John Cole Scott Gives His First Take On 2024

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed John Cole Scott, President of Closed-End Fund Advisors and Chairman of the Active Investment Company Alliance. Read the Q&A below as John drills into the first-quarter data for closed-end funds. He notes that while municipal-bond funds still couldn't break out of their long-running slump, the first three months were a strong time for most closed-end funds (more than 90 percent were up for the period).

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

CHUCK JAFFE: We're looking at how closed-end funds came through the first quarter with John Cole Scott of Closed-End Fund Advisors, welcome to The NAVigator. This is 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, which is a unique industry organization representing 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 will point you in the right direction. Joining me today, John Cole Scott, he's president of Closed-End Fund Advisors in Richmond, Virginia, which is online at CEFAdvisors.com, and we're about to dig into closed-end funds using the firm's research, which you can do for yourself at

CEFData.com. John is also the chairman of the Active Investment Company Alliance, and you can learn about the alliance and about closed-end funds generally by going to AICAlliance.org. John Cole Scott, great to have you back on The NAVigator.

JOHN COLE SCOTT: It's always good to be here, Chuck.

CHUCK JAFFE: First quarter, really interesting, and so much there that we may have to have you back later to talk about the outlook for the rest of the year. But let's dig in because, yeah, this was a very interesting time for closed-end funds.

JOHN COLE SCOTT: Yes, so we really want to do a high-level cover of the trends we saw this quarter, of course next week on April 24th we'll be doing a full in-depth research call, your listeners can listen to it at CEFAdvisors.com/quarterly, but we first want to talk about the asset levels at the end of the quarter. Traditional closed-end funds ended with about $310 billion in gross assets across about 423 funds, equity funds were $142 billion in 181 funds, taxable bond funds, $81 billion across 131 funds, and tax-free muni bond funds, $86 billion across 111 funds. When we look at the leaders in that space, Nuveen is the largest sponsor by assets, and they have $54 billion in 45 closed-end funds across 18 different peer groups, but BlackRock is the largest by the number of funds with $48 billion in 51 closed-end funds across 22 peer groups. We then want to look at BDCs, and BDCs had total assets of $319 billion in gross assets across 147 funds, 50 listed on exchanges BDCs, $142 billion in gross assets and, 97 non-listed or private BDCs, $177 billion, one of the fastest growing groups in our universe of funds, and again, five BDC sponsors are 53% of those assets, Blackstone, Blue Owl, Ares, FS KKR, and Golub.

CHUCK JAFFE: So let's move from that to interval funds.

JOHN COLE SCOTT: Yeah, so interval and tender-offer funds, there's 94 interval funds now, about $89 billion in assets, 10 years ago there were only 22 interval funds, and five years ago, 68. There's 115 tender-offer funds with $72 billion in assets, and that's the non-BDC tender-offer structure. BDCs are a smaller part of our universe, and we always feel like we're giving people a reason to consider them because you either love or hate them in a way, but there's 1,500 portfolio companies in the combined universe of listed and non-listed BDCs, the average BDC loan size is about $8.7 million and 73% of these loans are under $25 million, this is truly access to lending to private American companies. And BDCs have an 18-year quarter correlation of their NAVs to muni closed-end funds of 0.13 to preferred closed-end funds of 0.33, to REIT real assets of 0.36, and even senior loan high-yield bond funds of 0.47, these are diversifiers if you've ever seen one. And we find BDCs really are one of the best places to blend manager analysis, data trends, and they tend to be more volatile than traditional closed-end funds, so you typically can react and be active, and potentially make more money.

CHUCK JAFFE: And I'm glad you pointed it out, because there was a guest on *Money Life* recently who was talking about how he doesn't find them all that investable, he's like, "On the one hand I like the story, on the other hand I don't like the risk." So that tends to show up when people who do not like risk and things like discount, so let's move from BDCs to discounts.

JOHN COLE SCOTT: Yeah, so for the average traditional closed-end fund, they ended the quarter about a 6.5% discount, which is versus the 25-year average of 4.5%, and only a month-end wider discount in the last 25 years 15% of the time, so not the extreme levels of 90 days ago but still very attractive historically speaking. For equity closed-end funds, they ended the quarter at about a 6.9% discount versus a long-term 6% average, and the month-end wider about a third of the time. And to highlight some sectors there, MLP funds ended the quarter at about 11% discount, and during the quarter about a 2% narrowing. REIT real asset funds narrowed about 4% to about a 5.7% average discount end of the quarter. Then we start to look at taxable bond funds, 3.4% discount, which is actually its 25-year average, that sector has had a healthy recovery in the last 90 days, month-end wider only 45% of the time. And some sectors of note, convertible bond funds had 4% narrowing to about 2% discounts, and senior loan funds had about 3.6% narrowing to 4% discounts. Another big sector of interest to a lot of income investors are muni bond funds, they ended the quarter at a 10% discount to net asset value, which is about a 2.5% narrowing. It's of note that 98% of muni funds had a discount at the end of the quarter, and only 4% of the time are they wider than the end of this quarter. Though as you might remember 90 days ago it was 1% of the time, still very attractive. BDCs, 41% of BDCs ended the quarter at a premium with an average discount of -1.6% to net asset value versus their 18-year average of 3.6%.

CHUCK JAFFE: Yeah, that premium is what was scaring the person on *Money Life* away from BDCs at this point. But what of course attracts people, whether it's BDCs or closed-end funds, is yields, how have payouts been looking?

JOHN COLE SCOTT: Answer that in a moment, but of course if you don't like the volatility you can use private or non-traded BDCs and get the access without the market listing, and that is a choice as an investor.

CHUCK JAFFE: Good point.

JOHN COLE SCOTT: Let's go back to yields. So the average fund is measured by our 15-sector index, ended the quarter at 9.5% forward-looking yield, and their one-year dividend growth is about 7%, which is a much different change than a year ago. When we think about discounts and leverage, we love the concept of leverage-adjusted NAV yield, the average fund was 7.6%. So if we think about the 7.6%, take away leverage, take away the discount, that's 25% more forward-looking yield than the manager has to hit to meet that policy set by the board, that's a powerful thing. And if for our client portfolios it tends to be a third higher, really even more magical with our work. Equity closed-end funds, about a 7.7% yield, only 13% leverage there. Taxable bond funds about a 10% yield with 25% yield. Muni closed-end funds, a 5% yield with 31% leverage. And to note because it's been a big issue, especially last week with Bryce on the podcast, the average cost of leverage is at 4.6%, and as the average coupons go higher, this becomes additive and beneficial to investors and should be an outcome for the year. It's worth noting this 5% yield, for high-income earners why this structure's so attractive, can be an 8-9% tax-equivalent yield, which is really powerful if you're a tax-driven investor. Now you should note the average duration is at 11, so it's a real-duration asset. And to close out the list for BDCs, they actually have an indicated yield of 10.4% and use about 51% total leverage on average.

CHUCK JAFFE: And for anybody who missed that connection there, Bryce Doty from Sit Investment Associates was on The NAVigator last week and he has said before, and was saying again, that muni bond funds using leverage, he finds that trend a bit alarming and he worries about them, and so now you know the leverage cost and the rest in there. And all of that brings us to performance, how good was the first quarter?

JOHN COLE SCOTT: Well, our clients are pleased and hopefully our listeners are pleased as well. The average fund measured by our 15-sector index was up 8.3% for the quarter, and about 4.5% was NAV and about 3.5% was discount narrowing; 91% of closed-end funds were positive in the quarter, total return on a market price basis. Some of the net asset value or manager or sector standouts were MLP funds, up 13% and mid change year to date, preferred closed-end funds were up almost 6% year to date, but of course there were some losers too. Muni funds were actually -0.6% year to date on a NAV total return basis, and REIT real assets were -0.4% NAV total return year to date. Think about muni funds, 90% of muni closed-end funds were positive total return, but 57% were negative NAV total return, really showing that discount narrowing in the headwinds of the current interest rate environment.

CHUCK JAFFE: We just finished the first quarter, which means we're getting into proxy voting season. Are there activist issues that you are thinking are going to be big plays and talked about a lot during the next couple months?

JOHN COLE SCOTT: Yes, so we'll cover it deeply next week. I also did a CFA talk for the CFA Virginia group in January, that's posted on our website, that's only on activism for a really deeper dive, but there are a lot of active players. The best known and most known is Saba, which has $4.2 billion in this universe of funds. Karpus has $2.3 billion, Sit has $2.1, Allspring has $1.2 billion, 1607 Capital has about a billion, as does City of London. Lazard has about a half billion, and Bulldog, a very well-known activist has about $200 million. That combines to about $12.5 billion of activists or focused managers that are maybe pro-structure but push on funds, about 5% of the market cap, and we really do expect some tenders, some standstill provisions. It wouldn't be crazy to have Saba take over one or two more funds this year, they've got a lot of ownership and a lot of ammunition and a lot of marketing power, and has really made this sector pretty scared, but overall that could lower fees, it should narrow discounts, and most funds will live to see another day.

CHUCK JAFFE: John, great stuff, always is. We will continue this discussion soon, thanks so much for joining me on The NAVigator.

JOHN COLE SCOTT: Always great to be here, Chuck.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. And yes, I'm Chuck Jaffe, you can learn all about my hour-long financial podcast by going to MoneyLifeShow.com or by searching wherever you find great podcasts. And if you're looking for great information on closed-end funds, interval funds, and business-development companies, well, AICAlliance.org, the website for the Active Investment Company Alliance has it for you. They're on Facebook and LinkedIn @AICAlliance. And their chairman is John Cole Scott, he's also president of Closed-End Fund Advisors in Richmond, Virginia. And speaking of great ways to do research on closed-end funds and learn more, CEFAdvisors.com and CEFData.com will do that for you with John. He's on Twitter @JohnColeScott. The NAVigator podcast is new for you every Friday, make sure you don't miss a single episode by following along or subscribing on your favorite podcast app. We'll be back next week, and until then, happy investing everybody.

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