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AICA CEF Panel:

Staying Flexible is Key to Unlocking Returns in High-Rate Environment

A panel of portfolio managers at AICA's 2023 Fall Roundtable said the underperformance of closed-end funds (CEF) is pushing institutional investors to stay ever flexible and find new total return opportunities. When pressed to prognosticate, experts from Bramshill Investments, Cohen & Steers, City of London Investment Management, and Shaker Financial said they believe the impact of higher interest rates on income strategy is unlikely to let up soon. The event took place in New York City on November 15, 2023.

Those comments came during the panel discussion, *Institutional Investor Perspective for Closed-End Funds,* which also touched on the current state of market liquidity and distribution policies.

Interest Rates

One of the themes at the Fall Roundtable focused on how fund managers were navigating the current high-rate environment. One panelist suggested that if bonds were your bellwether, then you might be inclined to think we're entering a bear market. But Douglas Bond, Portfolio Manager, Cohen & Steers, had a different take:

"We're not necessarily believers that we are at the beginning of a 40-year bear market in bonds, but [it's more likely that] inflation is going to run higher than it has in the last 10 to 20 years," he said. "And if we have relatively a warmer inflation climate, then probably at the margin from an asset allocation standpoint, that's going to maybe mean you want to own more equity in your portfolio, because at least if there's more inflation, companies are able to raise prices and earn great nominal profit," Bond added.

Bond manages Cohen & Steers' Closed-End Opportunity Fund, a listed CEF with the NYSE ticker symbol FOF, as well as several institutional accounts focused on income and total return opportunities in CEFs.

While clarifying that at least 80% of the fund's net assets are always invested in closed-end funds, he said his team sometimes pivots to exchange-traded funds if they think will deliver better investment outcomes for shareholders. "We own a couple of S&P 500 index funds and for us that's a liquidity valve to use when and if closed-end fund discounts blow out," Bond added.

Rob Shaker, Portfolio Manager, Shaker Financial, said his firm tracks discount capture minute by minute:

"We're an investment advisory firm that manages separately managed accounts, almost exclusively in closed-end funds," Shaker said. "Our main trading strategy is what we call discount capture, in which where we're buying closed-end funds at a wide level, holding them until they narrow so we can get an additive by selling them and replacing them," he added.

Derek Pines, Portfolio Manager, Bramshill Investments, said his firm has its own approach to CEFs:

"If you believe that … rates are going to be range-bound, then I think this is … starting to be a decent entry point for closed-end funds if you have those extreme discounts," he said. "There's a lot of variables we look for in closed-end funds, not just the discounts to NAV, but one of them is certainly you have to see at least double-digit discounts for us to really start to think of them as an attractive investment."

Bramshill is an alternative asset manager that offers strategies across various debt and fixed income markets. Said Pines of his firm: "We [view closed-end funds] as a security type or a security structure that we can invest in within our five core asset classes."

When asked where else he currently sees value in fixed income, Pines said: "We've loved fixed-to-floating-rate preferreds [and] we think that's a great place to supplement a portfolio."

Liquidity

When the subject turned to the state of liquidity for CEF trading, Pines and other panelists said liquidity had become increasingly worse over the years. So much so, that Bramshill created a liquidity team to provide regular reviews of the firm's positions and strategies:

"When we're involved in closed-end funds we're typically trading more than the average daily volume, so we really need to be careful about pushing things around," Pines said.

Agreeing that the situation has worsened, Carolyn Murphy, Portfolio Manager, City of London Investment Management, said the liquidity environment is "odd" considering the multitude of pathways there are for trading and sourcing volume. But Murphy said she's optimistic: "You just keep plugging away, and we haven't found that we really have difficulty at the end of the day achieving our goals despite that." City of London is a boutique investment advisory firm that specializes in CEF strategies.

Bond said he likes the illiquidity of the closed-end fund market: "I think to me you need to think about closed-end funds as micro-cap stocks, because rarely do you find one that trades more than, say four million dollars' worth or five million dollars' worth in a day," the Cohen & Steers portfolio manager said.

Distribution Policy

Pines said Bramshill thinks of every closed-end fund as an individual security or company.

"Just like a company reports quarterly earnings, most of these closed-end funds, whether they're quarterly or semi-annually, you can think of it just like a company that has a cash flow," he said. If you can roughly predict a fund's free cash flow and expenses, then "you can make pretty good investment decisions on which closed-end funds are going to have to cut their distributions [and] which ones are going to increase their distributions," Pines added.

To hear more valuable insights from this panel, register to access a replay and review the full agenda of AICA's 2023 Fall Roundtable. The cost of the replay is $30 for access to all nine panels.