Calamos’ Bush: Tough Conditions For Closed-End Funds To Stand Out, Excel

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed Robert Bush, director of closed-end products at Calamos Investments. Read the Q&A below as Robert says that with risk-free money from bank accounts and Treasury bonds at high levels – and with leverage costs up in response to those higher rates – investors can have a lot of choices for good income without ever considering closed-end funds. But with the average closed-end fund discount widening from roughly 8 percent at the start of the year to nearly 10 percent today, closed-end investors are likely to be rewarded for their patience. Bush also discusses how CPZ, the Calamos Long/Short Equity and Dynamic Income Trust, has navigated these challenging conditions to be better positioned regardless of how the market plays out from here.

Robert Bush

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CHUCK JAFFE: We're talking with Robert Bush, director of closed-end fund products at Calamos Investments about the state of the market for closed-end funds, 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's 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 Robert Bush, director of closed-end products at Calamos Investments, you can learn more about the firm and its suite of closed-end products at Calamos.com. And to learn more generally about closed-end funds, interval funds, and business-development companies go to AICAlliance.org, the website for the Active Investment company Alliance. Bob Bush, it's great to have you back on The NAVigator.

ROBERT BUSH: Hi Chuck, it's always a pleasure. Thanks for having me back.

CHUCK JAFFE: I want to cover a lot of ground because you're a guest who can do that, because I could talk to you about specific funds but I can also talk to you about big picture because, yeah, you're overseeing closed-end products. So let's start with just the closed-end fund market, because everybody's been talking about the stock market's had a good year but it's been very narrow. But closed-end funds, they really haven't had a good year, and there are some reasons for that but I think to some extent the public hasn't recognized this has been a bad year because, hey, yields have been good and as long as things are paying you kind of don't recognize the pain points. So help us understand what's going on generally with closed-end funds right now and why 2023 has just been kind of hurting.

ROBERT BUSH: Closed-end funds are very much a nuanced product, they certainly are impacted by the general financial markets, they have their own intricacies that certainly impact the way they're viewed and the way they trade. Discounts, the secondary market have widened considerably since the end of last year, the average closed-end fund was trading at roughly an 8% discount, today that discount has widened to nearly 10% at roughly 9.68%, that's a huge jump. Especially since, as you've pointed out, we've seen a recovery in certain financial assets in 2023 with the equity markets up roughly 13%, high-yielding vertical markets up roughly 6%, so you've seen this bit of recovery in financials since what we've seen last year. As a comparison, in late 2021 before interest rates began to take off, the following March equity closed-end funds were trading in averages of only 5%, well actually bond closed-end funds were trading generally parity, so we've seen this very much a disparity here in the closed-end fund market pricing. Of course all that changed, the short-term rates began their 525 basis point escalation in March of 2022; 2022 was really the worst of all worlds in the closed-end fund space. Why? Well, again, we saw short-term rates soar, the Fed jacked up rates 11 times between March 2022 and July of '23, higher rates cause higher leverage costs, and as you know, many closed-end funds use leverage, so now these short-term rates went up and that cuts into the investment returns. Leverage of course exacerbates negative portfolio returns, which you saw in 2022, so leverage can be very helpful if it's positive in an up market but it can certainly be even worse in a down market, so we saw that last year. Equity markets and bond markets alike were pummeled last year, registering double-digit return drops in 2022. Huge market volatility also put pressure on closed-end funds as many closed-end funds investors will fund the closed-end funds for cash during volatility. Bond yields are now looking attractive, now bear in mind, as you known, closed-end funds are often sourced by investors for their income. You're seeing one-year CD rates, I saw one this morning at a 5.5%, that's essentially risk-free money. You've seen the 10-year go up to 5%, high-yield bonds in and of themselves are approaching 9%, so you can get a lot of other investments that are going to give you income X the closed-end fund space. Many extremely large, this is sort of a different issue that we have in this particular market, many large, broadly syndicated closed-end funds done in 2021 cut distributions and source return of capital as really the sole source of their funds for distributions, those funds are trading at deep discounts, have lost half of their NAV. So their experience many inventors have had recently in the IPO market in the 2021 funds that had rough 2022's are still very much resonating out there, and the closed-end fund issuance dropped from about $15 billion in 2021 to about $1.5 billion in 2022 to nothing this year.

CHUCK JAFFE: Yeah, I was going to say zero.

ROBERT BUSH: It's a tough go. Yeah, it's a tough go.

CHUCK JAFFE: Zero this year when it comes to new closed-end funds, there have been no IPOs, and what this also leads out to is that higher cost of leverage is a big reason why discounts have gotten increasingly wide. But the flip side of that is, for somebody who understands it, while there's a pain point that we've been going through, those bigger discounts in this kind of rate environment and the yields you're able to get should make it that closed-end fund are particularly attractive now, but yet the investing public generally doesn't seem to be waking up and smelling the coffee. Is there a point traditionally where they figure that out?

ROBERT BUSH: You know, you'd think. I think a large part of problem with the closed-end fund investor right now, and again I think it's akin to what many investors are seeing. It's interesting, there's an article in the *Journal*, I don't know if it was yesterday or the day before, that talked about asset managers expecting bond flows, closed-end fund, not general market, bond flows and mutual funds to increase as yields have increased. Well, the problem is we're not sure whether or not the Fed is really holding pat here, are we going to see more interest rates going up? You see the 10-year keep going up and up and up and up, it's knocking on the door at 5%. So I think in theory, where are we with the equity markets, we thought we were coming out of it and we had a day like yesterday, again, with Fed activity going to increase it's going to make it even more difficult. So I think the markets are still unsettled because they're not quite sure what the direction is going to be with the Fed, and that certainly impacts bond prices, and it effects equities as well and has been.

CHUCK JAFFE: Let's bring it down to the fund level, and specifically let's talk just a little bit about how those conditions impact a fund. Let's pick CPZ, Calamos Long/Short Equity and Dynamic Income Trust, this is a fund that it's employing leverage, it's doing all these other sorts of things. When you look at a fund like that and you've got investors who are saying, "We're living with the discounts and the rest in the industry," what is somebody supposed to be taking out that's going to make them say, "Wait, hold it. I'm looking for income, I'm looking for some growth, I'm going to be able to get it here and do it in these conditions"? Is there something that makes you say, "Hey, the long, cold winter is over," or about to be over?

ROBERT BUSH: Well, CPZ's a great product in this context, and I'll tell you why. So last year in CPZ, the Calamos Long/Short Equity Dynamic Income Trust, last year the portfolio returned minus six, which if we compare it to the S&P and the MSCI World, they were down roughly 18%, the high-yield bonds were down roughly 11%, the US Agg Bond Index was down 13%, convertibles were down 18%, so everything was down double digits, this fund held. Why? Because again the strategy of the long-short fund, the Calamos Long/Short Equity Fund is that we, unlike any other closed-end fund out there, can manage the general equity exposure of the portfolio vis a vis a long/short strategy, so if we think the opportunities in the equity market warrant it, we can have the portfolio fairly long. Last year though, we were able to curtail it, and so what we did was we were able to preserve capital, precious capital, in a market where other funds were losing it because they were long. And so what that's allowed us to do, so in spite of the fact that the discount on this is roughly 15%, it allowed us to maintain our distribution rate, which by the way, the distribution rate on this fund has increased not once, not twice, but three times since its inception in November 2019, so it's an aggregate increase of three cents per share, roughly 27%. So because we haven't had to dig ourselves out of the big holes like we saw last year, we're able to maintain that distribution rate of 14 cents per share per month and we're not paying return of capital on it, or at least in any large extent are. Most of the components of the distributions are through capital gains, a portion of it is through income because about 70% of the portfolio is in a long/short equity allocation, so we can manage that equity exposure. The balance of the fund is invested in preferred stocks and high yield which helps support the income of the portfolio, so this portfolio has really done everything it was asked to do with that precious preservation of capital in a down market. And I'd also say that the performance of this has been good, the fund currently pays a monthly distribution rate of 14 cents a share, that's an annualized rate of about 11.79% on market prices of last night, and over the last three years, which we've had a lot of tumult, it's outperformed both equity and fixed income benchmarks related to its underlying portfolio. But again, it's offered less risk by virtue of its equity risk management strategy. So again, that's very, very important when you think in terms of volatile markets, which we've experienced, and really continue to experience here as we get into the fourth quarter 2023.

CHUCK JAFFE: It's just another case where you could go, "I don't like recent performance," or "I don't like the discount," or "I don't like that," but man, there's opportunity to be had in closed-end funds. Whether it's that fund, the other stuff you're doing at Calamos, and I know you've got some interesting things in the works, or the industry in general, it's really interesting to get your perspective. Bob, thanks so much for joining me on The NAVigator.

ROBERT BUSH: Always a pleasure, Chuck. Thanks for having me.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. And I am Chuck Jaffe, and you can learn more about my hour-long weekday podcast by going to MoneyLifeShow.com or by searching wherever you find your favorite podcasts. 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, on Facebook and LinkedIn @AICAlliance. Thanks to my guest Robert Bush, director of closed-end fund products at Calamos Investments, learn more about the firm and its suite of closed-end fund products at Calamos.com. The NAVigator podcast is new every Friday, be sure not to miss an episode by subscribing or following along on your favorite podcast app. And if you like us, please leave us a review and tell your friends, because that stuff really does help. Until next week, happy investing everybody.

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