Active Investment Company Alliance (AICA) To Broaden Investor Access to Listed & Non-listed Closed-End Funds, Business Development Companies

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Sophisticated retail investors have known for a long time how closed-end funds and business development companies can provide them with diversified, dependable access to less liquid but higher yielding asset classes than are typically available through mainstream investment products.

Veteran closed-end fund analyst, publisher and data provider John Cole Scott recently launched the Active Investment Company Alliance (link) in order to broaden this base of knowledge, allowing providers of investment products and services within these markets a multi-faceted platform for reaching and educating potential investors, while providing those prospective investors the tools and information they need to get up the knowledge and confidence curve with investment vehicles and asset classes they have not been previously exposed to.

Today we have Steven Bavaria, author of *The Income Factory* (link) and a long-time user and advocate of closed-end funds in his writings and personal investment strategy, interviewing AICA founder John Cole Scott. Scott is Chief Investment Officer at Closed-End Fund Advisors, Inc. and also founded CEFData.com, a data service covering all US listed and nonlisted closed-end funds and BDCs.

Bavaria: *John, for our readers who may not be as familiar with closed-end funds, could you describe some of the features that make them attractive to many investors?*

JCS: Many closed-end fund investors are particularly attracted to the idea of having active professional management within a fixed capital structure, so long-term investors don't have to be worried about a constant inflow and outflow of funds, often at just the wrong times, forcing portfolio managers to make inopportune buy-sell decisions in order to provide instant liquidity to fund investors. This avoids the sort of "run on the fund" risk that investors face with traditional open-end mutual funds, where a relatively few investors panicking and redeeming their shares when markets are depressed can sometimes force fund managers to liquidate what would otherwise be valuable long-term holdings.

Closed-end funds also offer investors an opportunity to take advantage of cheap, institutional leverage, since large funds and other institutional investors often have access to less expensive funding sources than private retail investors, especially investors using IRAs or other tax-deferred vehicles that can't be easily leveraged. Closed-end funds are generally allowed to leverage themselves up to 50% of their equity capital. Being able to borrow at 2.5% to 3.5% (average is 3.2%), as many funds have in recent years, and re-investing the proceeds at 6-7% or higher, can often add an additional 2% or more to the overall yield on the fund's underlying earnings. This is the "financial alchemy" that allows a closed-end fund whose asset class (high yield bonds, preferred stocks, convertible debt, utility stocks, etc.) may pay a "natural" (i.e. unleveraged) yield of 4% to 7% (average 5.37%), to distribute, as a result of leverage, a dividend yield of 7% to 9%+ (average 8% for taxable funds).

Of course, if you manage to buy that fund at a 5% or 10% discount to its net asset value, as smart investors can often do, then you have 100 cents on the dollar of assets working for you that you only had to pay 95 cents or less for. That boosts your yield even further.

Bavaria: *It is sometimes said that closed-end funds offer thoughtful investors an opportunity to "monetize liquidity" by deliberately trading off liquidity they don't really need for higher yields and returns. Can you explain this idea for us?*

JCS: Liquidity is one of many risks that investors face in making investment choices. Investors can choose to avoid or minimize liquidity risks by sticking to blue chip stocks or to large index or other mainstream mutual funds and ETFs that hold the stocks of broadly traded companies. They know they should always be able to liquidate their holdings either instantaneously at a readily determined market price or through overnight redemption at net asset value from the mutual funds. But there is an opportunity cost to be paid for confining your investment choices to highly liquid securities and asset classes.

As noted above, investors in closed-end funds cannot redeem their shares at their net asset value from the fund itself, the way traditional open-end fund investors can. Closed-end fund investors have to sell their shares in the market, at whatever price the market puts on them at any moment, which may be more or less than the actual net asset value of the fund. For taking this liquidity risk, however, closed-end fund investors can earn the higher yields described above, which are not available to traditional open-end fund investors.

This raises the question for many investors, especially those with a long-term horizon, of how much liquidity do they really need, and is it worth giving up 2 or 3% over the long run in order to get it. Buy-and-hold investors with 20 or 30 year horizons, like those investing for retirement, may well decide that they can afford to live with the short-term volatility and lack of immediate liquidity of many high yielding investments in order to re-invest and compound their returns at the higher rate. This trade-off, some illiquidity in the short term in return for higher income and greater returns a decade or more later, is what we refer to as "monetizing liquidity."

Bavaria: *You have said that you expect AICA to be "more than just a trade association." What do you mean by that?*

JCS: Our goal is to raise the bar beyond just representing closed-end fund and BDC sponsors and managers, although we certainly expect to welcome them and serve their needs. But beyond that we want to be an educational organization that empowers entire new groups of investors to achieve the knowledge base and level of confidence needed to participate in closed-end fund vehicles of various kinds and the asset classes they represent.

We want to be a mecca for discussion forums, podcasts, webinars and conferences, with rich content about investment options that many financial advisors or retail investors have never had a chance to be exposed to in a meaningful way or even knew were easily available.

Bavaria: *Closed-end funds, by their nature, are ideal vehicles for holding less liquid, higher yielding and more complex asset classes. Will you be showcasing various asset classes in your educational forums?*

JCS: Yes, we have already launched AICA's weekly podcast series, The NAVigator, with three episodes and a new one getting posted this and every Friday with our experienced host, Chuck Jaffe of MoneyLife. (https://aicalliance.org/alliance-content/pod-cast/) The podcast will feature professional investment managers and other experts on asset classes that are uniquely suited to the closed-ended / BDC structure as well as experienced service providers; think the CEF/BDC ecosystem.

One of our first podcasts focused on credit and alternative structures that have previously been largely confined to institutional investors, but are now finding their way into the retail sector through Closed-ended funds, especially vehicles like non-listed tender offer and interval CEFs. https://aicalliance.org/2019/10/07/alternative-investments/ and the next week we had the index company that created the indexes that power PCEF and XMPT which highlights ways to gain passive exposure to CEFs. https://aicalliance.org/2019/10/11/the-value-of-indexes-made-up-of-closed-end-funds/.

Credit investing, because it is more predictable and returns are more dependent on cash flows than on market appreciation, is uniquely suited to being held in closed-end funds. Similarly other high yielding asset classes, like master limited partnerships, high yield bonds, preferred stocks and convertible bonds, and many others that we will be featuring in future NAVigator podcasts. But we also have on the schedule the attorneys that help create new CEFs / BDCs, CEF / BDC Analysts and commentary and perspective from both The NYSE, where CEFs have traded since 1893 and NASDAQ, where many of the listed BDCs trade today.

Bavaria: *I hear you have been developing a website and planning an event in New York City; tell me more about the benefit for visitors to the website and for attendees at the conference***?**

JCS: We have been programming AICalliance.org for about 6 week and it has been live for only two weeks. It is being powered by our database, CEFData.com via an API feed and programmed to have listed CEF/BDC and nonlisted CEF/BDC filterers, news feed and resources. We expect to have lots of high quality content and help advisors and investors create their own user experience and email updates from the platform.

We have an event in New York City November 6th from 8am to 7:30pm with 7 Panels, and three presentations. Each speaker has been invited to speak (at no cost to them) on their expertise and attendees will pay a conference fee of $249 to get a full-day of content and networking with the industry's best. Investors and advisors can view the panels, speakers and register to attend: AICA's CEF / BDC Bootcamp & Roundtable.

Bavaria: *That sounds like a full day. So it sounds like you have high hopes for AICA?*

JCS: Yes, we think our timing is right and there is a terrific demand, among retirees and those who are planning to be retired at some point (and their advisors), for higher yielding vehicles of the sort that the closed-end fund and BDC industry has been generating for many years. This will give the ability to create multisector, multimanager custom portfolios based on individual; risk, income and even tax-brackets.

Our mission is to broaden the knowledge-base and help many retail investors, and the financial advisors that serve them, achieve the level of confidence they need to participate in this arena, one that institutional investors have successfully been able to access for generations.

Check out AICalliance.org and download The NAVigator each Friday to follow our progress. We plan to have our first webinar at the end of October.

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