NAVigator Bonus: As Market Nears Record Highs, Boughton Still Finds Lots To Buy

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Chuck Jaffe, in this bonus episode of The NAVigator podcast interviewed Eric Boughton, chief analyst at Matisse Capital and portfolio manager for the Matisse Discounted Closed-End Fund Strategy. Read the Q&A below as Eric says that while the stock market has roared this year, things haven't changed much with the closed-end fund space this year, meaning there are plenty of highly discounted issues, particularly in muni bonds and some other fixed-income spaces, as well as international funds. He notes that many closed-funds that were good deals based on discounts a year ago haven't narrowed those bargains but now deliver improved yields, which is why he is buying certain issues now 'hand over fist.'

Eric Boughton

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

CHUCK JAFFE: Hi, it's Chuck Jaffe, host of The NAVigator podcast from the Active Investment Company Alliance. Every weekday I also host an hour-long interview program called *Money Life*, and our show on July 25th featured Eric Boughton, portfolio manager and chief analyst at Matisse Capital. Because Matisse runs funds that invest in closed-end funds, we wanted to make sure that you got a chance to listen in, so here's my Money Life Market Call interview with Eric Boughton as a bonus episode of The NAVigator. Enjoy! Eric Boughton, portfolio manager and chief analyst at Matisse Capital is here, we're talking investments in closed-end funds, and this is the Market Call. Welcome to the Money Life 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 determines their buys and sells, what they see happening broadly on the market, and how they put it all together. And my guest today is Eric Boughton, he is chief analyst and portfolio manager at Matisse Capital, which runs the Matisse Discounted Closed-End Fund Strategy Fund, that is MDCEX, and the Matisse Discounted Bond CEF Strategy Fund, that is MDFIX. If you want to learn more about the funds, which have a great long-term track record, MatisseCap.com. Eric Boughton, it's great to have you back on Money Life.

ERIC BOUGHTON: Thank you, Chuck, I appreciate it. It's always great to talk closed-end funds with you.

CHUCK JAFFE: It is, and especially because closed-end funds are so sort of counterintuitive in market conditions, people want the discounts but they don't find it easy to go buy them because the things are most discounted when the market looks ugliest, et cetera. Last time you were here, which was at the end of 2022, there were a lot of places in closed-end funds that you liked, munis, junk bonds, foreign stocks and more. Let's start a little bit with methodology, but then I gotta know, are you finding it easier to buy with that methodology right now or are you finding it tougher to buy right now?

ERIC BOUGHTON: Yeah, this is a great opportunity to buy closed-end funds again today, things have not changed much in closed-end fund land since the end of '22 since we talked last. And what we do is we try to find funds that are extremely discounted to their net asset value, that have attractive cash distributions, and that can achieve excellent long-term returns, are run by great managers, just kind of everything, we look for a fund that checks all the boxes. And it's interesting that although the stock market has roared recently, the NASDAQ 100 is up a lot, the magnificent seven are at $11 trillion in total market cap, closed-end funds are still highly discounted, especially in some of those same categories that we talked about before, municipal bonds, international funds, and there's really opportunities across the space.

CHUCK JAFFE: So let's talk a little bit about those opportunities and how much of this is simply, as you point out, you're looking for big discounts. So we're at a spot where yields in a lot of ways, and certainly for a lot of fixed-income asset classes have gotten better, and so is it more the discount that's driving the attractiveness or is it more the market conditions that are driving what's making it attractive?

ERIC BOUGHTON: I say it's all the above. Interest rates have come up and things that were just good deals on discounts a year or more ago are now good deals both on that basis and on the basis of their attractive yields. I see investors putting money into money markets and even CDs, locking in 5% interest rates, and many of them aren't considering the possibility of buying closed-end funds that can yield seven to even 10+% with some of the same characteristics actually. Some of the things we're looking at now for example, they're term trusts, so like a CD they have a defined termination date and they still trade at big discounts, which causes us to do two thing, one, scratch our heads, and two, buy hand over fist.

CHUCK JAFFE: Before we get into what areas of the market you like, if you're looking at things that you can say about certain areas, "I could buy closed-end funds hand over fist," what is determining issue A from issue B? How much of it is portfolio construction where you don't want too much of any one issue to make up a big chunk of the portfolio or you don't want too big a percentage dedicated to one asset class? But how do you decide between multiple closed-end funds in the same space, all facing pretty good discounts? What is it that makes you say, I'll letter A as opposed to letter B, when both have the big discounts, both have the asset class that's attractive, et cetera?

ERIC BOUGHTON: It depends on the market climate. In some market environments there are clear distinctions between closed-end funds based on the quality of the management of the fund, based on the willingness of management to do the right thing for shareholders, based on the presence or absence of activist investors, a lot of different factors like that. But in a market like today's, it's interesting that, as you point out, most of those things are positives for nearly all funds, and so we just basically buy everything and we have smaller positions in more attractive closed-end funds.

CHUCK JAFFE: So now let's get to the areas that you particularly like, because there are a lot of areas. So what stands out to you right now? And then as you said, not much has changed, but is there anything that is on the outs as well where, hey, for all of the good buys you can see that, nah, you can't go there?

ERIC BOUGHTON: Yeah, I would say the answer to the second question is just no, there are great buys across the universe in every sector really. I would point out once again, not to beat a dead horse, but I would point out once again the high attractiveness of municipal bond closed-end funds. They trade at average discounts around 11%, 89 cents on the dollar for your typical municipal bond fund, with many trading at 14, 15, 16% discounts. If you look and compare that to history, municipal bond closed-end funds typically trade at 3-4% discounts to NAV. I think investors have kicked those to the curb to some extent, in part because of their fear that interest rates will continue to rise. And it's very interesting, as we look at that, we think that interest rates have already risen enough to where it's causing economic damage, and I think the Fed sees that too. Also, inflation seems to be cooling a little bit, and the combination of those two things could lead to interest rates stopping their move up, and in fact there is a chance that with a serious recession in the next year or two, longer term rates could come down materially. If both of those things happen, or either one, you will probably see municipal bond closed-end funds underlying portfolios do very well because of the rates coming down, and also the discounts are likely to narrow substantially from the 11% as investors chase after the asset class that they got out of before.

CHUCK JAFFE: So drop a couple of examples for us, what is a name or two that is an exemplar for the fund?

ERIC BOUGHTON: Sure. They're all fairly similar in terms of attractiveness, so all of the funds, almost all of them are levered. We're looking at some Nuveen funds that are individual specific state funds, we look at some national funds, BlackRock has a number of national funds that we find attractive. I think I'll give some tickers later on in the lightning round segment, but essentially what we're looking at right now is funds that yield about 4%, that trade between 12 and 15% discounts when they typically trade at more like single digits, and funds that are run by large fund companies that know what they're doing, and funds that can benefit from any reduction in interest rates going forward.

CHUCK JAFFE: Let's flip this around and put on the equity hat for just a second, because obviously you're finding lots of attractive bargains on the fixed income side. I've had folks say, "If you can get nice enough yields, if you can do all the right things, why are you messing with equities in a market that's as topsy-turvy and has the magnificent seven leading everything but being over value?" Obviously you have an equity fund so you're going to be doing equity there, but in terms of the equity funds, are there areas of the market right now that stand out to you? Or is that basically again it's going to be play the discount right now and be specific to the funds but do that more than any one area of the market or another?

ERIC BOUGHTON: Right, right, I'd say there's a couple things to think about on the equity side. So first, yes, there are a few closed-end funds, not very many but there are a few that own highly overvalued stocks that we would say be cautious there, or at least you could short something against a highly discounted closed-end fund that owns tech stocks for example. But there are a lot of areas actually in the markets that are still incredibly cheap, MLPs is just a key example and something that we've made 20% of our equity fund. So your average MLP trades at less than 12x earnings, has an attractive free cash flow yield, it has a dividend yield of 7 or 8%, and it's just highly attractive. It still has not recovered from the declines it had in 2020, and if you look at the closed-end funds that are dedicated to that space, those closed-end funds tend to also be in the high teens discount, many of which are term trusts and will liquidate in a certain number of years. And again, I'll talk about some specific tickers in the lightning round, but I think that that's a space to look for great opportunities. Another one is foreign stocks, so valuations overseas are quite a bit more attractive than in the US, and investors will say, "Well, that's for good reason," but there are certain funds that own foreign stocks that also trade at attractive discounts and with good yields.

CHUCK JAFFE: Well, now we're going to get your quick and dirty take on some closed-end funds my audience is particularly interested in. Well, we do think you're going to like our lightning around, it's what we call Quick and Dirty and it's where we put our guest to your test. And if you want to test our guest directly, send your name, your hometown, and the ticker symbols you're interested, and yes, closed-end funds, traditional funds, ETFs, and of course stocks, send it to Chuck@MoneyLifeShow.com, we'll add it to our list and hope it makes it into an interview soon. And we're going to start today with a request from David in Escondido, California, and you were talking about liking some big single-state muni funds, well, this is the Nuveen California Quality Muni Income Fund, it is ticker NAC.

ERIC BOUGHTON: NAC is a great example of what we were talking about, municipal bond closed-end funds at big discounts. So this fund launched back in 1999, it has a great long-term track record versus other California municipal bond investments, and it trades at a 14% discount right now. If you look back in history, for example, over the past 10 years it's traded at an average of 7% discount to its NAV. It yields about 4%, which is much better than municipal bonds from California if you just buy them directly, it's a large fund, $1.6 billion, run by Nuveen, fairly stable approach. It is levered, that's one of the things that adds to its attractiveness, because we think that the borrowing rates for these types of funds are headed down as well as long-term rates, so we think they'll be benefited on both sides. The NAV should go up, the discount should narrow, this fund could get a 10-20% return over the next few years, so that's a strong buy.

CHUCK JAFFE: Well, the fund is cheap, 14% discount, and so if you wanted to test your faith, you do it with a buy on NAC, Nuveen California Quality Municipal Income. Moving from David in Escondido, California to Dave in Jacksonville, it's the PGIM Short Duration High Yield closed-end fund, SDHY.

ERIC BOUGHTON: Yeah, SDHY is kind of the opposite side of the coin in terms of credit quality and duration, so the municipal bond fund is long duration, high credit quality, SDHY is short duration and lower credit quality. This fund launched in 2020 by Prudential at a $20 price, and now it trades at $15. It trades at a 12% discount to its net asset value, and most interestingly it terminates in 2029, so six years from now this fund will return NAV, whatever it is, to investors. So if you buy it today, your get not only whatever the returns are of short-term high-yield bonds between now and then, but you'll get an extra roughly 2% per year from now till then. The fund in the meantime yields 8.6%, so you get paid while you wait for those things to happen. Overall, even though we think that there's a little danger to the credit quality of the fund, we think even taking that into account this is a strong buy.

CHUCK JAFFE: Well, yeah, there's some really interesting long-haul thinking, that date that tells you when the closed-end fund will terminate, so when you know you can make that amount of money and what you can do in the interim, really interesting pick. That was a buy on SDHY, the PGIM Short Duration High Yield Fund. Javier in Wilmington, North Carolina gets our next request, he wants to know about the BIGZ, that's BlackRock Innovation and Growth.

ERIC BOUGHTON: BlackRock is a great manager. This fund owns some mid and small cap tech stocks along with some other sectors, so there's some risk to that, but like SDHY this is a term trust, it will terminate in 10 years from now, and it trades at a 17% discount to net asset value. So between now and 10 years from now, again you get about 2% per year in excess return above and beyond whatever the fund gets. In the meantime, it yields 10.6% and there is also activist pressure in this fund, which could cause it to terminate earlier, so you just have a baked in extra couple percent and the opportunity to perhaps have that happen earlier. In addition, the fund has been buying back shares, it's bought back 16 million shares back since it started its share buy-back program, that also adds to the return because of the share accretion. So overall, this is a strong buy.

CHUCK JAFFE: That's a buy on BIGZ, BlackRock Innovation and Growth. We're going to combine our last two requests because they are in related fields. Javier in Wilmington, North Carolina's in on the first one, he shares it with Rick in York Pennsylvania, it's the NRGX, the PIMCO Energy and Tactical Credit Opportunities Fund, and then Robert in Holland, Ohio wants to know about the Ecofin Sustainable and Social Impact Fund, it's TEAF. They don't necessarily sound related but they are.

ERIC BOUGHTON: Yeah, these two funds are very similar funds in the sense that they both launched in 2019, and like BIGZ and like SDHY, they will terminate. In this case their termination date is in 2031, only eight years from now. Both funds trade at high teens discounts, in the case of the PIMCO fund, NRGX, it trades at a 16% discount, in the case of the Ecofin Tortoise Fund, TEAF, it trades at a 19% discount. I think both of these funds invest in attractively discounted merchandise as well, so above and beyond the high discount on both funds, they both invest in what I see as attractively valued MLPs and other types of investments in the energy space. They're run by great teams, they should have good performance, and again, activist pressure exists in both funds that could cause the ultimate realization to be sooner than 2031. These are strong buys.

CHUCK JAFFE: So we finish on a high note, or a double high note, NRGX, PIMCO Energy and Tactical Credit Opportunities, and TEAF, Ecofin Sustainable and Social Impact, both are buys. Well, yeah, in fact, all we've thought about during Quick and Dirty, our lightning round, has been buys, because we've had five of them. But five really interesting, different closed-end funds with some really cool tactics, the activist investor angle, the term angle, and much, much more. It's what Eric Boughton does. Eric, this has been great, thank you so much for joining me on the show, I look forward to the next conversation already.

ERIC BOUGHTON: You too. Thank you, Chuck, I appreciate being here.

CHUCK JAFFE: Eric Boughton is portfolio manager and chief analyst at Matisse Capital, it's the Matisse Discounted Closed-End Fund Strategy, MDCEX, and their fixed-income strategy, their bond strategy, MDFIX. MatisseCap.com for more information.

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