



Big Premiums And High Dividend Yields Key A Banner Year For Closed-End Funds

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed John Cole Scott, chief investment officer at Closed-End Fund Advisors and the executive chairman of the Active Investment Company Alliance. Read the Q & A below as John Cole Scott reviews 2021,



John Cole Scott

discussing the high number of closed-end funds that are currently trading at premiums, and the rebound that has represented in performance, as well as the expansive use of leverage, current high levels of dividend yields and more.

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 looking back at the year that has been 2021, 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 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's going to point you in the right direction. Today we're going in the direction of 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. They have helpful research tools online for you to use at CEFdata.com, and you can learn more about the firm at CEFadvisors.com. As for the Alliance itself, AICAlliance.org is the website. John Cole Scott, great to have you back on The NAVigator.

JOHN COLE SCOTT: I always enjoy chatting with you, Chuck.

CHUCK JAFFE: John, we're kind of doing a year in review this week, and next week we'll be back doing a look ahead. But it has been quite a year in closed-end funds, the market itself has done things that people really weren't expecting when we were doing the year ahead looks in 2020 for what was going to happen this year. So let's dig in because there are a couple of areas that really deserve a little bit more light shined on them. We'll start with the area that I think is most surprising, at least to me as an observer from the outside, which is the level of premiums. There was a time in the middle of the pandemic where closed-end funds had taken it on the chin and discounts were massive. Now not so much. It's kind of like, hey, that whole thing has turned around, hasn't it?

JOHN COLE SCOTT: Absolutely. I mean, if you think about it right now there's about 21 closed-end funds, traditional funds trading above a 10% premium. A third of all closed-end funds are trading at a premium. And we went through the data, in the last year, two thirds of closed-end funds were trading at one point at least above their net asset value, which is impressive. And you mentioned the comparison versus Covid, even going back five years further to really boring time periods, average discounts were average and premiums were far less common. It's just been a very good, successful year for those that held on for the ride.

CHUCK JAFFE: And let's take a quick look at that as well, holding on for the ride. Because the truth is that we know nobody wants to pay a premium, but you like nothing better than to see your fund get to where it's gone from a discounted level to a premium level. So should people who are lucky enough to be looking at their funds and saying, "Wow, look at where this has gone, it's beyond net asset value." Should they be looking to sell? Is this is a time when maybe they match up those winners with things that haven't won and do a little bit of a tax-loss selling and pairs trading?

JOHN COLE SCOTT: Absolutely. First I'd say go back to asset allocation, decide if where you set the portfolio is now your next, my opinion is, going forward, then you can look to make those changes. And again, even right now our discounts have widened 2% since early

November, but net asset value performance is still beaten since then. So you can't forget that discounts aren't the only answer, the NAV performance is the anchoring point. But where you can find relative discounts or comparable discounts for what makes up your portfolio, it's a good time to make those decisions because it's hard to be right forever. The best fund rarely is the best fund forever. Discounted funds tend to make more money long term than premium funds, we've studied it tremendously in my career.

CHUCK JAFFE: Let's also talk briefly about another element, and that is leverage. Because, well, there have been a lot of different ways that people have been leveraging their closed-end funds, we've seen some interesting trends. What's your take on where we are in the leverage picture right now?

JOHN COLE SCOTT: Right now 76% of closed-end funds are using leverage at some level, the average amount's about 29%. And while some people get scared of leverage, I've been doing this a long time, leverage is rarely if ever cheaper than it is right now. If you want to deploy a portfolio of levered assets, this is the right time from a cost of leverage perspective. Just remember, make asset allocation decisions not leverage decisions. But leverage is very powerful to the future success and dividend payments for closed-end funds.

CHUCK JAFFE: Now with all of these funds going to premium levels, etcetera, it hints that 2021 has been a great year performance-wise. Has it?

JOHN COLE SCOTT: It is. The average is up about 15% year-to-date but there's some interesting segments of differences like preferred equity funds are up 6% year-to-date and MLP funds are up 49% year-to-date. But again, preferred equity didn't get hit nearly as hard in Covid as MLP funds, that's the nature of just the year we're in. Going to senior loan funds versus high-yield bond funds, they've beaten them this year by about 2%, and that's usually not the case. Usually on this show I'm like, "Buy senior loans, they're cheaper. They've underperformed but we think they'll do better later." That ties in perfectly for a future of rising rates. And in munis they've done well, but I think you need to be cautious. They're up 7.5% year-to-date but only 3.9% from the NAV, which is discounts have narrowed a lot and they've averaged just under a 10 duration. Where I'm not saying to avoid them, but use them carefully and part of a diversified strategy even in the highest tax bracket.

CHUCK JAFFE: You've talked about a couple of different areas that have done well or badly, any surprises, especially in the bond area where so many folks were looking for income? Were they able to find it? Were they able to do the right thing there?

JOHN COLE SCOTT: We looked at the data again for dividend growth, not just what's the current yield of 7.5% but what's the growth of that? And that's been basically 6% from one year ago when we recorded this episode last year, but at a three-year number is still up 4%. And what that means is even with all those cuts that scared investors after Covid, the dollars are bigger today in a diversified portfolio than they were back in 2018. That was a long time ago in market math. And so I think it's really important to realize that you can't just worry about discounts, but you have to worry about the dividends and finding those that can and should grow going forward.

CHUCK JAFFE: We at The NAVigator are always talking about governance issues. Some of it gets a little esoteric, so I don't want to lose us into that minutiae, but are there trends in the governance area that we should be looking at? We've had some recent interesting discussions on some of the control shares issues, etcetera. But what do you see? What happened in governance for 2021?

JOHN COLE SCOTT: At a high level I'll say the institutional ownership still is hovering around 20%, so whatever's happened, the number of shares owned by those that filed SEC 13F or G or D filings is around the same, no real big changes. The Maryland Control Act, there's now 77 funds have opted into that, which we covered many times on this podcast. And a staggered board, which is another way to defend activism, there's 404 that do that. But only 15% are doing both. And you would think if you're really, really worried you'd be putting those two policies in place from activism. So while it's always going to be there and some funds will be liquidated or defend successfully, it doesn't seem as pervasive as sometimes the headlines seem in our ecosystem.

CHUCK JAFFE: And lastly of course we'll be back next week talking about the look ahead for 2022, but we hinted at it a little bit with some of those funds that are at premiums but are there things that people should be doing? We've got a couple days left in 2021, anything in the closed-end space that people should really be looking at before they close out the year?

JOHN COLE SCOTT: Absolutely. I think a lot of people have just avoided energy because it's been so painful. Even at those impressive results they're still at large average discounts and

they have a dividend growing story, so I still think that it's appropriate as a piece of your portfolio to look at some of those energy funds. And the other thing I would say is if you have losses today in a taxable account, even in a lower bracket, take them if you used your deductions. Because that's guaranteed reductions in taxes and we never know what the market will do. And you can't get future short-term losses unless you sell something. If you have only long-term gains it's hard to get short-term losses. That's the main thing I'd spice up for next week.

CHUCK JAFFE: And we will talk to you again next week. Until then, John, have a great holiday. Looking forward to the next conversation already.

JOHN COLE SCOTT: Thank you so much, Chuck.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. And yes, that's me, and you can learn more about my work and my show at MoneyLifeShow.com or by searching on your favorite podcast app. 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. They're on Facebook and LinkedIn @AICAlliance. And if you have questions about closed-end funds, send them to TheNAVigator@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 normally available on Fridays, available Thursdays through the holiday season. Please subscribe on your favorite podcast app and check us out again next week. Until then, happy holidays and happy investing.

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