



AICA's Scott: 1 Interview, 2 Funds To Consider, 3 Questions Answered

Friday, October 30, 2020

Chuck Jaffe, in The NAVigator podcast, interviewed John Cole Scott, chief investment officer at Closed-End Fund Advisors and the founder and executive chairman of the Active Investment Company Alliance. Read the Q & A below as John does a quick 1-2-3 in this week's edition of



The NAVigator, answering three questions from the audience and giving two ticker symbols worth following in one wide-ranging interview. He discusses the way discounts widen during bear markets, the expanded role closed-end funds could play in fixed-income portfolios looking for higher yields, and why he likes master-limited partnerships now.

John Cole Scott

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

CHUCK JAFFE: John Cole Scott, founder of the Active Investment Company Alliance is here and we're taking your questions about closed-end funds 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's brought to you by the Active Investment Company Alliance, a unique industry organization that represents 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 will point you in the right direction. Joining me again today, it's John Cole Scott, who not only runs the Active Investment Company Alliance but who is chief investment officer at Closed-End Fund

Advisors in Richmond, Virginia which has helpful research tools online that you can use at CEFdata.com. You can learn more about the firm at CEFadvisors.com, and about the Alliance at AICAlliance.org. John Cole Scott, thanks for joining me again on The NAVigator.

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

CHUCK JAFFE: We have been getting questions, and so we're going to take a week and answer some. And our first comes from Alvin in Union Township, Pennsylvania who writes, "Dear Chuck, I like that you talk so much about closed-end funds, I've learned a lot from the s how. I'm worried about another market downturn and closed-end funds really suffered the last time. I didn't know so much about them then, so I was buying in at the right time when discounts got big. My question, is what happens to discounts during bear markets? Like what is the average discount when things are normal compared to the discount in a bear market, is there a sign that things are moving from cheap to something I should worry about? So John, is there something he should be looking for?"

JOHN COLE SCOTT: The short answer is that the average discount over 20-year period is around 4%. Right now today, sitting just before the election, discounts are about just under 10%, about 9.6% on CEFdata.com. And we look at the really deep valleys, the Financial Crisis proved to be the widest, where the average fund went to 27.3% on 10/10/2008, just around 12 years ago. The current level of just around 10% has really only been breached. Back when energy blew up, it bottomed around 10-11%. Back in the technical movement of December of '18 it went down to about 12%. Of course it went down to less than the Great Recession, but a very deep 22% in March of this year. And then it narrowed to its recent high in June, and has basically drifted down in the last few months, again it's slow, to this 10% level. And I would say it makes sense, we have a lot of uncertainties. There's concern about an election, there's concerns about COVID, there's concerns about what could and should happen with capital markets and the economy. My only answer is, that if you buy a diversified portfolio of closed-end funds that meet an asset allocation goal, long-term makes sense to you, that the up gravity is there of about 4-5%, and oftentimes at some point in the future we should trade above an average.

CHUCK JAFFE: So you don't worry about the size of discount getting bigger, if it gets above double digits from here and the market's in the tank, that wouldn't actually scare you, it might make you think it's a better buying opportunity?"

JOHN COLE SCOTT: If that happens, because it's so uncommon, it's usually very short-lived. Again, extremely short this time around. But literally in the Great Recession, a much worse recession than we've seen so far, it only took a few months to get back above to negative 10% consistently.

CHUCK JAFFE: Here's a question from Peter in Wesley Chapel, North Carolina who writes, "Chuck, you have talked a few times about how experts are wavering on the 60/40 portfolio balance between stocks and bonds, and how a lot of the problem is that bonds just aren't producing enough income. Wouldn't you be able to get more for your fixed-income dollars by using closed-end funds? You buy at a discount and that makes your effective yield higher, doesn't it? It might not be enough to make up the difference but wouldn't putting more of my money into closed-end funds improve my yield? And it's not really chasing yield because I'm buying it at discount rather than paying more just to get a bigger dividend."

JOHN COLE SCOTT: Absolutely. So first off there's over 500 closed-end funds right now in the U.S. market, the biggest one in the world, they're roughly half equity funds and half bond funds. Inside of the equity side, it does include things like real estate and other more value-focused and some financials, the things that haven't been the frothier this year. Not a lot of NASDAQ in the closed-end fund universe. Some, but not a lot of NASDAQ and S&P focused. So when we think about that, the average closed-end fund yields around 9% today, versus normal is around 8%. And right now if you take that average 10% discount and that average 23% leverage for the universe, the manager has to hit about 6.7% to fuel that 9%. So with that you basically are getting roughly \$1.33 of exposure for a dollar in your account. So what he's saying is true, because usually if you had a guy on your regular show talking about 9% yields being average and kind of normal, you'd probably call him out on being kind of a little crazy because that's huge.

CHUCK JAFFE: Yup.

JOHN COLE SCOTT: But because of discounts, because of less liquid investments in sectors like preferred equity, and BDCs, and muni bonds, and senior loans, and REITs, and real assets, uncommon things, it's much easier to say long-term a diversified manager can probably hit 6.7% on average. We both know averages aren't everything, but they're a great way to think about what's normal.

CHUCK JAFFE: That's a case where you look, you find the right kind of discount. And at that point when you buy-in, if you're going to keep it as the long-term fixed-income piece of your portfolio, it's kind of like lay that out, leave that in there, don't really worry about day to day whether the discount gets narrower or widens or whatever. As long as you're consistently getting that income, you've got that yield on your money, lock it in and you can make it that bedrock position, right?

JOHN COLE SCOTT: Yes. So today I was talking with one of the support people for a closed-end fund sponsor, and we were talking about the conversation he has with financial advisors and the wholesalers regularly. I really picked at this idea that risk is volatility. Because in the closed-end funds, to me risk is losing money and can't get it back, like you put a dollar in a Coke machine and a Coke didn't come out, you lost. To me the fact that discounts are volatile is the opportunity, it's a chance to pick spots and be patient. When we build a portfolio as at Closed-End Fund Advisors, I always tell our clients, "We're going to build you a portfolio that pays you monthly, typically 6-7%. It pays our fees, typically 1% or lower for bigger accounts. And a cushion, because we're not perfect, and we reinvest that cushion." And that's our ability to have navigated 2020 with very little impact to our clients income in the worst dividend cut environment I think in 20 years.

CHUCK JAFFE: The third question is not so much from the audience as it is for me, because I know that the folks who listen to The NAVigator love to get some names to look at and consider. So we've got an election coming next week and we hope to have the results relatively soon. We're looking towards the end of the year, hoping that maybe there's a Santa Claus rally, worrying about what happens as we turn the corner and more, whether we'll get stimulus and all those other things. Are there closed-end names right now that are particularly appropriate for folks to be looking at?

JOHN COLE SCOTT: Yeah, so out of the major groups the two that are beat up the most is the BDC sector and the master limited partnership or MLP sector. They're both trading 20-25% wider than their 10-year averages, and so to me I don't know any bottoms, I never have. I've never known a top, but it's a great place to pick a spot. The challenge is we're in the middle of BDC earning season so I'm not going to throw any ticker symbols into that mix, but there are two I think good potential bets in the MLP space. One is NML, it yields around 6.7%, it trades around a 30% discount, and is only 13% levered. To me it's a dividend grower story

at a wide entry point. Then there's Tortoise, a better known manager, but an 8% distribution yield, 26% discount, but about 29% leveraged. I would say that they're both interesting pairs because I think one's probably a good dividend that's unlikely to change, and one's going to grow. But usually people have heard of Tortoise, a more focused manager than Neuberger Berman. But again, funds we both use in our portfolios, funds worth considering if you can be patient and you understand you're a contrarian when you buy.

CHUCK JAFFE: The ticker on Tortoise, TYG. The ticker on the Neuberger Berman MLP fund is MNL. John, great stuff as always, thanks again for joining us.

JOHN COLE SCOTT: Always enjoy being here, Chuck.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. I'm Chuck Jaffe and you can learn more about my work and my show at MoneyLifeShow.com. To learn more about closed-end funds and business-development companies go to AICAlliance.org, the website for the Active Investment Company Alliance. On Facebook and LinkedIn @AICAlliance. And if you've got questions about closed-end fund investing, send them to The NAVigator at AICAlliance.org. Thanks to my guest John Cole Scott, chief investment officer at Closed-End Fund Advisors in Richmond, Virginia, the founder and executive chairman of the AICA. His firm is online at CEFadvisors.com and CEFdata.com, and he's on Twitter @JohnColeScott. The NAVigator podcast is available every Friday, please subscribe on your favorite podcast app and join us again next week. Until then, stay safe everybody.

Recorded on October 30th, 2020

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