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CEF Discounts Remain Wide, Yields Attractive in Q4 2023

Business development companies (BDC) continued to rally in the fourth quarter of 2023, benefitting from stabilizing dividend policies and narrowing discounts, said John Cole Scott, AICA Chairman and President of Closed-End Fund Advisors (CEFA), on CEFA's 48th consecutive quarterly research call. Now is a good entry point for closed-end funds (CEF) and BDCs, Scott said in presenting the Q4 2023 review and outlook of the CEF and BDC universe on January 18, 2024.

Closed-End Fund Advisors (CEFData.com) tracks $750 billion in fund assets across 755 closed-ended management companies, which include traditional CEFs, BDCs, and interval funds.

Discounts

Scott says discounts at year-end were right around -7% for CEFA's 15 Major CEF Sectors Index, which benchmarks the seven most liquid funds by 90-day average trading-dollar liquidity in each of the 15 major groupings of funds, and includes many of the types of funds that Scott covered on the Q4 call.

Total CEFs

The average CEF ended the year at a -9.5% discount, with munis trading at a -12.4% discount, MLPs trading at a -12.1% discount, and BDCs trading at a -8.1 discount:

	Equity Funds	Taxable Bond	Municipal Bond	BDCs
Number of Funds	181	131	111	47
Total Net Assets ($M)	$126,398	$55,627	$56,580	$60,242
Total Gross Assets ($M)	$137,949	$81,764	$85,232	$130,845
Premium/ Discount	-10.8%	-5.6%	-12.4%	-8.1%
Market Yield	8.3%	10.5%	4.8%	10.1%
Average Net Assets ($M)	$698	$425	$510	$1,282

Municipal Bond Funds

At the end of 2023, discounts for munis widened by -4.4% year on year. But Scott also noted that the average discount for munis is "almost flat" since November 2021 — during the height of the pandemic — when he said many people assumed that states would lose tax revenue and offices would stay closed.

With total returns for municipal bond funds unlikely to reach their late-2021 price peaks in the near-term, Scott said those funds are currently attractive for tax-driven income investors with discounts ending the year with only one month-end wider in the past 25 years — going back to Fall 1998.

He noted that CEFA still diversifies portfolios into many sectors of funds with as many as 40 listed closed-end funds: "Whether it's a $2 million account or a $20 million account… [CEFA] can typically add [muni] exposure if we like the fund, and then if there's unexpected [market] pullback or unexpected gains, we can pare back or add more."

BDCs

BDC-sector discounts, while continuing to remain wide — especially for debt BDCs — were narrower in Q4 over the previous quarter. To provide some perspective, Scott said that BDC "NAVs have performed so well in the last two or three years that you can have discounts widening and still have positive market price performance in a very powerful way."

As of December 31, 2023, BDCs held a total of $301.4 billion in gross assets, including listed ($130.3 billion) and non-listed ($171.1 billion) BDCs. Most (70%) of these BDCs hold first-lien loans, and the majority are variable (86%) loans. Fourth-quarter NAVs for BDCs have yet to be released, but publicly traded BDCs continued to trade at a discount, averaging -8.44% year-over-year in 2023. That tracked closely with the 2014-2023 yearly average discount of -7.37% for BDCs.

At the end of the year, Blackstone and Blue Owl led the pack of all BDC asset managers in terms of AUM:

Sponsor	Gross Assets ($B)	No. of Funds	No. of Listed BDCs	No. of Unlisted BDCs	Gross Non-Lev Exp Ratio (%)
Blackstone	$61.5	2	1	1	2.09
Blue Owl	$47.5	7	1	6	2.07
Ares	$25.1	2	1	1	2.32
FS/KKR	$17.5	3	1	2	2.40
Golub Capital	$10.3	6	1	5	1.89

"The top four are half the gross assets of the universe for BDCs," Scott noted on the call.

Yield, Dividends, and Distribution

Market yield for the average CEF ended the year at +8.2%, CEFA data show. One-year dividend growth saw a +0.8% increase, while three-year dividend growth rose by +9.8%, with taxable funds and BDCs seeing the biggest impacts.

Municipal bond funds aside, the average liquidity (90-day $ADV) of closed-end funds spiked in the fourth quarter of 2023 over Q3, finishing the year +15% higher than in 2023, Scott said.

CEF and BDC distribution increases also saw a spike in Q4 2023, rising +16.09% over Q3, while dividend cuts fell by -6.67%. That's good news as the number of announced dividend cuts were generally larger over the last 12 months and are now beginning to stabilize, Scott noted. "That should be a starting point for more investor confidence in where discounts will go and [it supports our belief that] the bulk of dividend policies will continue to stabilize or potentially go up," he added.

Scott noted that not all distribution increases reflect higher earnings, saying that some increases are simply intended to narrow discounts. Expanding on that note, Scott told Chuck Jaffe on the January 5 NAVigator podcast that he expects to see mild discount narrowing this year as bond funds rebound.

Listed BDCs

Scott also shared data on CEFA's Q4 call showing that the distribution growth rate for debt BDCs over the last 10 years has risen by +120% as of December 31, 2023. He said that debt BDCs should outperform equity markets going forward, especially if shareholders are thoughtful on managers and fee structures.

The average liquidity (90-day $ADV) of BDCs in Q4 rose +21% over the previous quarter, climbing +41% year on year, Scott said.

Activism

Activism continued to be a big focus of the CEF universe in Q4 and in 2023 generally, with the top five activists consisting of Bulldog Investors/SPE, City of London, Karpus Investment Management, Saba Capital Management, and SIT Investment Associates. At the end of the year, activists had $5.1 billion at work, rising to $19.8 billion when combined with the movement's followers.

During the call, Scott touched on the recent judgment in Saba-led lawsuit concerning CEFs and shareholder rights, saying he expects the outcome to set the standard. "If you own 20% of a closed-end fund, you should be able to vote 20% of your shares" by proxy, he said. "Closed-end funds are different than a private operating company versus a public [company], but if you don't want the public oversight giving people the ability to buy your shares, then you then you shouldn't be public — become an interval fund."

Initial Public Offerings

Following a slow 2022 for CEF and BDC IPOs and direct listings, 2023 saw none emerge at all. CEFA data analyzing current price (year-end) vs IPO over the last 12 quarters reveals that 69% of the IPO price and CEFs are at an average -14.60% discount. "This helps to explain why activism is so prevalent," Scott said.

Interval CEFs and Tender Offer Funds

Scott also touched on the rapid growth of interval funds and tender offer funds, pointing to CEFA data showing that as of December 31, 2023, there were:

- 89 interval funds with $88 billion in total AUM
- 196 tender offer funds with $228 billion in AUM.

The bulk ($171 billion) of tender offer funds are non-listed, private BDCs, Scott noted. The remaining tend not to be retail investor-friendly, he added. Most of the active interval funds were created over the last five years and are largely focused on asset classes such as global credit, loans, and structured credit.

CEFA tracks 285 non-listed strategies (interval funds, tender offer funds, and BDCs) totaling $316 billion in AUM — a sum that is swiftly "getting closer to gross assets of the listed universe."

Conclusion

The average closed-end fund was up +15% last year. In total, traditional CEFs held $305.2 billion in gross assets as of December 31, 2023. At the end of the year, the largest asset managers of traditional, or listed, CEFs were Nuveen, BlackRock, PIMCO, Eaton Vance, and Franklin Templeton:

Sponsor	Gross Assets ($B)	No. of Funds	No. of Sectors	Gross Non-Lev Exp Ratio (%)
Nuveen	$49.5	45	18	0.86
BlackRock	$48.8	51	22	0.76
PIMCO	$23.1	21	7	0.83
Eaton Vance	$20.4	23	7	0.96
Franklin Templeton	$13.2	29	16	1.10

From a much broader perspective, when looking at median CEF discounts over the last 25 years, Scott said the current scenario resembles that of the technical recession in 2018. Without predicting how things will eventually play out, Scott said tailwinds are in CEF investors' favor right now:

Despite the current overweight nature of the CEF sector, Scott believes a diversified closed-end fund portfolio can beat the general equity markets.

John Cole Scott's presentation also covered the impacts of leverage, activism, CEF institutional holdings trends, and NAV correlation across different sectors of the CEF and BDC investment universe.

Access the replay of [CEFA's Q4 2023 presentation and full slide deck] on CEFA's website. CEFA is an income-focused investment firm with an industry-leading database and a suite of model portfolios centered on the listed and non-listed universe of CEFs, BDCs, interval funds, and tender offer funds.

About CEFA

Closed-End Fund Advisors is a SEC registered fee-based registered investment advisory firm founded in 1989. CEFA has its headquarters in Richmond, VA. CEFA's primary business is discretionary customized asset management for income focused portfolios. Since November 2014 they have a BDC Fund with partner Smarttrust. In 2012 they built CEFData.com; the most granular and robust database of CEFs, BDCs and Interval Funds covering 330+ CEF and 240+ BDC data points. Visit [CEFA's website] to learn more.

About AICA

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