



Roosevelt's Konrad Talks Closed-End Fund's Value-Investing Edge

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Chuck Jaffe, in The NAVigator podcast, interviewed Rick Konrad, director of value strategies at the Roosevelt Investment Group. Read the Q & A below as Chuck discusses with Rick why he says that closed-end funds have some natural advantages over traditional mutual funds and ETFs



Rick Konrad

when it comes to investing with a value bent, and while he uses all of the various types of investments, he makes a case for how and why an investor might want to pay up for closed-end funds and business-development companies.

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

CHUCK JAFFE: Rick Konrad, director of value strategy at the Roosevelt Investment Group is here and we are talking value-investing, and closed-end funds, and business-development companies today in 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, which is a unique industry organization in that it represents all facets of the closed-end fund industry, from sponsors and creators to users and investors. If you're looking for excellence beyond indexing, the idea is for The NAVigator is to point you in the right direction. Now today we are talking with somebody who represents investors. Rick Konrad is director of value strategy at the Roosevelt Investment Group, which is a registered investment advisory firm that focuses mostly on high net worth individuals. If you want to learn more about the

firm, RooseveltInvestments.com is the website. If you want to learn more about closed-end funds, the Active Investment Company Alliance is at AICAlliance.org. Rick Konrad, great to chat with you.

RICK KONRAD: Good to be here, thank you very much.

CHUCK JAFFE: Let's start with some basic decisions that you as a value manager have to go through. I'm curious why you feel closed-end funds are a superior investment versus traditional mutual funds. Where do closed-end funds have a natural advantage or edge?

RICK KONRAD: I think they do have a natural advantage for both portfolio managers as well as for investors. The beauty of it for a portfolio manager, again, I've been doing this for more than forty years, is portfolio managers, days when the markets are very weak, have to sort of out-guess what their redemption schedule is going to look like. In order to provide some flexibility, they have to keep cash on hand. On days when it's very hot, when markets are rising and they're seeing inflows, they have to plan for the types of stocks that they're buying. The beauty of a closed-end fund is, guess what? It's closed-end. It gives the portfolio manager a lot greater flexibility in terms of dealing with that enclosed space, and also allows him or her to employ leverage to enhance the distributions and to provide for investors a much great cashflow than other instruments.

CHUCK JAFFE: A lot of closed-end funds are leveraged. Is that an advantage? Is it something that you particularly want? Is it something that becomes more attractive as you become more of a high net worth investor? What's the role of leverage in closed-end funds in terms of the value proposition?

RICK KONRAD: The notion here is that you have greater assets to invest and consequently you can enhance returns, providing you have a difference in the sort of returns you're earning on your assets versus what you're paying out as far as what you're borrowing. Most closed-end funds do utilize leverage. They borrow at short-term interest rates, they may use preferred stock, and they re-invest not only the assets that initially funded that closed-end fund, but also borrowings that they've done at hopefully a relatively low cost to invest in a bigger asset base. Consequently, they generate a much greater cashflow than more traditional fixed income instruments.

CHUCK JAFFE: You are, by title, director of value strategy. You're looking at closed-end funds. Can you be a value investor and like closed-end funds that are trading at premiums?

Because we know everybody loves a discount, who doesn't like a bargain? But are there times when you should be thinking, "Yeah, premium is okay"?

RICK KONRAD: There are times when a small premium may be okay. Like everybody else, I love a bargain. Just the fact that assets go on sale because number one, it's the volatility of closed-end funds, people get nervous. Especially if you have down markets, people get scared and start to sell, perhaps there's unreasonable prices. But I think there's far too much focus on just the discount and premium without really looking at, what is the true value of the underlying position? Investors love to scare themselves out of markets, and the volatility of a closed-end fund on a day-to-day basis really has no bearing on the underlying true value of that position. These things tend to be somewhat smaller, certainly smaller in terms of asset size or market value size than the mutual funds that are associated with them. It's simply supply-demand in the low liquidity markets, that can drive the volatility, can drive discounts. Ninety percent of the move of the price of a closed-end fund, I think, is emotions based, rather than looking at the underlying fundamentals.

CHUCK JAFFE: Speaking of looking at the underlying fundamentals and the underlying assets, one of the things that we talk about here on The NAVigator is closed-end funds versus business-development corporations. BDCs, while some people kind of just feel they're an extension of closed-end funds, others feel they're an asset unto themselves. Where do you fall in terms of the proper use of BDCs relative to closed-end funds?

RICK KONRAD: I use them both. I don't think they're sperate. They're basically a pooling of assets just as you have in a regular open-end mutual fund company but happen to be packaged under slightly different regular. Again, they are there to produce greater cashflow than the more traditional underlying fixed income analogue. I can give you some interesting examples of how that has worked.

CHUCK JAFFE: Yeah, please.

RICK KONRAD: I'm going to make this really ugly. Another aspect of the comparison is we talk about index funds and the low-expense ratio. We compare that with the actively managed mutual funds. Then we look at these ginormous expense ratios on the closed-end funds. I thought it would be an interesting comparison to look at something like a T. Rowe Price mutual fund, which happens to be focused on junk bonds, high-yield bonds. Very well rated by Morningstar, by Lipper, etcetera. Five-star gold ranked by Morningstar. I did the

comparison looking at a sixty-four basis points expense ratio. So again, quite low. I looked at a closed-end fund managed by T. Rowe Price called the New America High-Income Fund. Which instead of sixty-four basis points, suffers from a 1.19% non-leveraged expense ratio. Throw in the leverage costs and you're looking at \$2.56, so it's David and Goliath. Then I threw into the portfolio mix, Ares Capital, which is a BDC. One of the largest BDCs.

CHUCK JAFFE: Right.

RICK KONRAD: It has a non-leveraged expense of three hundred and six, 3.06%. Throw in the leverage expense and you're looking at 5.18%. Now what I did is I said, "Okay, I'm going to put this into a retirement portfolio. I'm going to take a 401(k) or an IRA. Take a hundred grand and I'm going to do a withdrawal of one percent a quarter, four percent as your RMD, your required minimum distribution.

CHUCK JAFFE: Right.

RICK KONRAD: Which, again, is fair. I did a fifty-six, fifty mix of this New America High-Income Fund and Ares Capital as one portfolio. The second portfolio was a mutual fund with a much lower expense ratio. Then I did a traditional sixty-forty mix of the S&P 500 ETF SPY, and forty percent AGG. So again, your expense ratios, there are five and four. So I've got four and a half basis points in the one portfolio. I've got a huge amount in the closed-end fund, BDC combination that's going to be somewhere around three and a half, three seventy-five. I've got this simple mutual fund in the middle, the institutional variety, so you need a million bucks. So I really disadvantaged the comparison by using a sixty-four basis point expense ratio for it. Low and behold, if I look back over a five-year period and rebalancing quarterly, when you look at what the starting balance was, it was a hundred thousand across the board, the combination of ARES and New America ended up with a hundred and forty-two thousand. The closing balance of the high-yield T. Rowe Price was a hundred and fourteen thousand. And of the sixty percent SPY, forty percent AGG, was a hundred and twenty-one thousand. So the combination of these two asset classes, the closed-end fund and the BDC, actually gave you a compound return of over seven and a quarter percent, versus four percent for the SPY/AGG combination, versus about 2.7 for the high-yield itself. Now you know, people are critical of the fees in the closed-end funds or the BDCs. But the fact of the matter is, the underlying volatility of that New America High Income Fund, that HYB, is essentially the same as the T. Rowe Price US High-Yield Fund. It's the same manager. That's

one of the things I think people can look to. The closed-end fund is a relatively minor portion of the one trillion dollars that represents T. Rowe Price assets.

CHUCK JAFFE: Yeah.

RICK KONRAD: About twenty-one billion of T. Rowe Price is high-yield mutual funds. It's exactly the same culture, the same structure. The same monitoring of interest rates, the same monitoring of industries, the same monitoring of the quality, the same monitoring of the issuers that takes place across the board within T. Rowe Price. You may not see that because you have SEC disclosure. There's no marketing really that's associated with closed-end funds. They're relatively unknown and they can be very inefficient not priced properly relatively to other assets. Yet that same thinking, that same culture, that same research quality, essentially the same portfolio construction goes into the closed-end fund. Despite the higher costs, despite the leverage, it actually pans out because that cashflow, provided you rebalance quarterly, is there to serve the withdrawals, is there to fund the cheaper assets at the time they're rebalanced, and it has ended up giving you a much better return, and a similar return in terms of the maximum drawdowns. Overall, if you can bear with the downturns and reinvest appropriately to rebalance, you're out ahead. It's an interesting combination relative to the holy grail of ETFs and that five bit, four bit combination of SPY and AGG.

CHUCK JAFFE: It's a really interesting point. Rick, I wish we had more time to talk about it, but thanks for sharing with us. I look forward to chatting with you again in The NAVigator down the line.

RICK KONRAD: I really appreciate your having me. Thank you so much.

CHUCK JAFFE: That's Rick Konrad, he's director of value strategy at the Roosevelt Investment Group. Go to RooseveltInvestments.com for more information on him and the firm. The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. I am Chuck Jaffe, your host, 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. The NAVigator podcast is available every Friday, please subscribe where you find all your favorite podcasts. We hope you'll join us again next week.

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