# Sit's Doty Says Rates Will Rise, Peak And Shift Downward by Year's End

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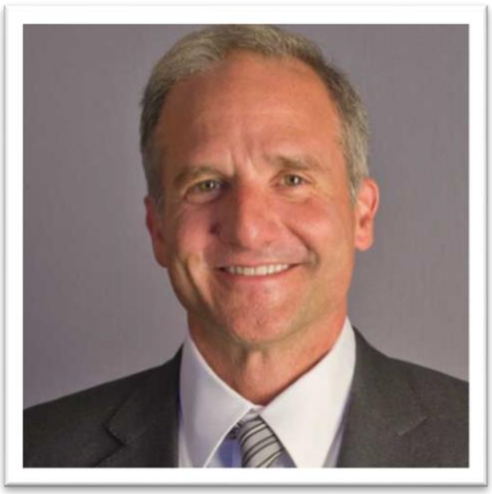

Chuck Jaffe in this episode of The NAVigator podcast interviewed Bryce Doty, Senior Portfolio Manager at Sit Investment Associates. Bryce says that "the worst is over as far as yields going up," noting that the next shift could be down, but he calls the conditions "tricky" and emphasizes that investors "need to be in the right part of the curve." Doty's case hinges on oil prices; if oil stays below $110, it's viewed as inflationary, but above that level "we have a problem, and so does the rest of the world." At that point, central banks will have to cut rates to "save economies from disaster." Doty, whose team manages $2.7 billion in closed-end fund-of-funds for separate accounts, likes two-year TIPS, municipal bonds, and high-yield corporate bonds. He also discusses the IPO market, closed-end rights offerings, and the quality of private credit investments.

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

**CHUCK JAFFE:** Bryce Doty, senior portfolio manager for Sit Investment Associates is here, and we're talking about what's next for income-driven investments now on 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, an industry organization that represents the entirety of the closed-end fund business from investors and users up to fund managers, sponsors, and creators. If you're looking for excellence beyond indexing, The NAVigator will point you in the right direction. Today we're talking with Bryce Doty, senior portfolio manager at Sit Investment Associates, where of the firm's $20 billion plus in assets, he and his team manager more than $12 billion, including $2.7 billion in closed-end fund of funds for separate accounts, you can learn about the firm and its funds and what it does at SitInvest.com. And before we start, a reminder that if you want to learn more generally about closed-end funds, interval funds, and business-development companies, you can get more information at AICAlliance.org, the website for the Active Investment Company Alliance. Bryce Doty, it's great to have you back on The NAVigator.

**BRYCE DOTY:** Yeah, thanks for having me back, Chuck.

**CHUCK JAFFE:** Let's start with big picture on interest rates, because we certainly have seen changes in the last couple of weeks, where everyone was still holding on to the idea that we would get rate cuts, then it got to, even if there are rate cuts, we're still going to see the Treasury yield go up. Now it's, rate cuts, nah, it's going to be hikes. So where are you on the interest rate picture and how rapidly that picture is changing?

**BRYCE DOTY:** Well, it's tenuous because it's linked to the price of oil. If oil is $90 to $100 a barrel, everyone sees it as inflationary but not bad enough to derail the economy. But let's say it shoots up to over $110 or $120, now we have a problem with the economy, and so does the rest of the world. So yields will rise as long as oil is $100 or less, but if it gets too out of control, interest rates will actually come down because central banks will have to cut to save economies from disaster, so you can get whipsawed as a bond manager. You can be thinking, well, rates are just going to keep going up as long as oil goes up, but then all of a sudden you'll see interest rates move the other direction if it looks like the economies around the world are in jeopardy.

**CHUCK JAFFE:** What does that do for you as a manager, as an investor? Does it lengthen your time horizon to just say, "We'll ride out the bumps"? Does it shorten your time horizon to say, "Let's try to anticipate the next thing before it's happening"?

**BRYCE DOTY:** I see people starting to get really nervous and selling, and that caused rates to spike last week. Well, after a while there's not enough people left to sell. I think we're actually getting close to a peak in rates because either bond investors and even equity investors are going to start to find these yields pretty attractive, or oil does keep going up and wreck the economy and there'll be a flight to quality that also brings in a demand for bonds, so I think the worst is over as far as yields going up, the next shift could be down. I think the new Fed chair is going to reduce the balance sheet, at the same time he cuts rates from 3.5% to 3%. That'll be in the fall, it's going to take people to kind of get their arms around this new trimmed core CPI that he's been pushing that is actually lower than the current measurements for core inflation. That's probably what's going to happen, that'll cause the long end to go up in yield, 30-year yields go up, short end will go down, and you gotta get that right, you gotta be in the right part of the curve, it's going to be a little tricky.

**CHUCK JAFFE:** What part of the investment allocation do you want to be in at that point? I mean, not just curve but are you leaning more towards one type or another? I mean, is it muni, is it high-yield, is it something else that you think winds up being the sweet spot?

**BRYCE DOTY:** We have an interesting blend. We like two-year TIPS, short TIPS, there's even closed-end fund TIPS portfolios that are great, we like munis for downside protection. Investment-grade corporate bonds are not as attractive relative to high-yield right now. High-yield has a couple things going for it, one, some of these high-yield closed-end funds have just been beat up with all the fears around private debt and liquidity problems, but the cavalry is coming. All the banking re-regulation and normalization of that is going to free up a ton of bank money to come in and provide liquidity in that space, so we like high-yield closed-end funds at 10% yields. You couple that with the safety of TIPS and munis, you've got a great portfolio.

**CHUCK JAFFE:** You like high-yield closed-end funds with yields in the 10% range, I'm not sure who would dislike that. I want to talk about high-yield because you said you liked the space, but in there you were also talking about how closed-end funds got hurt because of private credit and BDCs. We saw interest rates go up and we didn't see a wave of defaults when it came to high-yield. High-yield has always been considered junk bonds, that's not what the industry wants to call it but that's what the public wants to call it, but if you don't have defaults in high-yield then it means that either they're not junk bonds or that junk has moved someplace else. And I'm curious, is what we now call private credit, is that what we should be calling junk? Because there certainly seems to be more default potential there, and we've got companies that are doing more deals on the private credit side than they are on the high-yield public side, so have we seen a shifting or a change in the high-yield market?

**BRYCE DOTY:** I think so. I think we've seen a bifurcation in private debt. You have a portion that are pretty high quality, equivalent to maybe the traditional high-yield, debt that banks should be actually lending to and will again, because borrowers were borrowing paying 14% to a private debt person when they should be paying 8% to a bank. But then there's the other portion of the private debt realm that is just really risky, it's more risk than any of the high-yield, traditional high-yield bonds or bond funds, and we are starting to see defaults there, and there'll be more, there's definitely cracks that will widen if the economy weakens any further. One area that might just save them is the IPO market is coming back to life, this banking regulation is helping everything, because the IPO market wasn't alive due to a problem on the debt side, everyone thinks it was a stock problem, right? Stock market problem, these companies can't raise a bunch of capital. Well, the reason they can't is because they can't get enough leverage at a cheap enough rate to make it a good deal for the equity investor. Well, now you're going to do that, maybe some of these really dicey companies are going to be able to access equity and avoid default, but a lot are just not. You're going to see much more default in the private debt market than the high-yield market.

**CHUCK JAFFE:** Let's take that from the IPO market, et cetera, and bring it over to closed-end funds, because what we've seen with closed-end funds has been a number of rights offerings and things along those lines. Historically, rights offerings haven't always been considered a good deal, are they now? If you like what you're seeing in the IPO market over there, are there better things happening in the rights offering market in the closed-end space?

**BRYCE DOTY:** There are now. I tell you, there's four primary ways for closed-end funds to do rights offerings, some are more shareholder-friendly than others. Well, the governance on closed-end funds has really improved from the toxic nature of two, three years ago, a lot of these fund managers it was like Jekyll and Hyde, they were super sweet and loving to their shareholders for the open-end funds, and attracting clients and money, and then you go to the closed-end funds and it's like they hated their own customers, they treated them terrible. They were offended if, god forbid, a shareholder made a suggestion that might help, and that's all changed. Now their governance has improved so much that the discounts have narrowed significantly, they like their shareholders again. It's like they're treating both open and closed-end fund shareholders equally, and so they're able to do rights offerings, and they're doing them in the right way. They're making them attractive for existing shareholders to increase their investment, grow the fund, without some of the downsides, without a massive dilution or a disruption to the trading of the strategy. And right now, with yields as high as they are, it's a fantastic option for both the shareholder and the fund company to do. So you're right, it is a much different and better environment for rights offerings in closed-end bond funds in particular, for equity funds as well for that matter.

**CHUCK JAFFE:** Has it changed the closed-end IPO space? I mean, we're actually expecting one or two more new fund offerings than we have gotten for a while. There was a time when every closed-end fund IPO was a terrible deal, then there was a time when they looked better, then you got Bill Ackman coming into the picture this year, that's garnered some attention. What's your take on closed-end fund IPOs?

**BRYCE DOTY:** Well, I think BlackRock has gone in a full circle, right? They have really improved their governance dramatically, and they're seeing results, they're doing rights offerings, next is doing more funds. I think they're a real turnaround story. I think they can make their business a real growth business again like they had in the past, the next step is this IPO of new funds that can be done. I think the funds that got themselves in trouble are ones that tried to do private equity, and that just doesn't really seem to work well in closed-end funds, so as long as the new IPOs stay away from that, I think there's a ton of opportunity out there. There's a real place for assets that have to fund investments that are illiquid, and that's the sweet spot for 'em, but not private equity, I think we've kind of proven that that's not going to work.

**CHUCK JAFFE:** As you are looking at closed-end funds in the industry, and you talked about how closed-end funds are treating shareholders better, et cetera, one of the things we've seen a dramatic reduction is shareholder activism. Is it just because it's not much of a fight if you're dealing with a fund that has a 3% discount and is kind of within its range with what the discount's expected to be? So as a long-time investor in closed-end funds, is activism less interesting to you because it's less necessary right now? Or, no, activism will always be there, can't wait for the next one to somehow perk up?

**BRYCE DOTY:** You're kind of like why do I have to tell an asset manager to do the right thing? Why would you have to tell anyone that it's a bad idea to borrow money at 5% to invest it at 4%? Why am I having to do that? The activism shouldn't be there, funds should just be professional, know how to do the right thing for the clients, and they are doing it. They're being smarter with their leverage, they're being smarter with their investments, they're being smarter with their distribution rates, they're being smarter with how they realize gains and losses. It's just a lot more professionalism there, and I don't know if they finally realized that they had taken their eye off the ball and they're getting back to basics, but it's really showing up in the narrower discounts. So we love participating in the rights offerings, we love growing a fund by $50-100 million that's treating their customers right, that's way more exciting than the other things. You see RiverNorth is great, even Nuveen did a couple of rights offerings, they've been sometimes tone deaf at times and they're kind of coming around. It's much more enjoyable to have everyone pulling in the same direction, as they should, I definitely prefer that environment.

**CHUCK JAFFE:** It's much more enjoyable to have a market that cooperates. This market has been very cooperative, from the sounds of it you think it's going to continue to be cooperative. Is there a point out there that you worry about, whether it's the geopolitical thing, et cetera, recessions have not been repealed, so is everybody nice as long as we've got a market flirting with record highs, we've got double digit yields in closed-end funds, all these other sorts of things, but oh by the way, put it all into the recession blender, or something along those lines, and everybody's mood changes?

**BRYCE DOTY:** Well, as a bond manager, I'm always paranoid, okay? And one of the worst things that you can endure as a bond manager is a new Fed chair, Greenspan caused the '87 stock market crash, Bernanke brought on the Great Recession, it's always a frightening thing to see what a new Fed chair is going to do or come up with. The war, I don't see that ending soon. We want the Strait closed because we're getting $100 barrel oil orders from China. We don't like China, them paying us a bunch of money draining themselves when a year and a half ago they said they'd never buy another barrel of oil, we love that. Iran actually thinks they've brought the world to its knees, they don't want the Strait open, they don't want this to end, so that could cause all sorts of ripple effects and problems for other economies. There are plenty of landmines out there, that's why we think you've really got to have a blend of these different components to protect against the downside. That's why we like that inflation protection, we like munis because, hey, schools went remote during Covid but they didn't close, they still paid their debt. And stocks, the high flyers, the AI companies, they can't all win, we would rather invest in the servicers and suppliers to the AI companies, that's probably a safer bet, they're making a fortune. If you're worried about war, invest in the defense stocks and things like that because, what did you say, they didn't outlaw recessions or something? Yeah.

**CHUCK JAFFE:** Yeah, they haven't been repealed.

**BRYCE DOTY:** They haven't been repealed. Yeah, you always have to keep an eye on that downside economic picture.

**CHUCK JAFFE:** The good news is that while they haven't been repealed, they also don't seem to be in your outlook, but we'll get more on your outlook, we'll talk again down the line. Bryce, always great to connect with you.

**BRYCE DOTY:** Great, thanks a lot.

**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 you can check out my hour-long weekday show by going to [MoneyLifeShow.com](MoneyLifeShow.com) or by searching for it on your favorite podcast app. To learn more about closed-end funds, interval funds, and business-development companies go to [AICAlliance.org](AICAlliance.org), it's the website for the Active Investment Company Alliance. Thanks to my guest Bryce Doty, senior portfolio manager at Sit Investment Associates, he and his team manage more than $12 billion in assets, including $2.7 billion in closed-end fund of funds for separate accounts. Learn more about Bryce, the firm, and what it does at [SitInvest.com](SitInvest.com). The NAVigator podcast has something new for you every Friday, so plan to join us again next week for some more closed-end fund fun, and until then, happy investing, everybody.

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