



John Cole Scott On When CEFs Have The Edge Over ETFs

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Chuck Jaffe, in this episode of The NAVigator podcast interviews John Cole Scott, President of CEF Advisors. John acknowledges how many consumers shy away from closed-end funds, fearing complexity or an investment type they don't fully understand. The chairman of the Active Investment Company Alliance would obviously favor closed-end funds, but he sizes up situations where a closed-end fund and an ETF or a fund-of-funds cover the same asset class and why he would choose one over the other or whether he might mix and match for better balance.

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

CHUCK JAFFE: We're talking with John Cole Scott of CEF Advisors about when it's right to make the leap into closed-end funds, welcome to The NAVigator. Yes, 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, which is a unique industry organization representing all facets of the closed-end fund business 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 returning to The NAVigator today, John Cole Scott, he's president of CEF Advisors, which is online at CEFData.com and which has re-done their website which you should check out if you're looking for information on closed-end funds because all of their data is there. You can

plug in any closed-end fund you want and get John's analysis and what the firm is looking at when they're sizing up that fund, but beyond CEF Advisors, John is 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: Great to be here with you, Chuck.

CHUCK JAFFE: Now I'm going to point out that anybody who heard me say, "Oh, we're talking about when it's right to make the leap into closed-end funds," realizes that closed-end funds is your backyard pool and this is a place that you're going to dive into a lot, but when I talk with individual investors about doing The NAVigator, I hear a lot, "Closed-end funds, I don't understand 'em," "I don't get the difference," et cetera. So we're going to look today at two situations, one, where you literally are deciding between a firm that offers the same assets in an ETF and in a closed-end fund, and another where we're talking about a closed-end fund of funds. We want to help people understand how we size it all up, sound about right?

JOHN COLE SCOTT: Absolutely, correct.

CHUCK JAFFE: Let's jump in first. So we're going to talk about two Eaton Vance funds, one is an ETF, ticker symbol EVLN, the Eaton Vance Floating-Rate ETF, and we're comparing that with the Eaton Vance Senior Floating-Rate Fund, that's a closed-end fund that trades under EFR. So both are buying floating-rate securities, and for the general public, and we see this because of inflow numbers, they would say, "Oh, ETFs, they're simple, they're cheap, let's go in that direction." But when you look at the two, same assets, very different results, explain what it is that you see and why your choice might be the one that the general public doesn't make.

JOHN COLE SCOTT: Sure, absolutely. EFR is currently about an 8.8% indicated yield and EVLN is about 7.3%, not uncommon, because as you might suspect EFR has leverage, but there's a current discount of EFR and relatively wide for its peer group at around 6%, versus effectively ETFs have no discounts in regular markets, and that leverage is 36% versus obviously zero for the ETF. Now as you would expect, the management fee on the closed-end fund, which is not the only expenses but a good comparison, is about 1.13% and it's 60 basis points, so roughly half for the ETF. The closed-end fund is 22 years old and the ETF is less than two years old, and size-wise, the closed-end fund is moderate at \$350 million and the ETF is at \$1.4 billion as of this September. When we really dig into it, the things that we see

that are attractive is that the leverage-adjusted NAV yield of the closed-end fund is about 6.1%, which is about 15% lower than what the equivalent yield would be for the ETF, which suggests to us that it's probably more likely to have a higher distribution upside in most market environments. We did notice it had some return of capital last couple of years, but we also noticed in August they reduced the dividend a couple percent, we feel, aligning their current plan with current markets. With that combination, this is the really fun or terrible closed-end fund thing, the dollar in your portfolio with discounts and leverage is about \$1.45 of manager assets. The good there is you get more exposure per dollars, the bad is you could have that become more terrible if discounts widen or if leverage wasn't a great use at that moment of time.

CHUCK JAFFE: What you're saying is that because of the leverage, because you are basically buying exposure to almost a dollar and a half of assets for every dollar you invest, you get a lot more action for your money, and that action, well, it could be a double-edged sword, but if you really believe in the assets, which is why you would be buying them regardless of how you're buying them and you want the juice, you'd go with the closed-end fund. If you are more concerned about the volatility in that space, you might then go with the ETF, correct?

JOHN COLE SCOTT: Correct. So right now that fund is trading, the widest discount recently is about 12% discount for the closed-end fund and a 3% premium, so it's 38% in its range, but if you think there's going to be a bump or bruise and discounts could blow out, you would not want to be in the closed-end fund, you'd want to live in that ETF and wait for a double-digit discount in this fund, like we've talked about before, to rotate back into it if you're a more conservative risk-thoughtful income investor.

CHUCK JAFFE: Here we are waiting for the Fed to cut interest rates, when we see rate cuts it will impact floating-rate funds and senior floating-rate debt, so would you be leaning towards the ETF or the closed-end fund if you're making that choice in this asset class now?

JOHN COLE SCOTT: So two things, as you said on the front end, we're closed-end fund focused investors and our client conversations talk about volatility being a benefit not a risk, and so if there were an event that brought these discounts wider, we'd be actively rotating as we could inside of the different funds in that universe for most of our clients. Now imagine there's a brand new client coming on the market right now for us, we might do a two-thirds closed-end fund, one-third ETF, take some of the risk off the table with a little bit of dry

capital for deeper discounts but still not avoiding the entire allocation, and that is one of the ways we find firms like ours have grown to use these funds as companions and not just pure rotations, is to size up the near-term risk based on entry point for our client.

CHUCK JAFFE: And that's an important point, because it doesn't have to be an either or choice. It's not binary, you must go with one or the other, for most people the answer would be you could use both, you just need to understand that you're using one to give you a little bit more juice and the potential to get more squeeze out of it, you're using the other to make sure you've got that basic coverage of the asset class.

JOHN COLE SCOTT: Absolutely, and if you don't know what's going to happen, it's good to split the difference, especially since the last five or so years, commissions have gone to zero.

CHUCK JAFFE: Well, now let's turn it from that situation to the RFMZ, that's Rivernorth's Flexible Municipal Income Fund II, and that is a closed-end fund that invests in closed-end funds. It's hard enough when you use a fund of funds in the traditional open-ended fund space, because then you've got what's happening with expense ratios and what have you, but when you add leverage into the picture it makes things that much more wonky for somebody who's trying to evaluate what they are getting. So help us understand, when do you want to go with the closed-end fund of funds versus when do you just want to go, "I'll put a few closed-end funds directly in my portfolio"?

JOHN COLE SCOTT: So I would say the more plain vanilla and the bulk of our muni assets are in those multitude of regular closed-end funds that you and I can buy for our portfolios as any advisors can, however when we feel like we have a stronger opinion of rates going down versus up, which is where we sit at my firm today, taking a closed-end fund of closed-end funds and layering in discounts on discounts, leverage on leverage gives you more magnified exposure for a more convicted bet with less dollars utilized. It's a more complex analysis, but it definitely lets you, if that's your goal, and we've talked about this before, this is one of the funds that when a discount's wide and they're overweight muni closed-end funds with leverage at the fund level, leverage at the guts level, it can be a very powerful outcome.

CHUCK JAFFE: But don't you therefor also face that downside risk we were talking about earlier, where having done this you are making the risk that much more intense? The rewards could be bigger, but so could the downside?

JOHN COLE SCOTT: Absolutely. So if you do not have that belief or if you're a more skittish investor, this would not be a good buy and hold current fund for you. If we think about the current 9% discount at the fund and about 42% leverage, first at the wrapper level, 91 cents control that \$1.42, there's duration there, about 10, but they hedge it a bit so it's down to a seven at the fund level. Dig in deeper, through the mid-year updates they were 37% disclosed muni closed-end funds and they disclosed a weighted 7.5% discount for the holdings, and if we take our average leverage for the basket of funds we look at with 35%, then this is a 13% blended discount. When we combine all that math with a rough estimate, a dollar in your portfolio will give you \$1.81, which again tells you that's the upside bull case, but if it goes the other direction, that would be the downside bear case.

CHUCK JAFFE: Yeah, so you're getting good yield, you're getting the regular payouts that you want, you have the upside potential with a wide discount that can be narrowed, and you're getting really good literal bang for the buck, you're getting more ammunition for what you're paying but you again better be pretty certain that you love the asset class.

JOHN COLE SCOTT: Absolutely, and I'd say that obviously it's a higher beta version of the exposure, and also because many closed-end funds overpay, this one is not immune. We would recommend re-investing a portion of it, we model roughly 15%, back into something in your portfolio and not spend that in retirement.

CHUCK JAFFE: And this case as well, again if somebody is looking at closed-end funds, on the one hand you could say, "I'll buy the closed-end fund or two closed-end funds in the muni space that kind of cover me," on the other hand you could hire a professional manager. Does that factor into it? I mean, obviously you are a professional manager for your clients, but for the person who's not using someone like you, does using the closed-end fund of funds give them a little bit more of a gain where they're getting the benefit of the management that they don't get with closed-end funds otherwise?

JOHN COLE SCOTT: I would say they're getting tactical management, we find a lot of investors here are very sit on their hands and not make changes, not discount rotating or thinking about interest rate decisions and its impact on, some muni funds have lower duration, some have higher, some discounts as you know evolve and move through time, some people trade more actively like myself, even more so for a Rob Shaker, and you trade a lot less than Rob and I combined. It all depends on what you're looking for, it's a great opportunity to have

some active management, but don't forget about the complexity of the wrapper and the guts aren't as easily analyzed as a more traditional Nuveen, PIMCO, BlackRock traditional muni bond fund.

CHUCK JAFFE: Yeah, it's important. Like I said, I hear all the time from investors who now are listening because they listen to The NAVigator, and they're honing in on closed-end funds but they're struggling to pull the trigger, this helps 'em understand why to pull that trigger. John, really interesting, thanks as always for joining me, we'll see you again soon.

JOHN COLE SCOTT: Glad 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 I am Chuck Jaffe, you can learn more about me and my show by going to MoneyLifeShow.com. Now 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. If you have questions about closed-end funds or anything going on in the industry, send 'em to TheNAVigator@AICAlliance.org. Thanks to my guest John Cole Scott, he's president of CEF Advisors and the chairman of the Active Investment Company Alliance, his firm is online at CEFDData.com where you can dig into their data for yourself. John's on X by the way @JohnColeScott. The NAVigator podcast is available every Friday, make sure you don't miss an episode by following or subscribing on your favorite podcast app. We'll be back next week with more closed-end fund fun, and until then, happy investing, everybody.

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