you're getting, it's hard to get below an 8%

yield in a diversified portfolio, many models are doing 9, 10, 11%, covering almost all the sectors because of those distributions with leverage and discounts where they are.

CHUCK JAFFE: In most places where people might go for advice, they're of course hearing, "Stay the course, stick with your strategy." But in closed-end funds, one of the most common strategies is, "Hey, take advantage of tax-loss selling, do some of those other things." With discounts moving this quickly, are you finding that there are some opportunities to make changes to portfolios, to do some upgrades, to capture some tax losses and do some other things along those lines?

JOHN COLE SCOTT: Absolutely. We've had a position from a conversion of an MLP fund to an ETF for a couple clients that were terrible tax gains, and I was able to finally take them in the last week because we could offset them with other parts of the portfolio. I mean, just looking at some of the MLP funds, their discounts moved I think 12%, a lot of large volatile losses. And again, with closed-end funds, you can probably do it with other areas, but you're often trading this manager you've heard of's fund in the space with a similar duration, similar leverage amount, similar data, for another fund. And again, for 31 days, the minor differences are basically unimportant and we are able to take these losses to counteract the gains that we took in January and February on some crazy trading that happened on a few specific funds then. So if you're not changing your mind today in closed-end funds, you are not doing your job. The volume for muni bond funds today was 2-4.5X average, that was just today, so if you're trying to make the trades, these periods give you the liquidity to do them so you can actually turn over shares even when you have a very large closed-end fund portfolio.

CHUCK JAFFE: So what that means, if I hear you correctly, is that even if you are a long-term investor, you've picked your closed-end fund because you love the discount it was selling at at the time you bought it, you like the yield, you're planning to hold it, you don't necessarily have a tax loss, this is a time that you should either be looking at upgrades or how you can overhaul the portfolio even when everybody else is saying, "Stand still," the nature of closed-end funds says, "Maybe not."

JOHN COLE SCOTT: Absolutely, and you've got to look into what you have, so when we were sifting for new funds we were looking at cost of leverage and expense ratio, the discount volatility, the actual disclosed duration for muni bond funds. It's not just the discount and the yield, you've really got to understand the NAV you're buying into and how likely that discount is to move back in the other direction, and how much the NAV will be impacted by interest rates. Because as we've covered before on this podcast more than once, there are muni bond funds where the duration differences are usually 6 to 8% peak to valley in these spread of options, and you get to lean which way you want to be based on your opinion on the 10-year at four or the 10-year at five.

CHUCK JAFFE: Are you watching for anything particular to be put on sale here? Is there an area in the closed-end market where you're saying, "If I'm a bargain hunter looking for yield and looking for the biggest discount, here's where I expect to find it"?

JOHN COLE SCOTT: So in the last six months or so previous to February 19th's pullback, it's been really hard to maintain a full weighting of taxable bond funds at reasonable levels because they've done so well, NAV, dividend, discount, you've got to be very active and proactive in that analysis. So we saw funds, their discounts widening 8 to 14% in the last six days to levels that we like them again, but you do gotta be careful because the NAV you're seeing is yesterday's close, the market price you're paying is today's trade, and if it's a credit fund, you can't ignore the current bond market and just take yesterday's NAV at face value. You've got to estimate in your gut if you're retail, or with tools if you're institutional, if you're still getting that same discount, but there are some super juicy fat discounts, funds I haven't owned for almost a year that I've been waiting for this day to happen.

CHUCK JAFFE: That being the case, again, just as the standard advice in most areas of the market has been, "Wait, don't change your portfolio," everybody says, "Well, if this market keeps going the way it has, especially if it pushes to the downside, it is a buying opportunity." You are suggesting, I want to make it clear that it's a buying opportunity right now, that the buying opportunity is here. That it might get better, but you're not waiting to buy?

JOHN COLE SCOTT: Once you've done a discount period widening of I'd say over 5%, you are in a very small number of outcomes. Things like the energy recession, things like the Great Financial Crisis, things like that move in December of '18 with markets, there's about six times it happened about every two to two and a half years in our career that give you these opportunities. But the way we think about not knowing the next 30, 60, 90 days, historically after pullbacks like this those returns are positive, but even if they're not, these distributions keep coming out of NAV. If you need to live on the money, do so, but we always reinvest something every quarter into our client portfolios in the funds and sectors we think will do best near term, and that is a layering of more [inaudible 0:11:23] per share, to stack the deck in your favor, to always be buying something where you actually don't mind these low prices because you're reinvesting at levels and you're living off the cash flow, you're not redeeming shares to pay your bills.

CHUCK JAFFE: John, great stuff, you helped ease our mind as we're going through all of this. We'll talk to you again soon, thanks for joining me on The NAVigator.

JOHN COLE SCOTT: Always great to be here, Chuck.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe, and yeah, I'm Chuck Jaffe, you can learn more about me and my show at MoneyLifeShow.com. But if you want to learn more about closed-end funds and business-development companies go to AICAlliance.org, that's the website for the Active Investment Company Alliance, and if you have questions about closed-end funds, send them to TheNAVigator@AICAlliance.org. Thanks to my guest John Cole Scott, he's president of Closed-End Fund Advisors in Richmond, Virginia, and the chairman of the Active Investment Company Alliance. His firm is online at CEFAdvisors.com, dig into their data for yourself at CEFData.com. The NAVigator podcast is available for you every Friday, make sure you don't miss any of our episodes by following or subscribing on your favorite podcast app, and if you like us, leave us a review or a comment because that stuff helps. We'll be back next week with more closed-end fund talk, until then, happy investing, everybody.

Recorded on April 10th, 2025

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