2024 In Review: John Cole Scott On How His Forecasts Turned Out

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Chuck Jaffe, in this episode of The NAVigator podcast interviews John Cole Scott, President of Closed-End Fund Advisors. John revisits the forecasts he made for the closed-end fund business a year ago and to grade himself as a soothsayer. Having made his 2025 calls for closed-end funds a week ago, he puts some weight behind his prognostications by showing that, for the second year in a row, the data that's now in the books proved most of his predictions to be correct.

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CHUCK JAFFE: John Cole Scott from Closed-End Fund Advisors is here, and we're seeing how his forecast for 2024 actually turned out, 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 is brought to you by the Active Investment Company Alliance, 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, and today, well, we're looking at the directions John Cole Scott pointed last year. Now John is the president of Closed-End Fund Advisors in Richmond, Virginia, which is online at CEFAdvisors.com, and we're digging into the firm's research, which you can do for yourself, at CEFData.com. John was here last week and he was giving his forecast for 2025, and he did that first rather than reviewing 2024 because he likes to be efficient with the data and he wanted to wait until he was absolutely sure how 2024 played out. So if you missed what he was saying about his expectations for 2025, go back and listen to The NAVigator last week, now however, we're going to look back at what he saw happening in 2024 and see where things turned out right, which is pretty much all of them, or wrong. If you want to get more information, again CEFAdvisors.com, John is also the chairman of the Active Investment Company Alliance which is online at AICAlliance.org if you're looking for more information on closed-end fund investing. John Cole Scott, Happy New Year, welcome back to The NAVigator.

JOHN COLE SCOTT: It's always good to be here, Chuck. Happy New Year to you as well.

CHUCK JAFFE: Let's jump right in because you made a number of predictions last year, basically there were eight predictions, although a few of them had a few different tentacles. So let's dig in, starting with your first one, which was that you thought that the 15-sector index would beat the S&P 500 equal weight, and that one worked out for you.

JOHN COLE SCOTT: It did. So our 15-sector index, which is only 24% US common stocks and definitely not overweight large cap growth, did 19.5% to New Year's Eve total return, a large part of that was a 6.7% discount narrowing. There was a discount high on December 9th, and it did a bit of a pullback into the year, which is partially why we waited to do this final report, but really, you know, just 1% pullback in the last three weeks. And RSP, which is the ETF that covers that index, was only up just under 13% on the year, so I call that an easy win.

CHUCK JAFFE: Absolutely, that one was a pretty easy win. Your second forecast involved yields, I'll let you explain how it turned out.

JOHN COLE SCOTT: Yeah, so because of activism and defensive posturing by the funds, we chose the forecast that we thought there would be above average fake yield, which means yields that weren't based on economic return of credit and net investment income or total return from equity funds, and the best way to make that answer in our opinion is we looked at the leverage adjusted NAV yield of this index, which backs out discounts and leverage, it was 7.5% last New Year's Eve, and this New Year's Eve in 2024 it was 8.5%, that's 13% more, which tells me a lot more aggressive over distribution of performance to shareholders every month or quarter. And the other way to look at it was that return of capital numbers, while relatively similar on a one-year basis, just under 42% in '23, just above 40% in '24, but the destructive return on capital we calculated was about four points higher in '24, which tells us that the NAV performance is not fueling the over-return of capital. So I would say that's relatively a solid win because discounts have narrowed and distributions have stayed higher, not because of credit results or just economic results of the manager.

CHUCK JAFFE: That's right. So first two out of the box, working for you, your third look-ahead last year was about the January Effect. You thought we would have one, but that it would be muted, explain how it turned out for you.

JOHN COLE SCOTT: We look at the average January Effect and it's historically been on average 2.6%, we've had it eight of the last 10 years at CEF Data and the lowest it's been really has been 1.5%, if it happened, and this year it was 2.3%, so while it was above the lowest, it was below the average. I would call that muted, though maybe moderately muted, not fully muted.

CHUCK JAFFE: So another one on the right scale here, you've been three for three. One of the things you have to look at if you're in the closed-end fund space and you're looking at the year ahead is discounts, and those worked out pretty well for you too.

JOHN COLE SCOTT: Yeah, so at New Year's Eve last year the average discount for the index was negative 7.1%, not just us, many firms were talking about how exceptionally wide that was historically speaking. We basically went to +0.06% New Year's Eve, which is within maybe 10 basis points of where they were on 12/31/21, which really means we had a full recovery. I had actually called for a halfway recovery, we got more recovery than expected, it's the right way to be wrong if you're going to be wrong about these things, and we really did look that bond discounts would narrow more than equity, and we did find that to be true. The equity funds went from basically a 12% discount to 7.8%, +4% give or take, the taxable bond index went from -6% and change to -1% and change, +5%, and the muni bond index went up from up 4.5% on the year and the NAV was only up 2% total return, and if we had done it three fourths of the year, discounts went 3.5% during the fourth quarter, so munis had a blowout for nine months and then pulled back but still did above equity, so we were right that bonds would rule the year for closed-end funds as a group.

CHUCK JAFFE: And now four for four. The activism front, another key area for you?

JOHN COLE SCOTT: Yeah, we really wanted to highlight that we thought there'd be more tenders in the universe, and so we looked at '22, there were 11 tenders, about $250 million, in '23 there were 13 tenders at $417 million, and in '24 there was 44 tenders at $3.2 billion, so definitely more capital returned to shareholders. We looked at share redemptions, really buying back stock, which is another common thing closed-end funds do, it was just under a billion dollars in '22, just over a billion dollars in '23, and almost two billion dollars in '24, to me that's more defensive stature of the fund sponsors trying to narrow discounts. And there were 24 mergers this year, that's not a huge number of funds involved, but still that was an active part of funds reorganizing and trying to trade better in the market. The last thing we talked about was the management fee reduction, the year-end management fee was roughly 1.19%, at the end of this year it was 1.09%, so about an 8% reduction. It may sound small on basis points, but 8% is a fair amount to lower your fees in a given year.

CHUCK JAFFE: So we lumped activism together, but it was tenders, share redemptions, mergers, and fee reductions, and if we had to break them out it would be, yeah, one win or four wins, any way you cut it, you're on a streak. Then we got to where you said we would see outperformance in infrastructure, covered calls, muni bonds, and multi-sector bond funds.

JOHN COLE SCOTT: Yes, and sadly infrastructure underperformed, covered calls outperformed, munis underperformed, but multi-sector outperformed, so basically that side was flat.

CHUCK JAFFE: So it was half and half, that's the bad side, and then of course <ding> is the good side, so yeah, you're split decision. For underperformance you said it would be high yield, convertibles, and real estate funds.

JOHN COLE SCOTT: And yes, high yield underperformed, convertibles did not, they're one of the better performing at almost 22% this year, but REIT real assets also underperformed. So again, a slight edge in our favor but I'd call that basically a neutral to slightly correct. Our crystal ball was a lot worse on sectors than it was on structure.

CHUCK JAFFE: If we were trying to be generous, we would say you got four out of seven, that would be a win. However, the fact is that in that win there were three in which <buzzer>, so yeah, no better than a draw, I think. I think you expect your performance to better than that.

JOHN COLE SCOTT: Correct.

CHUCK JAFFE: Your seventh area of forecast was your outlook for BDCs.

JOHN COLE SCOTT: And again, they had such a phenomenal '23, the words that we chose were a tricky '24 and muted dividend growth as we expected them to hold their reserves for eventual problems, higher cost of leverage, lower non-accruals, writing down fair market value, so it's still a good year, BDCs are 10% on the year, nobody should be sad about 10% in a credit fund. The dividend growth was literally 0.2% for the index versus last year, 30%, I think we got that relatively correct.

CHUCK JAFFE: I think so too, which leaves us with just one area. And again, it's one area, so we can score it as a group or we could look at individuals because you always pick five funds for the end of the year. You picked five, and although I know you don't consider them all winners, they were all up at least double digits, so they couldn't have been too bad.

JOHN COLE SCOTT: The first one was DIAX, it's a Dow Jones covered-call style fund, it was up 16.5% on the year but still about 4% behind a peer group average, because those peer groups have a lot of S&P 500-oriented funds that did much better but was not our call. We had in the infrastructure space ASGI, it was up 10 and low change percent in '24, but about 7% behind its peer group average, but to be fair, it's a less homogeneous peer group, and so that's just sometimes the way it works in peer group analysis. We had a nice senior loan fund, BGB by Blackstone, it was up almost 19% on the year, which was 2% more than the peer group average. And then we had the muni fund RFMZ, which is up 10% total return on the year, which is four and change percent over the peer group average, so very pleased with that. And then there's BCSF, a BDC, it was up almost 30% in '24, 18% over the peer group average we just talked about. And I did check the previous two years, those two years the BDC pick did very well as well. We never recommend only owning one BDC, but we are happy so far. We picked one outperformer three years in a row, we hope for a fourth next year. On average it was 12% over the peer group, and basically two thirds were credit funds when the equity markets were on fire.

CHUCK JAFFE: Again, you can't argue much with 12%+ on average, and of the five, three of them finishing on the right side of their peer group average as well. Again, if I wanted to be picky, I could play your wins and your losses, but overall <ding>. So John, a stellar year, like this is not bad if you can play that many bells and that few buzzers. We hope of course you're going to do as well in 2025, but we'll be watching, and I know we'll be talking with you as we see things play out, so thanks so much for joining us. Thanks so much for being willing not only to make your picks but to stand up behind them and talk about how they turned out, warts and all, which in this case, not too many barnacles on these ones.

JOHN COLE SCOTT: No, an above average year, and we hope for a similar next year, our clients would all be happy.

CHUCK JAFFE: Great stuff, John. Thanks so much, we'll talk to you again soon.

JOHN COLE SCOTT: Cheers.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. And yeah, I'm Chuck Jaffe, and you can learn more about my show and me by going to MoneyLifeShow.com or by searching for the show wherever you find your favorite podcasts. If you want to find your favorite closed-end funds and business-development companies, you might want to go to AICAlliance.org, that's the website for the Active Investment Company Alliance, and if you have questions about closed-end fund investing, send them to TheNAVigator@AICAlliance.org. Thanks to my guest John Cole Scott, he's the chairman of the Active Investment Company Alliance and he's the president of Closed-End Fund Advisors in Richmond, Virginia, the firm is online at CEFAdvisors.com and you can dig into their data at CEFData.com. John's on X or Twitter @JohnColeScott. The NAVigator podcast is available every Friday, make sure you don't miss an episode by following along on your favorite podcast app. We're back with more closed-end fun next week, and until then, happy investing.

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