Year-End Action – Not Bubble Worries – Will Drive Year-End CEF Discounts

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Chuck Jaffe, in this episode of The NAVigator podcast interviews discount-capture investor Rob Shaker, Portfolio Manager at Shaker Financial Services. Rob says that he's "not seeing anything in the closed-end fund space that would point to any type of bubble conditions." He sees generic, slow widening of discounts happening now, mostly due to a mix of year-end tax-loss moves starting now and some fund-specific actions, rather than because investors have lost faith and courage in current market conditions. Still, Shaker does see potential market storms coming and he says investors should make sure they are comfortable that they can weather those flurries "and readjust to the better things that are on sale and then double-collect on the way up."

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CHUCK JAFFE: Rob Shaker, portfolio manager at Shaker Financial Services is back to update us on the state of discount capture investing with a market that's flirting with record highs, 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 representing the full spectrum 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's going to point you in the right direction. And today we're looking at how the market is impacting discounts and the investors who love those discounts with Rob Shaker, portfolio manager at Shaker Financial Services, which managers over $250 million in closed-end fund investments and which you can learn about at ShakerFinancial.com. And if you want to learn more generally about closed-end funds, interval funds, and business-development companies, go to AICAlliance.org, that's the website for the Active Investment Company alliance. Rob Shaker, thanks for joining me again on The NAVigator.

ROB SHAKER: It's nice to talk to you.

CHUCK JAFFE: We last talked in June, and at that point you were discussing how the market's wild moves around tariff announcements had stress tested the market, they stirred up investor emotions, and closed-end funds generally do some trading on emotions, so you had discounts widening when investors got scared, you got rewarded for staying patient and opportunistic, and then the market kind of returned to a little bit more normal and discounts narrowed. But of late, discounts have been widening again, what do you think is going on?

ROB SHAKER: Well, it's good that you point out the main widening that we had earlier in the year, typically we'll have a widening based around fear-based selling, and so that's what we had in March and April of this year around the whole tariff tantrum, but now this time after that we've had a really nice steady period of growth not only in the NAVs of closed-end funds but with discounts overall. So now we enter in the end of the year season, different season in which you have a whole bunch of things pushing different reasons for widenings across different sectors, at this time of year you can typically have two main things that occur, the biggest one being tax-loss selling. Tax-loss selling historically started in November, early December, but as things have sort of caught on, people sort of started fronting it, fronting it, fronting it, and now we find it to even start happening towards the end of September and October, so that's the primary one that we're always looking for in any given year.

CHUCK JAFFE: Are we seeing something different though as well given current conditions? Because we've got the market still flirting with record highs, but the narrative has been turning increasingly to we're living in bubble conditions, and yes, bubble can inflate for a long time, but that seems to have increased the mix of people who are at least frightened. So you've got this again balance between who's opportunistic and who's frightened, what do you see happening in a time when we've got heightened fear and maybe greed as the emotions driving things?

ROB SHAKER: That's one of the primary things you're going to have to do when you're looking across any given fund, discount widening or widening overall, right? So we'll call it widening overall, I wouldn't call it a generic widening, when you see a generic widening across the board of all closed-end funds or all bond funds or all equity funds, you want to start looking under the hood to figure out what is pushing this? Is it some type of fear-based selling? The reason you want to find out why this is occurring is because of the most important aspect, you want to know when it's going to stop, it's going to come back. At SFS, all we're trying to do at all times is try and figure out when can we get in at an attractive valuation, expecting the reverse to the historical average and being able to sell when things move back. So to be able to understand that, you want to understand why is it going out wide? Why is there excessive selling pressures? Because that's what lays at the heart of all widenings, is excessive selling pressures, more sellers than buyers. So your question as to whether or not this fear of the bubble is pushing things is something you have to look across and say, okay, where are we seeing the widenings? So if we're seeing it across the board in tech companies or the things that people might be afraid that are bubbly, then we would say, oh, okay, this must be something that's being caused by that. However here we're not really seeing that, we're seeing more of a generic type of slow, steady drip downward, possibly and primarily based on some early tax-loss selling, but then there's a whole bunch of other corporate actions that are leading to individual movements in individual funds.

CHUCK JAFFE: I know a little bit about the firm, and your firm was started by your father, Dr. Richard Shaker, who was a mathematician, I know at one point he was the chief mathematician for the NSA, and then he got into closed-end funds because this is where the market is inefficient. But I'm curious, because there's that mathematical background, and because he started your firm in the late nineties as the internet bubble was building, is there a comparison? Are you looking at this going, "We've lived through bubbles before and we have a sense of what's going to happen," and what does tend to happen when the market gets a little bit frothier or what have you than normal? I mean, obviously there's periods where discounts go out, but does it change your timeframe? Do you have to be longer term? What happens, and is there a period that you can relate this to?

ROB SHAKER: Appreciate you bringing up my father, he actually just recently passed but we still carry on all that he built up in this idea of discount capture. The concept of is there an impending bubble, is there going to be any type of bounce? Actually going back to my father, at Shaker Financial we do take a long-term approach, so we're never trying to avoid a loss, we're trying to limit a loss. There may be declines, there may be bubbles from time to time, there may be 2008, which is really one of our fundamental points we always try and look to because of just the dramatic action that happened in closed-end funds during the Great Recession, things when from par to 20-25% discounts over a short period of time. So what we're trying to look for in that circumstance is what are the ones that are going to be the most steady? Where are we going to be able to find the steady? And what we want to make sure that we're also doing is limiting any extra exposure, and so we don't want to be using a lot of margin, we don't want to be pushing ourselves out in more speculative convertible bond funds as opposed to maybe some reset bond funds, senior loans, or some multi to steady things out. We're not really trying to avoid that or predict a bubble, but we're trying to always be responsive to anything that we're seeing so that we can weather. The idea always being markets will go up over time, as my father said, markets go up over time so they should always be near all-time highs. You should never be afraid of an all-time high, that's where they should be, markets go up over time, but you do have to be prepared to weather any type of decline, any type of cycle, and when that happens you want to try and limit the losses on the way down and double up on the way up.

CHUCK JAFFE: Do you think we are in bubble-ish conditions? And if so, what will you do to prepare to limit your losses on the way down? I recognize that you won't be pulling out too early and you'll be looking for opportunities, but since you don't want to catch a falling knife, what will you do to prepare if indeed this is something of a bubble being built?

ROB SHAKER: As a starting point, we're not seeing anything in the closed-end fund space that would point to any type of bubble conditions. We have a bunch of restructuring, we have a bunch of mergers going on, we do have some rights offerings coming up, but we're not seeing a lot of dividend cuts or any type of excessiveness in the closed-end fund space. We had a couple of closed-end funds that were, you could kind of say bubbly, up at 100% premiums or 15% premiums when comparables were discounts, but those have actually cleared themselves out over the last bit of time, some through corporate actions such as mergers. So in the closed-end fund space specifically, we're not seeing any type of bubble conditions, to the extent that markets could be a little bit frothy or perfectly positioned, perfectly priced, we don't really make those types of judgments because we want to make sure that we're not interfering with the general concept of long-term investment horizon, create an additive through discount capture, and stay diversified.

CHUCK JAFFE: And so what that ultimately means is if the market's going to give you discounts because people get scared, those are buying opportunities?

ROB SHAKER: Right, so in the meantime you have a widening, anytime there's fear in the water, you're going to be able to get better deals, and that's the Warren Buffett philosophy of investing, and it's hard. And so we don't expect typical investors to be able to say, "Okay, every time there's a big selloff, I'm going to jump in with both feet," but the idea is to make sure that you're comfortable right now where you are that you can weather it, so that if there is a decline, that you can readjust to the better things that are on sale and then double collect on the way up. You're not really double collecting because you're market timing with some sort of crystal ball, you're double collecting because you're agile, and that as things progress and you're staying fully invested, you're able to rotate from things that are no longer containing big premiums of growth through a discount capture, but you're rotating out of those into ones that have been overdone.

CHUCK JAFFE: Rob, really interesting. We're going to be of course watching how it all plays out, we're going to hope for good discount capture moving forward. Thanks so much for joining me today on The NAVigator.

ROB SHAKER: Thanks. Thanks for having me.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe, and I'm Chuck Jaffe and I'd love it if you'd check out my show on your favorite podcast app or by going to MoneyLifeShow.com. Now to learn more about interval funds, closed-end funds, and business-development companies, go to AICAlliance.org, that's the website for the Active Investment Company Alliance. Thanks to my guest Rob Shaker, portfolio manager at Shaker Financial Services, learn more about the firm, its methods, and everything they do at ShakerFinancial.com. The NAVigator podcast has something new for you every Friday, make sure you don't miss an episodes by subscribing or following along on your favorite podcast app, and if you like this podcast leave a review and tell your friends, that stuff really does help. We'll be back with more closed-end fund fun next week, and until then, happy investing, everybody.

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