



NAVigator Bonus: Matisse Cap's Boughton Talks Discounts, MLPs and More

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed Eric Boughton, chief analyst at Matisse Capital and portfolio manager for the firm's closed-end strategy funds. Read the Q & A below as Eric says that since taking a beating during the 2020 pre-pandemic market meltdown, closed-end funds have rebounded to where discounts on average are now 3 percent, compared to a long-term average discount of 5 percent, making this 'a less-than-average time to invest in closed-end funds from a discount perspective.' Still, he noted that there are sectors and industries



that remain cheap, and he highlighted master limited partnerships, noting that the median discount for the sector is currently 16 percent, compared to the average of 6 percent over the last 15 years. In this NAVigator bonus – originally broadcast as the Money Life Market Call with host Chuck Jaffe – Boughton also discusses the prospects of some individual funds.

Eric Boughton

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

CHUCK JAFFE: Hi there NAVigator fans, I'm Chuck Jaffe, your host. I'm also the host of a show called Money Life, and on that show we do a segment called The Market Call. And recently, Eric Boughton, portfolio manager and chief analyst at Matisse Capital, which runs mutual funds that invest exclusively in closed-end funds, he was a guest on my show talking all about

closed-end funds. We didn't want you to miss it, so here it is as a bonus edition of The NAVigator. Enjoy! Welcome to The Market Call, the part of the show where we talk with experienced money managers about how they do their job, what they look for that informs their buys and sells, what they see happening broadly in the market, and how they're putting it all together. We find out what they like and dislike, we then find out how they feel about some of your picks as well. And today, well, you're in for a treat because the asset class that we talk about the least when it comes to The Market Call is closed-end funds. And I know that many of you are interested because we actually have, relatively speaking, a lot of closed-end fund talk on Money Life, but that's not usually in The Market Call. And Eric Boughton, my guest, he's been with us a number of times, you guys have really liked it and responded. He is the chief analyst and a portfolio manager for Matisse Capital, it's MatisseCap.com. The firm, which is based in Oregon, runs two mutual funds that are funds of closed-end funds, and they are closed-end fund specialists. Again, if you want to learn more, MatisseCap.com. Eric Boughton, it's great to have you back on Money Life.

ERIC BOUGHTON: Good morning, Chuck. It's great to be back again on the show. Love it.

CHUCK JAFFE: So let's talk closed-end funds and methodology. We always start with methodology, and in closed-end funds, well there are a couple things that people need to understand in terms of what do you look for, where do you prioritize, discount, and how do you dislike premiums, and all that other sort of stuff. So let's talk methodology first.

ERIC BOUGHTON: Great Chuck, this is a good intro for people to come in with on closed-end funds, which are a little understood corner of the market. They trade like a stock but they represent ownership in an investment company. So really, when you buy one you're buying a whole bunch of stocks and bonds that are professionally managed. Closed-end funds are really neat because they trade during the day at prices that can differ quite a bit from their value, their actual net asset value or NAV for short. People own closed-end funds for a lot of reasons, including income generation. Closed-end funds often tend to pay out a lot of income, and closed-end funds give you access to a lot of different sectors of the market, U.S. stock market, foreign stock market, bonds, all sorts of stuff. So individuals like them because of those factors. When we look at closed-end funds here at Matisse, we focus a lot on the discount. We are bargain shoppers and we like to buy closed-end funds that trade at big

discounts to their net asset values. And we believe that that's a good source of return for us when a closed-end fund can both increase its NAV and see its discount narrow.

CHUCK JAFFE: In terms of discounts and where they've gotten, you and I have talked at various times, and of course if you went to where the market was tanking in 2020, closed-end funds really took it on the chin. Discounts got super wide which created a pretty big buying opportunity and you were on the show saying it, then we saw discounts narrow. Where are we today in terms of the environment both for discounts and how easy it is for you to find things that you like?

ERIC BOUGHTON: Well, when we came on in March it was like shooting fish in a barrel for us and for any closed-end fund investor as we've talked about. Now it's a little bit more like you've got to get in your boat, and you've got to go somewhere where fewer people are fishing and really wrestle with the fish to use an analogy. The closed-end funds right now on average trade at 3% discounts to NAV, so the average closed-end funds trades for 97 cents on the dollar. If you try to put that in context, the long-run average discount for closed-end funds has been 5%. And so we're actually a little bit north of the average, it's a little bit less than average time to invest in closed-end funds from a discount perspective. However within that, there are sectors that are cheap and sectors that are more expensive, and we can dive into those weeds if you'd like.

CHUCK JAFFE: Yes please. It's particularly interesting to me because closed-end funds more than certain pockets of the market do tend to work where, hey, if you're in this area, discounts have their own tide, don't they?

ERIC BOUGHTON: Right, there's a big tide in closed-end funds as you've noted before, Chuck. Closed-end funds do tend to run in packs and their discounts move together, but often there are segments that ying when other segments yang. So today we have the biggest and most discounted sector of the market is MLPs, funds that are devoted to owning MLPs. Which trade today at a median discount of, wait for it, 16%, 84 cents on the dollar for a group of professionally managed closed-end funds in the MLP sector. Which is just incredible when you consider that those same funds have traded at 6% average discounts over the past 15 years.

CHUCK JAFFE: So then when we talk about say, the funds that you've got, or investor portfolios because you do both. And I should mention the funds, Matisse Discounted Closed-

End Fund Strategy Fund, which is MDCEX, and Matisse Discounted Bond Closed-End Fund Strategy, MDFIX. Whether it's them or in individual portfolios, how do you sort between the various bargains? I mean, okay great, the sector is there, but how do you decide if you're loading up on one or two names or 10 or 12 names?

ERIC BOUGHTON: Well, what we tend to do when we notice that there's a sector that is just on sale across the board, and we can identify a reason that the sector's on sale, and we can identify the factors that we think will lead to changes in that discount in the future just for the sector, then our work, basically our decision to invest in a sector leads to a broad investment in the sector. All we need to do is avoid funds that we think have problems, that are different from the other funds. In other sectors where the opportunities may be less widespread, we tend to be a lot more choosy and only buy one or two closed-end funds from those sectors. So MLPs specifically are very interesting if you want me to dive into those now?

CHUCK JAFFE: Yeah, let's go.

ERIC BOUGHTON: Cool. Yeah, so MLPs are interesting, right? Everyone hates energy, would be a statement that you can make certainly back in March, and in April when oil prices went negative April 2020, went negative briefly. And so everyone hated energy and the prices on pipeline operators, companies that own and operate pipelines that transport oil and natural gas, the prices of those companies just went down 80% below their highs of the previous few years. And it was interesting because those companies' cashflows had not been impaired basically. They were still collecting money for transporting oil under long-term contracts, it's just that people thought that their business would just into the ground even though their business is transporting oil through the ground, but people thought that their business would just wither away. And it's not the case. In fact, if you look at the climate, the regulatory and environmental climate today with a democratic administration and democratic control in the legislature, it looks like if new oil drilling is being curtailed and new pipelines find it difficult to get the clearance to be built, then existing pipeline operators should have a competitive advantage and the ability to maintain pricing. And that's great for the businesses of established companies like Energy Transfer and Williams Companies, etcetera. And so the MLPs really are not an impaired business, and yet their stocks were trading as if they were. So fast forward to today, MLP prices have recovered quite a bit and yet they're still incredibly

cheap. So how cheap? They're trading at about 11 times earnings on average, versus of course something like 30 for the S&P 500. They have a free cashflow yield north of 12%, versus 3% for the S&P 500. They yield about 8% in terms of payout to shareholders versus of course 1-2% for the S&P. And they're still 60% below their 2014 highs. And if you think about MLPs versus oil prices, a lot of people look at the oil price and say, "Well, MLPs should trade cheaply because oil is well below its \$100 plus level that it hit several years ago." Well, if you track the ratio of MLPs to oil prices, you find that even on that metric MLPs are 42% below that average relationship. The last time that MLP to oil ratio got this low, back in 2008, MLPs more than doubled over the next five years. So when you fast forward now to MLP closed-end funds, not only do you have a discounted sector but you have a discounted vehicle on top of that discounted asset class, so you have a bunch of funds trading at 20% discounts to net asset value. Another thing with tax considerations, if there's a democratic push for higher taxes, MLPs offer tax advantages too and that could become more attractive.

CHUCK JAFFE: Let's talk about one or two MLP funds that are kind of an exemplar for you right now, they're part of your methodology and part of the portfolios.

ERIC BOUGHTON: Sure. So we have a number of funds that are run by Tortoise, a typical example for our portfolio would be a ticker TYG, so Tortoise Energy Infrastructure Corp. This is an MLP that's trading at a 22% discount to its net asset value and it owns just the biggies. I mean there aren't that many MLPs out there, so a lot of these funds just own the same companies. It owns MPLX, and Williams Companies, and Enterprise Products as an example. It yields 5% and it's weathered. It's weathered through the storm of the March 2020 and it's come back.

CHUCK JAFFE: And quickly, because methodology's important here and I know that it applies across closed-end funds. You talked about a sector that you liked, etcetera. Well, what makes you sell? When you've got a closed-end fund, you've got a good discount, you've got all the right things, you bought it at the right price, what makes you sell? Here you've got a fund that you like in a sector you like, what would ultimately make you give up on a fund like that?

ERIC BOUGHTON: Well, we think it'll take a while with the MLP space. It takes several years typically for a blowoff sale event to recover. So first of all, time. And second we like to see signs of speculative excess begin to form in a sector. We like to see the discounts come back

to or above their long-run average in a sector. We like to see more signs of investors becoming very excited about a space on average, more mentions in newspapers, that sort of thing. Those are typically signs that it's time to lighten up in a position and find the next thing that's going to be highly discounted.

CHUCK JAFFE: Well, the next thing for us to do is get your quick and dirty take on some closed-end funds my audience is particularly interested in. Well, we are talking about something important, we're talking about investing in closed-end funds and we're doing it with Eric Boughton. He is portfolio manager and chief analyst at Matisse Capital, they run the Matisse funds. If you want to get more information, MatisseCap.com, also MatisseFunds.com to learn more about the specific funds. You know how Quick & Dirty works, so we're going to jump straight in. Starting with a request we got from Maynard in Phoenix who wants to know about Salient Midstream & MLPs. It's ticker SMM, and does it generally fit into the, hey, I like MLP space right now?

ERIC BOUGHTON: Absolutely. Salient Midstream is a buy for us. It is similar to the other ones. It owns cheap pipeline MLPs like Williams and Energy Transfer, pays a quarterly cash distribution that annualizes at 4.3%, and it trades at a 25% discount to its net asset value, which is an incredible deal compared to its long-run average of 13% discount. So we think this is a buy.

CHUCK JAFFE: Twenty-five percent discount certainly does. It's a buy on SMM, Salient Midstream & MLP Fund. Rich in Orchard Beach, Maryland and Dale in London, Ohio both wanted to know about Boulder Growth & Income Fund, that's BIF.

ERIC BOUGHTON: Boulder is a U.S. value equity fund primarily with big stake in Berkshire Hathaway, which it's owned forever and ever, it has a very long-term gain on that name and it trades at a 15% discount to its net asset value. So essentially it's an opportunity to own Berkshire Hathaway at a big discount, and it of course owns other stocks, many of the stocks favored by Berkshire Hathaway. It's kind of a mini-Berkshire at a discount. Unlike Berkshire it pays distribution as well. It pays a distribution that works out to 3% per year, which is pretty good for an equity closed-end fund. It's had good performance. It's five-year return is 13%, which is about 1% ahead of the Russell 1000 Value Index. And there's a catalyst in the form of the fact that the chief portfolio manager and owner of the fund is 83, so any changes to the situation of him and his family could lead to the fund changing its structure. And when

a fund is trading at a big discount, a change in that structure like a liquidation or an open-ending leads to a big pop for shareholders. So for all these reasons we think Boulder is a buy.

CHUCK JAFFE: It is a buy on BIF, the Boulder Growth & Income Fund. Our next request comes from Mark in Bound Brook, New Jersey. I used to work right near there. He wants to know about EDD, the Morgan Stanley Emerging Markets Domestic Fund.

ERIC BOUGHTON: So this fund, EDD invests in emerging market debt that's denominated in the currencies of the local countries. That would be scary to a lot of people, but for us we see another beaten down asset class because emerging market currencies are very cheap relative to the U.S. dollar. The average emerging market currency today trades for about half what it traded for in 2011. Now a bounce in this space may have already started because the index is up strongly since early 2020, but it still trades at that depressed level and it could have a lot further to run. On top of that discount, EDD trades at about 12% discount to its net asset value, so you're getting good bonds for 88 cents on the dollar and you're not really getting much of an increase in credit risk. A lot of people think emerging market bonds, it's a big problem. Well, EDD, over half of its holdings are investment grade and it itself yields 6.2%. So for all those reasons we think that EDD is a buy.

CHUCK JAFFE: EDD, the Morgan Stanley Emerging Markets Domestic Fund is a buy. Dave in Quincy, Massachusetts wants to know about a very different kind of emerging markets fund, the Morgan Stanley China A Shares Fund, CAF.

ERIC BOUGHTON: Another potentially scary fund for some people because it owns Chinese companies, China A Shares, as its name implies. Now despite some political risk, Chinese stocks and their currency are generally cheap. For example, the Shanghai Composite trades at only 13 times earnings. Over the long term this fund has done very well. It's returned 13% per year since its 2006 inception, which is right in line with its index. And it often pays out large year-end cap gains, at least historically it has, no guarantee in the future. So when purchasing the fund at a big discount, those distributions augment your returns. And in fact since inception, the fund has paid out an average of 12% per year, so it's paid out its entire return basically in the form of distributions. On top of that it trades at an attractive 11% discount to NAV and we think it's a buy.

CHUCK JAFFE: That's a buy on Morgan Stanley China A Shares, ticker CAF. And last for Michael in Boynton Beach, Florida, it's the Pioneer High Income Trust, PHT.

ERIC BOUGHTON: Pioneer High Income is a fund that owns a good slug of very low-rated bond, and we've noted that junk bond spreads today are very low compared to their long-run average. So typically people demand about 5% points extra return from junk bonds in order to own them over treasuries, and now that spread is only 2%, near record low like the ones that were hit back in 2014 and 2007 just before the Great Recession. So closed-end fund, PHT, a lot of its fund is in the low D rated bonds, and so it pays out a lot of yield and so it's exciting for investors. PHT pays 8.9%, but we think that it's taking too much risk to do that. On top of that, the fund trades at a small premium to its net asset value. So in the next credit crunch, whenever that happens, Pioneer's at risk in our opinion and we would sell it.

CHUCK JAFFE: Yeah, it's a sell on the Pioneer High Income Trust, PHT. But you know what's every bit as good as advertised, that was our chat with Eric Boughton. Eric, great stuff. Thanks so much for joining us, I look forward to the next chat already.

ERIC BOUGHTON: Absolutely. You're welcome, Chuck. Appreciate it.

CHUCK JAFFE: That's Eric Boughton, portfolio manager and chief analyst at Matisse Capital. You can learn more at MatisseCap.com and MatisseFunds.com.

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