

Closed-End Funds Finding Investment Opportunities Despite Ongoing Market Challenges

By Jennifer Banzaca

With the US presidential election next month, the ongoing impact of the coronavirus pandemic and the question of whether the economy is still in a recession or in a recovery, it can be tough for managers in the closed-end fund (CEF) space to navigate that uncertainty while preserving capital.

The volatility that rocked the markets in March caused a steep decline in prices, volumes that spiked, a lack of liquidity and valuations that were distanced from their operating fundamentals.

The resulting investment panic from retail shareholders created a self-fulfilling vortex, whereby downward prices begat more downward prices.

Panelists during the Active Investment Company Alliance (AICAlliance.org)'s Summer Summit on August 13th opened up about how the Covid-19 pandemic has impacted their businesses and investment strategies, ongoing challenges they are facing and where there are still investment opportunities.

Every industry and sector has been affected by the pandemic but panelists during the Real

Estate Investing in Interval & List CEFs session said real estate certainly is front and center in terms of the effects of the pandemic.

Svitlana Gubriy, Head of Global REIT Funds at Aberdeen Standard Investments, said the impacts of the Covid-19 pandemic will accelerate certain trends that we've already been witnessing, whether it's online retail or logistics or supply chain management or the role of the digital infrastructure in our lives.

Gurbriy explained that real estate is a reflection and a tool for economy.

"Real estate will reflect how the economy will change because of the pandemic and how our social lives will change. As a result, some real estate asset subsectors will eventually die probably, while some new real estate sectors will appear."

However, Sanjai Bhonsle, CEO of StoneCastle Financial Partners and Partner and Portfolio Manager for ArrowMark Partners' corporate credit and lending business said his firm's investment strategy has not changed due to the pandemic.

"Even prior to the pandemic, rates were pretty

low. Through the pandemic rates have pretty much gone to zero and there is a demand for yield. And the way we have been providing yield for our clients is kind of doing more of the same," Bhonsle noted.

Paul Brennan, a Senior Vice President and Portfolio Manager at Nuveen Investments Holdings said due to the effects of Covid-19 there is an elevated default risk in the taxable municipal CEF market.

"With the lockdown in the economy, revenue collection is going to be lower. Traffic, if it's a toll road, is going to be lower. Landings at an airport are going to lead to lower landing fees. And then obviously there's expense pressure related to COVID expenses. Because of the lower revenues and possibly higher expenses, that is creating budget gaps and that's going to have to be dealt with and that's going to also put pressure on the balance sheet," Brennan explained.

Some of the biggest challenges in the market have been a result of volatility. Ed Keating, a Client Portfolio Manager Lazard Asset Management, said during the General Session: Institutional Investing & Trading in Closed-End Funds, that he has never seen such a violent move in discounts over such a short period of time.

However, Keating said that volatility excited Lazard.

"Frankly, we need volatility, we need this inefficiency in order to drive alpha for our clients. If discounts are a flatline, that's not very exciting for investors such as ourselves. This is a period that we are able to take advantage of these discounts and of these inefficiencies."

Although not related to the ongoing pandemic, going forward activism is expected to be more challenging. In May, the Securities and Exchange

Commission (SEC) rescinded the Boulder No-Action letter, allowing a closed-end fund to opt into a state control share statute without risking an enforcement action.

Phil Goldstein, co-founder and principal of Bulldog Investors, said during the Recent Development in Corporate Governance & Activism in CEFs panel that activism will be tougher for managers.

"We don't really have a lot of options. If you're looking at the potential anti-takeover measures, the SEC has taken kind of a hands-off approach on the control share issue. Because of this we will have to assess what we're going to do. We could just give up and move onto greener pastures and say it's too tough, or we could think about a legal challenge to that."

And the recent volatile markets did cause managers to make some changes in their investment strategy.

Martin Connaghan, Investment Director in the Global Equity Team at Aberdeen Standard Investments, said during the Equity Access Through Closed-End Funds panel that his firm took a step back because of the market downturn.

"Initially, just when we would normally be very active, we did nothing. Now we were quite fortunate in that a number of companies had paid at that point their dividend for the year, but we had to wait for the volatility to die down," Connaghan stated.

Of course, even a challenging market will yield investment opportunities.

Doug Bond, Head of Closed End Funds and a portfolio manager at Cohen & Steers, explained that to find opportunities his firm scores and evaluates every fund in the U.S. closed-end fund

market on a daily basis, based on yield, relative yield, discount, relative discount, and then the momentum of change of the discount.

“Those inefficiencies unfold and show up in prices and relationship to price to net asset value and relative to comparably focused funds, this creates opportunity in the marketplace. So, I think it's a day-to-day process of looking at what's going on in the market place, evaluating what's happening in asset classes and relative returns being delivered by various investment managers as stewards of capital for their shareholders that surfaces these inefficiencies.” Bond noted.

Randy Anderson noted during the Real Estate Investing in Interval & List CEFs panel that the interval fund space has become increasingly popular and has experienced massive growth over the past five years.

“Today, the most popular interval funds pursue alternative investment strategies that provide exposure to real estate, alternative credit, and insurance linked products, among others. Because of the diversity in strategy, the risk/return characteristics may vary significantly across interval fund offerings.”

leverage, which can increase a fund's risk or volatility. The actual amount of distributions may vary with fund performance and other conditions. Past performance is no guarantee for future results.

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