



## Closed-End Funds Can Be 'On Sale' Without Being A Bargain

Friday, December 4, 2020

Chuck Jaffe, in The NAVigator podcast, interviewed John Cole Scott of Closed-End Fund Advisors, the executive chairman of the Active Investment Company Alliance. Read the Q & A below as Chuck and John discuss how closed-end funds can trade at big discounts yet still not be



relatively cheap, stressing the importance of keeping discounts in context. John also answers audience questions on using closed-end funds properly in a portfolio.

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 he's going to answer some of your questions, but he's also going to discuss why just because something is discounted doesn't actually mean it's cheap. 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'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 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. And oh by the way, you can follow John on Twitter @JohnColeScott. John, great to have you back on The NAVigator.

**JOHN COLE SCOTT:** It's always good to be here, Chuck.

**CHUCK JAFFE:** We have a couple of really good questions that I want to get to, but first I want to talk about something that fits right in with the holiday season and holiday shopping. We all love bargains, but you've got some research that shows that not everything that's on sale in the closed-end fund space, not every discount that's big means that every fund is cheap.

**JOHN COLE SCOTT:** Absolutely. So what we find is sometimes people just sift the universe by discount only, and they don't do two other factors that I've been doing for most of my career. You have to look at the relative range of the individual fund, so is a 20% discount relatively high for its experience or is it relatively low? Also if it's in a peer group, as many funds are with numerous other options to choose from, is it in the upper echelons of pricing or the lower? And so we talked about comparable and relative discounts and premiums in addition to just absolute discounts. Again, sometimes when we're fishing, we'll find a small premium is comparatively cheap and relatively cheap, and sometimes very useful for our clients. So we have a bunch of indices, and just for perspective think of the CEFdata.com/index and check out our Premium Index and our Discount Index, because what we found just as a driver of this belief is that the net asset value performance is best for the Premium Index, but the market price performance is best for the Discount Index. It really helps capsule that theory that we use.

**CHUCK JAFFE:** What that means for an investor is you shouldn't just look at a discount and go, "Wow, look at how big the discount is." You should be trying to come up with a relative value. It makes it difficult I guess in times like these, because we saw discounts get so widened with then market was tanking early in the year, that you could say, "Well okay, I'm buying something now at a 10% discount. But oh by the way it was at a 20% discount just a few months ago." So is it really still that cheap?

**JOHN COLE SCOTT:** Absolutely. And so at the end of the quarter, we're beyond that but I wrote some commentary for our clients. We have a deep discount history now in CEFdata.com, and it's basically able to tell them that discounts are far narrower than earlier this year because things feel a lot brighter and the future seems more certain. However, it's still only been wider than the current level six times. and so we're up a little bit from there, but like a point. I don't know the future, and you should have some discount, because we're not all vaccinated, the economy hasn't fully recovered. But I find often people price more pain into the market than is sometimes realized. Remember, with closed-end funds you're in more than one sector, you're generally using more than one fund, and so you've got diversification.

**CHUCK JAFFE:** Now let's get to the questions from the audience. Our first question today comes from Ray in Buena Vista, Florida. He writes, "Hi Chuck, I didn't know much about closed-end funds until I started listening to your show. I still don't, but I love The NAVigator. I haven't bought any closed-end funds yet, but I think I will in 2021. My question is, do I consider closed-end funds an alternative investment, or do I consider them whatever kind of investments they buy? Or are they both? Is there a reason that if I already own a municipal bond fund to go out and buy a municipal bond closed-end fund?"

**JOHN COLE SCOTT:** The thing about munis, I would say, and you've heard me speak that the muni closed-end fund is probably the most perfect version of it. The manager is active, sometimes the guts, the underlying holdings are very illiquid, very cheap leverage, and so they can offer yields on an investment grade oriented portfolio like a junk rated portfolio. But with a closed-end fund you have to be able to handle the discount movements and the extra volatility. So I'd say if you remove the volatility, it's the same guts, you're over the same NAV over time. But how an investor like your listener could use closed-end funds would be when things felt wider, overweight the closed-end funds. When things felt narrower or more frothy a little bit, underweight the closed-end fund. Again, we don't use any open-end funds, but a lot of investors like them, they can rotate that way. And so the guts of a closed-end fund like BDCs or CLOs or some of the interesting funds you've had on the show are alternatives because of the investments. I would just say that closed-end funds are alternative to an open-end fund in a tactical way for many investors, whether through their advisor or themselves.

**CHUCK JAFFE:** It's not necessarily that closed-end funds are a separate asset class. It's really a different way to buy the same assets, and different tactics within the assets.

**JOHN COLE SCOTT:** Absolutely. If you guys remember, the net asset value is one part of the equation. You have to get a handle on the closed-end fundedness, which is the board, the institutional investment space, the leverage cost, the expense ratio, the governance. Are they good to shareholders? Do they do dilutive rights offerings, or do they give a stable dividend that they manage prudently over time? There's a lot of different experiences from different sponsors that investors need to pay attention to that's separate from the actual net asset value outcomes.

**CHUCK JAFFE:** Now let's move to our second question which is a little bit related and similar. This comes from Peter in Pink Hill, North Carolina. He says, "I like dividend paying stocks, and I like the looks of a few closed-end funds like the Dividend Achievers Funds from BlackRock. With traditional mutual funds, I know you shouldn't own more than two or three funds that do the same thing. But does that apply to closed-end funds? I'd think I want to capture the discounts, so I might want to buy different funds at different times. But if all that does is make performance mushy and like the index, then no. So how many closed-end funds should I want to buy in any one type of asset, and does it matter if I have a few traditional funds and then a closed-end fund that buys the same things?"

**JOHN COLE SCOTT:** Ties in great to the last question. Imagine just thinking about dividend and equity funds as a bucket, there's more than one sponsor than BlackRock, Eaton Vance has funds amongst others. And so going back to it, our firm, we tend to build a portfolio of around 12-14 sectors, two to three funds per sector. Again, sometimes a sector only gets one vote because it's a small allocation, but that's normal for us. Remember what's important, it's tax-loss selling season. So let's say you own a dividend closed-end fund and you have a loss on it for some reason, or a gain, and you need to capture that result. You can pick often the same manager, similar fund, and hold it for 31 days. So I would say too many, he's right, you're indexing yourself. I think you need to look at your portfolio and understand what's going on if you're managing it. Otherwise there are indices that track the sector that you can just buy and forget. Or there's products from folks like us and others that you can buy and forget. So I think it's a great question and it's good to have one, two, three, but I regularly will

see a portfolio for a prospective client with five funds from the same sponsor in the same sector, and I have to scratch my head and go "Why? What's the alpha there?"

**CHUCK JAFFE:** Even if it's not five from the same sponsor but it's five in the same sector, with traditional mutual funds there's plenty of research that says if you own four large cap growth funds, you effectively have what they call a closet index fund. In other words you're paying active management prices but the funds combine to give you nothing better than an expensive index fund performance.

**JOHN COLE SCOTT:** Agreed. Oftentimes closed-end funds have a lot of success for international funds in the 90s, that's not the huge focus now. But often we're trying to get that non-U.S. equity exposure, we'll use a ratio based on the needs of the portfolio between the Aberdeen Global Emerging Market Fund and the Franklin Templeton Global Emerging Market Fund. They are fundamentally different managers, but we're splitting the trade and it's some sort of ratio between two ticker symbols, Chuck, not five, not six. And again, if one under performs, we can maybe do some tax-loss selling, or let's say we have so many losses from earlier this year, we can take the one that's maybe at a gain. So it gives you choices, but I think you have to look at your portfolio and be able to handle the management of the owning what you have. We don't understand why people own less than one or two percent of an investment, because it could be a homerun or a POS, and it's not going to help or hurt your future in my opinion. That's the way I see it.

**CHUCK JAFFE:** John, great stuff as always, thanks so much for joining us.

**JOHN COLE SCOTT:** Always great to be here, Chuck. We'll talk soon I'm sure.

**CHUCK JAFFE:** The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. I am Chuck Jaffe, 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. 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. The firm's 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.

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[TheNAVigator@AICalliance.org](mailto:TheNAVigator@AICalliance.org)

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