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CEF Advisors' Q3 Report: Taxable Bond Funds at '99th Percentile of Cheapness'

"The Data Says It's Not Quite Right": John Cole Scott on Why Closed-End Funds Still Cushion the S&P 500's Worst Days, and Why Record-Wide Taxable Bond Discounts Point to Opportunity



John Cole Scott
President
CEF Advisors

Chuck Jaffe, in this episode of The NAVigator podcast, interviewed John Cole Scott, President at [CEF Advisors](#). Scott walks through CEF Advisors' third-quarter data. He shows that, despite how it feels, closed-end funds still fell less than the S&P 500 on most of the market's worst days. He explains why the taxable bond index ended the quarter at the "99th percentile of cheapness," and why discounts that wide have historically signaled opportunity. He also covers how rates and AI financing are shaping the hybrids market.

TOPICS DISCUSSED

- How Q3 played out: CEF Advisors' diversified 15-sector index fell about 5% on price but only 2.5% on NAV, while 92% of distribution announcements held steady and fewer than 3% were cuts
- Why the feeling that closed-end funds move like the S&P 500 on bad days doesn't match 15 years of data: when the S&P 500 fell more than 2%, CEFs fell less 91% of the time
- Why the taxable bond index ended the quarter at a 9.8% discount, against a 2.6% average, putting it at the 99th percentile of cheapness and wider than all but four month-ends
- How "angry, aggressive and wide" discounts push out less sturdy investors and bring in new ones, and what a similar signal in munis in December 2022 led to
- Why 3.7% inflation and 20-year yields above 5% explain the selloff, but John doesn't see a major risk behind discounts that are nearly as ugly as 2008's
- How AI financing has driven about \$130 billion of U.S. convertible issuance in 2026, and why falling rates could set up a rotation within hybrids

The discussion is educational in nature and intended to help investors and advisors better understand the tools, trade-offs, and data points involved in evaluating income-focused strategies.

EXPLORE THE DATA REFERENCED IN THIS INTERVIEW:

- Free CEF & BDC profile pages: cefddata.com
 - 40+ CEF & BDC indexes: cefddata.com/index
 - Full Q3 quarterly deck: cefddata.com/quarterly
- Powered by CEFData, offering transparent data on U.S. listed closed-end funds, BDCs, interval funds, and ETFs

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THE CONVERSATION**CHUCK JAFFE**

We're discussing where the risks are hiding right now in plain sight in closed-end funds, and we're doing it with John Cole Scott of CEF Advisors. Welcome to The NAVigator.

This is The NAVigator, which is all about all-weather active investing and plotting a course to financial success using closed-end funds. The NAVigator is brought to you by the Active Investment Company Alliance, a unique industry organization representing the entire closed-end fund industry, from fund sponsors and creators and managers down to users and investors. In the search for excellence beyond indexing, The NAVigator is pointing you in the right directions. And today we're looking at what the third-quarter data is saying about closed-end funds and if it's showing any telltale signs of heightened risk. We're having that conversation with John Cole Scott, president of CEF Advisors. And if you want to learn more about the firm or maybe dig into its data on closed-end funds for yourself, go to CEFDData.com. John is also 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

Always great to be here, Chuck.

CHUCK JAFFE

You know, John, I don't need to tell you, but I do need to tell the audience that you have been reviewing quarterly numbers for 60 quarters now. It's 15 years ago for you, and your father, of

course, did a lot of closed-end fund data before that. But we got through the third quarter. What jumped out at you from the latest data?

JOHN COLE SCOTT

Yeah, so first, you know, we had CEFs being a tough September, but as we finalized the numbers, our diversified 15-sector index was down about 5% in price and only about two and a half percent in NAV, which was a big discount-widening month for, you know, all the interest rate activity that we had. But the income really did help. We only had 92% of dividends were maintained announcements, and less than 3% were cuts. And the smaller cuts were in line, and the larger cuts were lower than the previous year's worth of outcomes. And really, what we noticed the most was kind of the differences in how wide discounts had gotten. And a lot of our clients were talking about, why does it feel that my closed-end fund portfolio is acting like the S&P 500 on the bad days and against it on the good days? And so I had to do an interesting thing, Chuck. I had to go through 15 years of daily moves for SPY as well as for our index and really analyze that to understand that while the feeling might be true, the data says it's not quite right.

CHUCK JAFFE

Well, give me more on that, because I've talked to a couple of closed-end fund investors, or people who've gotten into closed-end funds more because they heard about them through The NAVigator, who are like, "I kind of thought I was going to get more of a cushion, and it doesn't feel like I got one." But apparently, it should feel like they got one.

JOHN COLE SCOTT

Kind of. There's always a caveat with closed-end funds. So basically, in that 15 years of rough data, the S&P 500 went the same direction as that index almost 80% of the time. When we looked at the days where the S&P 500 fell more than 2%, closed-end funds fell less 91% of the time, and we actually even put this slide in our quarterly slide deck. The typical 2% day for the S&P was a median 2.5 down, and it was a median 1.5 down for closed-end funds. And we then go to the bigger days, like 4% down: four and a third down for the S&P, three down for closed-end funds, and they're up 80%. So they're not down as much 80% of the time on those tougher days. It is worth noting there were two days where closed-end funds were as terrible on terrible days as the S&P 500, and it was June 11, 2020. I had to go look up the why. It was when the Fed gave very bad news, and the second-wave data in the Sun Belt area for COVID stats was getting really aggressive, and people thought we're about to have another terrible month like we had in March and April that year. And the other was in '22, when interest rates did, well, an aggressively tough thing.

CHUCK JAFFE

John, you were talking about discounts and how they've gotten to levels you don't really see very often. Give us a little bit more there, and just how unusual are these levels?

JOHN COLE SCOTT

Yeah, so when we looked at the taxable bond index, which really, you know, reminds me of a couple of years ago when we saw the muni bond index at the 99th percentile of cheapness. And I think that this other index got a little sad not to be matching munis and decided this quarter to end the month at the 99th percentile of cheapness over 15 years of data, really showing that that 9.8% discount at the end was way wider than the 2.6% average discount. And just how rare? Only four of about 300 months was it wider at month-end, and that is how you get the 1% data point showing how bad it was. And I had to go, where was it wider? It was negative 17 and negative 14, two terrible days in 2008, even before our index business. This goes back 25 years, of course. And even during COVID, the worst month-end discount was eight, almost 2% less than where we ended last quarter. It really shows the pain that impacted both the NAVs, about half of it, and market price, the other half of that move, by interest rates going up, not as aggressively as in '22, but way more than people expected, pushing these things down, you know, really aggressively, in my opinion.

CHUCK JAFFE

99th percentile of cheapness. Is that a data wonk's way of saying, "Here's your buy signal"?

JOHN COLE SCOTT

Yeah, so I know we at CEF Advisors were talking about munis. I think I want to say it was December of '22; I want to double-check that. I know Steve O'Neill at RiverNorth was going around talking to everyone about how cheap they were, and it was a very good follow-up period to that. And it really reminds us, this is the closed-end fund piece: when discounts get angry, aggressive and wide, it then sheds all those, I guess, less sturdy investors and attracts a lot of new investors, and creates much more likely tailwinds than headwinds, you know, in the market. You know, it's like we had a market almost as ugly as 2008, knocking on wood here, right? But all we just had was inflation's a little bit high. Yes, it's seriously high. Three-seven is a real high number based on today's data, I believe. And, you know, yields, the 20-year getting to five and mid-change, is kind of crazy based on the last 15 years of rates. So I understand it, but I don't see the major risk driving this factor, and that means that there should be a lot of opportunity. And of course, there's different investments in that universe that can give you different outcomes based on what happens next.

CHUCK JAFFE

Well, let's talk about some of those different investments. One of the things that some people have been talking up in this market is going towards hybrids, and on the bond side, that's going to mean convertibles, that's going to mean preferreds, maybe a few other things. So help us understand, you know, hybrids, what the differences are, and how are they doing right now?

JOHN COLE SCOTT

Yeah, so it's a really interesting quarter, and it's one, again, I'm so glad to have built a lot of our tools so later I can go play with them. But preferreds, if those aren't as familiar, you know, they are fixed-dividend securities that are in line above the common stock. So if AT&T has common stock and they have a preferred, then you're more secure in that preferred, and it does a fixed payment like a bond. It's mostly issued by banks, insurers and utilities. But the behavior of those preferreds acts much more fixed-bond-like, with long duration, which means interest rate sensitivity. On the other end of the spectrum, convertibles: they're bonds, but they can convert into a company's stock. The yields are typically low, or sometimes deferred, so that the companies can keep reinvesting their revenue and not paying interest yet to their lenders. And really big recently, in '26, the market for convertibles has become huge for AI financing, about \$130 billion of U.S. issuance just in the first nine months of the year. And it's been a big area where you get the equity upside, but you don't get quite as much cushion on the downside, because it's much more of a techie exposure than a duration exposure.

CHUCK JAFFE

You know, my favorite story to tell about convertible securities is that my parents, who were married for 60 years, managed their money separately, and my father loved convertibles because he liked the optionality there, et cetera. And my mom hated them. And when my father passed away, my mom's like, "Well, I think I'm just going to hang on to his portfolio, except that convertible fund. It's out of here." So you can see both sides of investors doing it. Is there a takeaway? Like, if you're using one, the other or both, is there a spot that's a little sweeter right now?

JOHN COLE SCOTT

Yeah. So in the third quarter, preferreds were down about 9.1%, and 4% of that was NAV. Converts were down about 10.8%, and almost 8% was NAV. And so it was much more that the convertibles were having a very tough quarter, and the discounts widened slightly. And preferreds had an average NAV quarter, maybe worse than average, and got destroyed, which is a much less risky component in my experience. If you look at the way discounts are, if you really look at it, you know, you've got the beta of the NAVs, so not the market price discount stuff. The NAV beta of our index is about one for convertibles. The beta is about 0.25, roughly, for the preferred equity index, which makes more sense. It's a more fixed-income component. And what's interesting is when we dig into the data a little bit more. So what happens after some moves in interest rates historically in our data business? If rates were going up about 50 basis points, and there's 41 times we found that to be true, we saw that basically preferreds were down two-and-change percent during, but they're up about 7% after, and convertibles were down about one-and-low-change percent during and about 6% after. So that wasn't the difference. What was really interesting was when the 90-day falls 50 basis points, and there's 33 episodes of that in our data. The preferreds were up three during and 10 after. Convertibles were up one during and 20 after. The base answer is, once rates go down, you'd want to overweight converts. If you're not sure, and we've had this carnage in discounts and interest rates, you're safer,

in our opinion, based on historical data, being overweight in preferreds versus converts right now. Now, also, if you're thinking the market could be a little expensive, it's also better to be overweight preferreds versus converts. But if we get interest rates coming down, and we get maybe some, you know, cushioning, we then could see a nice rotation from preferreds into converts going forward. But I wouldn't be out of the converts. Like for us, imagine 7% is an average allocation for us. We might be 3% to 4% converts right now. I've been underweight for a long time, as I may have mentioned historically, and we might be 7% to 10% preferreds, as it makes sense for the asset allocation of the portfolio.

CHUCK JAFFE

And because we have to include AI in pretty much everything we do: convertibles, typically, I mean, you can't really say typical, because each portfolio could be different, but it's a little easier to have AI exposure, from what I know, in convertible securities as opposed to preferred securities, isn't it?

JOHN COLE SCOTT

Yeah. So the impact to financials and utilities would be that those businesses just use AI and save money and have less risk of not paying their preferred dividend; that would be the way I would put it. So yeah, I can't imagine a world that exists where direct AI is being funded by direct preferreds, partially just because of the structure, and also the yields are higher for preferreds. Roughly speaking, preferreds are six-and-change right now. I don't have it right in front of me, but I see those notes, and converts are three-and-change. And as I told you, some of the newer converts are actually deferring the payments, kind of like payment-in-kind for private credit, basically deferring the payments to keep more cash on hand for the companies, because the investors in those bonds want the equity upside. Because remember, it's a one beta. So if you like the cash flow and you think it's going to be a good idea, then these converts can be very powerful as things do well. Like, they can go up basically continuously. Remind me, they can go up just like the stock market, even though they're in my bond bucket at CEF Data.

CHUCK JAFFE

Yeah, it's an interesting play. There's undoubtedly more stories to come from that, but there's more stories to be coming from the closed-end fund world generally. We'll be checking in on all of them, and we'll check in with you again soon. John, thanks for joining me.

JOHN COLE SCOTT

Definitely. And you can check out the full deck at CEFData.com/quarterly, as well as an article deeper on this topic next week on my LinkedIn profile.

The NAVigator is a joint production of the Active Investment Company Alliance and MoneyLife with Chuck Jaffe. And yeah, I'm Chuck Jaffe. You can learn more about my show by going to MoneyLifeShow.com or just search for it wherever you find your favorite podcasts. Now, if you want

to learn more about closed-end funds, interval funds and business development companies, go to AICAlliance.org. It's the website for the Active Investment Company Alliance. Thanks to my guest, John Cole Scott. He's president of CEF Advisors in Richmond, Virginia. He's the chairman of the Active Investment Company Alliance. You can learn more about the firm and dig into its research for yourself, including all the details from the third quarter that we were just talking about, at CEFData.com. And yeah, John's on LinkedIn, worth following because he posts a lot of articles there. The NAVigator podcast is available every Friday. Be sure not to miss our next episode, or any of them, by following or subscribing to us on your favorite podcast app. We'll be back next week with more closed-end fund fun. Until then, happy investing, everybody.

John Cole Scott is president of CEF Advisors and the chairman of the Active Investment Company Alliance. His firm is online at CEFData.com, where you can dig into their research for yourself. And John would invite you to follow him on LinkedIn, where he posts articles regularly on all things closed-end fund. By the way, if you want to learn more about closed-end funds generally, check out AICAlliance.org, the website for the Active Investment Company Alliance.

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