



## Covered Call Funds Help Combat Heightened Volatility

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed Daniel Ashcraft, portfolio manager for Gateway Investment Advisers, part of the firm's team responsible for running the Nuveen S&P 500 Buy-Write Income Fund. Read the Q & A below as Daniel says that with



Daniel Ashcraft

volatility on the rise and likely to stay that way, covered-call strategies are headed for a period that should be ideal, where they can deliver their 'bread-and-butter' of lower-volatility exposure to the markets with attractive risk-adjusted returns.

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**CHUCK JAFFE:** Daniel Ashcraft, portfolio manager for Gateway Investment Advisers is here and we're talking volatility and how you might be dealing with it now on 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 Dan

Ashcraft, he's portfolio manager for Gateway Investment Advisers, where among other things he's part of the team that acts as managers to the Nuveen S&P 500 Buy-Write Income Fund, it's ticker symbol BXMX. If you want to learn more about Gateway and its role as subadvisor and more, go to [GIA.com](http://GIA.com). If you're looking to learn more about investing with closed-end funds, it's [AICAlliance.org](http://AICAlliance.org), the website for the Active Investment Company Alliance. Dan Ashcraft, thanks so much for joining me on The NAVigator.

**DANIEL ASHCRAFT:** Thanks for having me.

**CHUCK JAFFE:** We're in a really interesting time where volatility is concerned, because of course at the beginning of 2020 when the market tanked, well the volatility was horrible in a downward fashion and everybody was scared and panicked. Nobody complained during the upswing, nobody was going, "Oh wow, there's too much volatility that's working in my favor." But now we're at a spot where the market is going through recovery, we're seeing a lot of volatility come into play as there's talk about rising inflation and rising interest rates. Is this an environment where people are going to have to be particularly worried about volatility? And why would someone want to add a covered-call strategy to do that?

**DANIEL ASHCRAFT:** Well, there's certainly a lot of features of the market right now that I think are supportive of a higher volatility environment going forward. Now for a strategy like we manage, a higher volatility environment can actually be a good thing. A higher volatility environment for a call writing fund is kind of the bread and butter, it's the primary source of the return, so it's one that we look to and try to take advantage of as sellers of volatility. So we think the environment is very supportive of a higher volatility environment that will be a benefit to a strategy like a covered-call strategy.

**CHUCK JAFFE:** Give a little explanation of how covered-call strategies work, but let's also talk about that in regards to closed-end funds. Because covered calls are a structure or an investment style that not every fund structure can support and it seems like closed-end funds would be a good way to do this.

**DANIEL ASHCRAFT:** Yep, that's absolutely right. A covered-call strategy at its core is an equity-based investment that effectively is exchanging the future unknown market performance for a fixed cash payment up front. So these strategies are looking to convert the uncertainty into a reliable stream of cashflow by giving up some potential upside, and that cashflow also helps to dampen volatility when markets decline. So these strategies are a

lower volatility way to have exposure to the equity markets, and historically have offered very compelling risk-adjusted returns. Option premium levels as I mentioned are determined by high volatility levels of the market, so the VIX Index or the Fear Gauge as it's known in the media is a great proxy for that. All else equal, these strategies are more appealing during higher volatility times like we're in today. Not only from an absolute premium standpoint, which is higher during a higher volatility environment, but also from a risk-adjusted return standpoint. So to your next question of why it makes sense in a closed-end fund, we think it does for a couple of reasons. In general a closed-end fund structure has a number of advantages. Because closed-end funds avoid shareholder inflows and outflows, portfolios tend to be more fully invested, which benefits shareholders as they're just a more frictionless product. But also fund flows can often happen in opportune times for like open-ended funds for instance, and then variably those come at poor times as investors tend to sell at the lows. So closed-end funds avoid that, we think that benefits shareholders in the end. But specifically as it relates to covered-call funds, the reliability of the cashflow that you're able to extract from the market is very supportive of longer term distribution rates for these products.

**CHUCK JAFFE:** So supportive of longer term distribution rates is important because one of the advantages as I understand covered-call funds is that we're at a time where everybody's trying to figure out, does 60-40 still work? The classic stocks to bonds, roughly what's a good allocation that you can use for most of your lifetime and what have you. Given the yield environment that we've been in there have been plenty of people who say 60-40 doesn't work, they talk about how they want to extend the equity side but they want to do it with things that pay dividends and the rest. I would imagine that one attractive way to do this would be to go for covered calls because fundamentally you're using the options as a big of insurance as you point out, you're giving up a little bit of the upside for a little more security. I would think that that would be something that's particularly attractive to somebody who's looking at their 60-40 and going, "I'm not sure I want to do it that way anymore," right?

**DANIEL ASHCRAFT:** Yes, exactly. For example if you look over the longer term, the cashflow you can extract from the markets from selling a one-month at-the-money call, which is a pretty standard contract that we would be looking to sell in a fund like this, that has averaged around 1.5-2% in premium over the long run. So for a fund structure that has a distribution

rate as we sit here today of around 6%, that cashflow turns into a very reliable return stream for continuing to support that distribution. As you mentioned, we're all painfully aware of the current yield environment, closed-end funds in general I think can play an important role in helping to solve that. Covered call funds specifically though have a lower volatility than an outright equity investment and a compelling distribution rate to boot. So in an environment where it's difficult to find yield today, and additionally you can oftentimes buy these products at a discount to NAV, it's an added benefit.

**CHUCK JAFFE:** Does it work better in an environment with more volatility? If somebody is considering this fund right now or they're looking at this strategy for their portfolio, should they be thinking, "Hey, if I see volatility being heightened, I am likely to see a covered-call strategy do better in that kind of environment"?

**DANIEL ASHCRAFT:** Yeah, absolutely. In a higher volatility environment, and I think the best proxy to determine if we're in one is looking at the VIX Index because that's directly related to the segment of options that we're selling, in a higher volatility environment that cashflow you're able to extract from the market is higher. Post-crisis like we saw in March of last year, also looking back further, the Financial Crisis, volatility tends to stay materially higher post these events. So looking forward, even though we're over a year in the rearview mirror from that type of environment where VIX was hitting all-time highs, we're still in an elevated volatility environment, we expect that to remain the case going forward.

**CHUCK JAFFE:** Let me jump in right there. In the limited time we have left, if you expect a higher volatility environment going forward is the idea here that you're using covered calls to generate consistency, or are you using covered calls because the volatility's going to mean you get excess returns?

**DANIEL ASHCRAFT:** I think it's a little bit of both. The higher volatility allows us more upside participation if the market continues to rise, and it serves as a larger buffer if markets fall. If markets kind of stall out here, you earn that premium regardless of what the market does. So it can serve a variety of purposes, all of which are better in a higher volatility environment.

**CHUCK JAFFE:** Dan, this was really interesting, that's so much for joining me to talk about it.

**DANIEL ASHCRAFT:** Thanks so much for having me.

**CHUCK JAFFE:** The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. I am Chuck Jaffe and you can check out my hour-

long weekday podcast 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, Daniel Ashcraft, portfolio manager for Gateway Investment Advisers, part of the firm's team responsible for running the Nuveen S&P 500 Buy-Write Income Fund, ticker BXMX. Learn more about him and the firm at GIA.com and on Twitter @Gateway\_LLC. The NAVigator podcast is new every Friday, follow along on your favorite podcast app and come back next week to learn more about investing with closed-end funds. Until then, happy investing everybody!

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