‘Once You Own A Closed-End Fund, You Shouldn’t Care What The Discount Is’

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed Mike Taggart, founder and chief executive at Taggart Fund Intelligence – a new analytical firm being built to cover closed-end funds. Read the Q & A below as Mike says that individual investors and financial advisers should move away from their obsession over discounts in closed-end funds, noting that total return and other factors drive long-term satisfaction with a closed-end fund investment. He discusses the factors he is focusing on – and that he thinks investors should be looking for – as well as the need for independent fundamental analysis of closed-end offerings that he feels the industry currently lacks.

Mike Taggart

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

CHUCK JAFFE: Mike Taggart, founder and chief executive officer at Taggart Fund Intelligence is here, and we’re talking about closed-end fund fundamentals and more. 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 is 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’s going to point you in the right direction. And today it's pointing us in the direction of Mike Taggart. Now he's a former analyst with Morningstar, done some other things as well, but now he's the founder and chief executive officer at Taggart Fund Intelligence, which is a brand new research firm that's coming up with ways to evaluate closed-end funds. And of course if you're familiar with closed-end funds, you know that they're not exceptionally well followed by the analytical community and there's a lot of work to be done. If you want to learn more about closed-end fund investing go to AICAlliance.org, the website for the Active Investment Company Alliance. Mike Taggart, thanks for joining me on The NAVigator.

MIKE TAGGART: Thanks for having me, Chuck. Appreciate it.

CHUCK JAFFE: For most investors out there certainly, closed-end fund research and analysis, it kind of amounts to, "Hey, there's a discount. Is it big enough?" "Okay, that looks good." There's a lot more to it, so explain, A, why there needs to be more than just, "Let's look at a discount," and B, what you're doing with Taggart Fund Intelligence.

MIKE TAGGART: Right, so the discount is obviously exciting, right? It was the thing that attracted me to closed-end funds in the first place, probably for most people as well. The problem with the discount is that most people don't understand really when a discount is actually attractive. "Oh, it's a 10% discount, that looks good." Well, maybe it's always trading at a 15% discount, and 10%, the valuation's a little rich but they don't know that. What I tell people is once you own a closed-end fund, you really shouldn't care what the discount is. All that really should matter to you is the total return versus your expectations for total return. And there are a lot of people out there, very smart people who make a lot of money trading the discounts. But these are people who are professionals, they spend their entire day looking at closed-end funds, and they trade them rapidly. So I'm not saying that you can't make money on discounts, I'm just saying that for the average investor you may get lucky, but anecdotally from conversations I've had over the past decade with a lot of people who don't like closed-end funds because they got burned on a discount investment.

CHUCK JAFFE: Well, it's a great time for closed-end funds as an industry. We're seeing a lot of expansion, there's a tremendous amount of interest, there's more money flowing in that we've seen before, we've got new types of funds, all this other sort of stuff happening right now. Is there the demand for what you're doing? And what have been the interesting things that you've found as you've broken out to say, "Hey, let's create this new firm"?

MIKE TAGGART: Well, I do think it's an interesting time to be in closed-end funds. We have the NAV equivalency pricing, we're seeing strong IPO to markets out there, we're seeing just a lot of rights offerings these days, and that all comes about because just generally healthy and strong underlying markets. But I think things could be even better. I think there's still a lot of work that needs to be done on educating investors, on being more transparent in terms of what the funds actually offer. Look, I think that people should know what they're investing in. Whether or not they actually do is another story, but they should be afforded the opportunity to understand what they're investing in. Right now people are talking about the prospect for higher interest rates or maybe another taper tantrum like we saw 10 years ago, so obviously duration is really important. If you go out to a lot of these closed-end fund websites, you can't find information about duration. Or if there is information about duration, you can't do apples to apples comparisons. And a lot of the funds, if you even look in their annual reports or their prospectuses or try to find some sort of investment mandate around duration or maturity even, they don't have them. They'll talk for page after page about the credit quality restrictions and mandates that the fund has, but they're kind of, "Well, is this fund restricted in any way on terms of the duration, the interest rate risk it can take on? Or can it kind of go anywhere in terms of duration?" Those things are hard to find. Those are probably things, at least I think and people I speak with, the investors are interested in, and advisors especially. What happens to closed-end funds when interest rates rise? That's a huge question, and without knowing the answer, most people will say, "Well, I'm just not going to invest in say, a municipal fund, because I don't know." The answer to that is when interest rates rise, what happens to closed-end funds really depends on what happens to the yield curve. But in any event, those are the types of transparency things. And also in terms of why did I come up with this idea for a research thing? There's no independent research out there right now on closed-end funds.

CHUCK JAFFE: It's very limited in terms of what you can find, and quite honestly I mentioned the fact that you had worked at Morningstar, and Morningstar at one point they were kind of doing some stuff on closed-end funds. Now you can go there and see information on closed-end funds but there's no more fundamental analysis there. And admittedly, you're not doing this for consumers, this is not Taggart Fund Intelligence is going to be selling Joe the average guy, "Here's what happens with your closed-end funds." But the problem is, there's no real research at this level even for institutional investors and for financial advisors, and it's tough to build a portfolio if you don't have it, right?

MIKE TAGGART: And I think you're right, Morningstar does a great job in terms of providing data for people, so does AICA through Closed-End Fund Advisors database. The issue is more, "Let's get independent research out there from somebody who isn't running a book of business." If I like a fund, you're going to know that I don't like it because I'm trying to jack the price up so that it benefits my portfolio. I like it based on its fundamentals or based on what it does. The other thing too is that the industry just doesn't have a mouthpiece so to speak, and hopefully I'll become that mouthpiece. Hopefully it's not because I have a big mouth.

CHUCK JAFFE: But a mouthpiece in this case is somebody who's actually more of a referee, and I say this who as somebody in my side gig is a referee. But the problem as a journalist covering closed-end funds that I have is that you can look in an activist situation, you've got the activist on one side, you've got the fund that's potentially trying to fight the activist on the other. They're both arguing and there's no arbiter in the middle who can go, "Hey, in this case I kind of think the activist is a good thing," or "Maybe the activist isn't a good thing." So ultimately you're putting yourself to some extent in the middle, and we need that because I'm not wrong that we kind of miss that so that you only have coverage of one side or the other with nobody really don't much of the analysis in the middle.

MIKE TAGGART: Yeah, I think that's a really good point that you bring up, especially in regards to the activists. Because the argument's always the same on the surface, right? The activist is arguing that the discounts are wide because the fund's a bad product. And then on the sponsor's side you're saying, "No, these guys are just after a short-term investment gain." And the truth is typically somewhere in between. And sometimes the activists in my opinion have a point, and sometimes the fund sponsors have a point. But in the absence of anybody kind of in there coming down one side or the other, it's hard to tell what's actually going on. And we've seen a lot of funds, especially in the past year, changing their by-laws and taking advantage of the control share acquisition mandates that they can put in there now. And one of the things we've seen for years now is kind of a merging and repositioning of funds to make them larger. Well, I mean maybe not just to make them larger but one of the outcomes is typically it's a larger fund, harder to attack, right? I actually think there's a lot more room for that because I think that over time a lot of these funds within fund families, they may have started out being slightly different and they've become quite similar. So then all of a sudden a fund family might have say, three funds, they're all similarly invested, their NAVs correlate very highly, and at the end of the day what does that lead to? The only differentiator is their discount and we go right back to the whole idea of the only reason you buy closed-end funds is for the discount, which I think the industry kind of wants to get away from. But they need to merge funds where possible I think, update their mandates to make them more modern in a lot of cases. And we're seeing a lot funds do this and continue to do this, but at the same time let's not forget about marketing, educating, becoming more transparent. All of that stuff helps increase demand for shares, it drives the discount narrower, and it mitigates the attractiveness of a fund to activists.

CHUCK JAFFE: Mike, it's going to be really interesting to see what you can accomplish. Good luck with the new firm, I look forward to chatting with you about it as we get into some of those issues and see you take up that mantle of responsibility in analyzing things down the line. Thanks for joining me on The NAVigator.

MIKE TAGGART: Thanks so much for having me, Chuck. Appreciate it.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe, and you can check out my show on your favorite podcast app or at MoneyLifeShow.com. To learn more about interval funds, 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. Thanks to my guest, Mike Taggart, he's the founder and chief executive officer at Taggart Fund Intelligence, and the firm is going to be online at TaggartFundIntelligence.com but he warns that the website, still in the development stages. The NAVigator podcast is new every Friday and you can follow us on your favorite podcast app, and please be sure to join us again next week to learn more about investing with closed-end funds. Until then, stay safe everybody.

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