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AICA Panelists Say Credit, Muni CEFs Help Tame Inflation Risk As Rates Fall

With the presidential race resolved and as rates continue to fall, investors with fresh questions about how Trump 2.0 policy will impact inflation should consider diversifying to credit-focused closed-end funds (CEFs) and municipal bond fund CEFs to manage risk, two panels of wealth managers said, respectively, at a recent conference in New York City.

The Active Investment Company Alliance (AICA) held its 2024 Fall Roundtable in lower Manhattan on November 13, 2024, and featured nine panels, including the two in question, both of which explored managing inflation risk in a changing rate and political environment.

Panel One: Credit-Focused CEFs

When pressed to prognosticate about the future of inflation, Kristofer Pritchett, a Managing Director and Portfolio Manager with Ares, said consensus around a soft or hard landing remained elusive and that some level of market uncertainty will remain going into next year.

However, he said Ares, a global alternative investment management firm with $464 billion in total assets under management (AUM) — including $335 billion focused on credit assets — was primed to turn volatility into opportunity through its Ares Dynamic Credit Allocation Fund, a closed-end management investment company with the NYSE ticker symbol ARDC.

Even though the current "higher-for-longer" rate environment continues to fluctuate, we expect ARDC to continue to perform well and deliver positive outcomes based on our experience navigating prior changes in political and rate environments, Pritchett said.

"I think what makes the rate environment interesting for this product in particular, is that because ARDC touches on loans and CLOs at a floating rate and bonds that are fixed, we can now start to move between those asset classes as this rate curve moves around and start to pivot," he added.

However, he cautioned that because dislocations in the current environment are a lot shorter — sometimes even a matter of days — investors need to be “nimble” and “dynamic” and “proactively react” to what they think is going to happen to the market.

“Today you need to be in a dynamic fund that allows you to move between those asset classes … rather than having to allocate at a high level,” Pritchett said.

Joining Pritchett on the panel was Christopher Remington, a Managing Director and Institutional Portfolio Manager with Eaton Vance, now a part of Morgan Stanley Investment Management — a $1.7 trillion global asset manager.

Remington concurred that investors should expect inflation to linger into next year and that credit markets offered a potentially useful hedge against that outlook. “Bank loans in particular check a number of boxes,” he said. Consensus expectations for many asset allocators are that long rates will fall and inflation will further subside next year — there are risks if neither happens. “The anti-bond structure and high coupons of loans protect on both fronts.”

He noted that Eaton Vance is also positive on CLO debt tranches and observed that investors are under-allocated in this area as well as to credit strategies more generally — a phenomenon he said has cost investors’ performance and could hinder optimal outcomes ahead. “The positive macro backdrop is supportive air cover for credit fundamentals, and on a relative basis loans and CLOs are bright spots in a dark sea of extended valuations.”

For loans in particular, Remington highlighted opportunity in the open-ended Eaton Vance Floating-Rate Advantage Fund, ticker symbol EIFAX. “This strategy has a yield and performance character similar to loan CEFs, without the common vagaries of premiums and discounts,” he said.

And for CLO debt investing, Remington highlighted his team’s new closed-end interval fund, the Eaton Vance Floating-Rate Opportunities Fund, ticker symbol FROIX. “Both sport high single-digit yields in the neighborhood of long-run equity market returns, with income delivered contractually and with negative correlation to bonds — an attractive mix.”

Panel Two: Municipal Bond Fund CEFs

The second Roundtable panel focused on municipal investment grade access in a moving rate environment and likewise explored its potential impacts to fixed-income investing. The speakers — Miguel Laranjeiro, Investment Director at abrdn, and Ryan McDonald, Managing Director, Municipal Fixed Income at BlackRock — were especially bullish on the potential for market opportunities based on market movements following the election.

Laranjeiro said the election results and Trump's proposed policy agenda spurred "slight sell-offs" in markets across fixed-income that he said signaled potential investment opportunities in municipals.

"In municipals, we've seen supply tick up 40% or so" and the next couple of quarters could see a market rally," Laranjeiro said. "With investment-grade yields at roughly 5 [to] 5.5% tax-equivalent yield, we think now is a good time to get invested … in the municipal market."

abrdn manages the National Municipal Income Fund, a closed-ended, tax-free municipal bond fund with the NYSE ticker symbol VFL. Its diverse investment sector approach includes hospitals, airports, and higher education. It also has a focus on charter schools.

"We think this administration is constructive on school choice," Laranjeiro said. "With that we think there's some additional federal funding and stimulus" possible that would boost charter school fundamentals, he added.

BlackRock's Ryan McDonald also pointed to municipals as a potential hedge against risk. "From a credit spread perspective … when you think about the all-in yield and you tax adjust it — high yields offering 8, 8.5 %, investment-grade offerings a little less than that, closer to 7% — it's really, really attractive." Similar to admonitions from the first panel, McDonald urged investors and advisors to be mindful of future Fed policy and duration risk.

McDonald also highlighted the advantages of the closed-end wrapper, saying that because CEFs obviate the need for daily redemptions, they help portfolio managers better weather market turbulence and position for potential outflow cycles. That's better than having to be fully or close-to fully invested in a mutual fund, he said.

He also said further rate cuts could help improve the cost of leverage, which he said still has some appeal among fund managers. "We're seeing closed-end fund dividends still at an elevated level relative to what they're able to generate on a tax-exempt yield basis," McDonald said. "There's an element of return … that is included in those distribution rates that I think most fund complexes are hoping the yield curve normalization ultimately will allow them to sort of grow those yields into where their distribution rates are," he added.

Visit AICA's website to view the 2024 Fall Roundtable agenda, interviews, and panel videos.

Resources

Learn more about:

- Kristofer Pritchett, Ares Management, and ARDC
- Review the individual fund profile for ARDC at CEFData.com
- Christopher Remington and Closed-end funds at Eaton Vance
- Miguel Laranjeiro, VFL, and other closed-end funds at abrdn
- Review the individual fund profile for VFL at CEFData.com
- Ryan McDonald and BlackRock