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In A Tight-Spread, Higher-For-Longer Rate Market, Discounts Matter Again

Why Muni And Taxable Bond CEF Discounts Just Flipped — And Where The Opportunity Sits Now



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On this episode of The NAVigator podcast, Chuck Jaffe sits down with John Cole Scott, President & CIO of CEF Advisors and chairman of the Active Investment Company Alliance, for a timely look at how a higher-for-longer rate market and tight credit spreads have reshaped closed-end fund discounts. John explains why national muni bond CEF discounts have narrowed while taxable bond CEF discounts have widened — effectively flipping their three-year relationship and the relative-value picture for income investors. He walks through how data-center municipal finance and a wave of taxable issuance (including an expected SpaceX financing) are reshaping demand, and applies his firm's “Trifecta Analysis” — discount, dividend, and NAV — to four funds he likes now from sponsors including Neuberger Berman, Aberdeen, DoubleLine, and PGIM. Listen to the full conversation or read the complete transcript below.

IN THIS EPISODE

- Why higher-for-longer rates and tight spreads matter for CEFs
- How muni and taxable bond CEF discounts have flipped
- Data-center muni finance and a wave of taxable issuance
- Building a duration barbell across muni and taxable funds
- Reaching for wider discounts — when it pays and when it doesn't
- Return of capital, mergers, and discount “healing”
- Four funds across muni and taxable bond CEFs

THE TRIFECTA ANALYSIS

1. Discount — absolute, comparable to peers, and relative to itself
2. Dividend — sustainability, taxation, and discount offset
3. NAV — manager, sector, leverage, and expense structure

The discussion is educational in nature and intended to help investors and advisors better understand the tools, trade-offs, and data points involved in evaluating income-focused strategies.

EXPLORE THE DATA REFERENCED IN THIS INTERVIEW:

- Free CEF & BDC profile pages: cefddata.com
- 40+ CEF & BDC indexes: cefddata.com/index

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THE CONVERSATION

CHUCK JAFFE

Interest rate and credit environments — and with them, closed-end fund discounts — are in flux. We're talking about where you can get paid for being patient, with John Cole Scott, President of CEF Advisors. This is The NAVigator.

CHUCK JAFFE

Welcome to The NAVigator, which is all about all-weather active investing and plotting a course to financial success using closed-end funds. The NAVigator is brought to you by the Active Investment Company Alliance, a unique industry organization representing the entire closed-end fund industry — from fund sponsors, creators, and managers down to users and investors. In the search for excellence beyond indexing, The NAVigator is pointing you in the right direction. Today we're looking in the direction of municipal bond and taxable bond closed-end funds, and we're doing it with John Cole Scott. He's President of CEF Advisors, where they produce great data covering closed-end funds, interval funds, BDCs, and ETFs — and you can learn about the firm and dig into its data for yourself at CEFAdvisors.com. John's also the chairman of the Active Investment Company Alliance, which you can learn about at AICAlliance.org. John Cole Scott, welcome back to The NAVigator.

JOHN COLE SCOTT

Always good to be here, Chuck.

CHUCK JAFFE

Let's start with interest rates and what we're seeing happen, because in the two spaces we're going to talk about — national muni funds and taxable bond funds — they're reacting in kind of different directions when it comes to discounts, as we watch the Fed try to figure out which way it's going to move next.

JOHN COLE SCOTT

It is. Even at the start of the year, we thought there was some chance for rates to go up, and even here in June we're not certain what will happen in the second half of the year — but I think a rate increase is definitely in the cards. There's also the possibility, whether it's late in '26 or sometime in '27, for rates to come down gently due to potential economic challenges that require support from the Federal Reserve. But because, as you can appreciate, we build a multi-factor portfolio, we try to build on both sides of that barbell — with muni funds tending to be above 10 in duration and taxable bond funds tending to be sub-five durations.

CHUCK JAFFE

You've got rates looking like they're going to stay higher for longer than people expected — again, we've moved from an easing bias to a tightening bias — and you've got spreads being tight. So what is that doing to discounts generally? Or is it not so much general, because each category is moving in its own direction?

JOHN COLE SCOTT

Yeah, it's interesting. These are rough numbers from last Friday's close, but the average national muni bond fund is at about a 3.5% discount to net asset value currently, versus a three-year average of seven and mid-change. And the taxable bond index is around seven and mid-change currently, but with a three-year average of roughly 3.5%. So it's really the inverse: there's been narrowing with munis and — not deep widening, but noticeable widening — with taxable bond funds. That's the lay of the land for the universe of closed-end funds we track at CEF Advisors.

CHUCK JAFFE

It can't just be about interest rates, though. The muni story has an interesting wrinkle right now, because all of the data centers that need to be located somewhere are, in some cases, finding a home through municipal finance. And then on the taxable side, you've got all of this capital-expenditure money going into AI, plus things like SpaceX and what they're doing — and that's creating new issuance, if not more demand, for taxable bonds. So how are current events beyond interest rates factoring into the markets?

JOHN COLE SCOTT

Absolutely. As you know, we're closed-end fund people at my firm — we're not stock people. I hear a lot about NVIDIA, but to me it's much more comfortable to get exposure to all the data centers and AI infrastructure that need to go in across this country through a discounted muni bond fund, because then we have possibly more upside relative to the risk involved — and it's definitely inside the wheelhouse of an income-focused, more conservative investor than a stock chaser.

JOHN COLE SCOTT

And then on the taxable bond side, this is an interesting story, because by the time people hear this podcast, SpaceX should be trading publicly, and they're expected to absorb about \$20 billion in short-term financing into the taxable bond market. That's a significant amount of debt, and some of it could trickle into the closed-end funds that we track actively at CEF Data.

CHUCK JAFFE

When it trickles in and you're tracking these funds, how does that impact things? As you're evaluating a portfolio — and as you pointed out, you're not a stock guy, you're a closed-end fund guy — I talk to a lot of long-term stock investors who say, “I don't want to touch anything SpaceX, at least for a while.” How does it play into how you analyze the portfolios?

JOHN COLE SCOTT

Yeah. At a high level, I personally think the multiple it's likely to come out at is almost 100x earnings — and yet, because of its size and history, it's also expected to be investment-grade rated. So I'd much rather get levered access to its bonds down the road than take a side on whether Morningstar is right in its thinking about SpaceX, or whether Elon and his friends are right about the future direction of SpaceX's stock.

CHUCK JAFFE

Let's move from those stocks back to the bond side of things. We're talking about demand and what's happening with the demand picture — that spread of discounts you were describing. How much is it worth it for somebody who's looking now to say, “Okay, I'm stretching for a bigger discount. Average isn't good enough; I want to be more toward the extreme”?

JOHN COLE SCOTT

Yeah. We generally like to weight our portfolios at a weighted wider discount to a peer-group average. Not every holding among the 30 to 40 positions will meet that criteria, but one of the reasons we're especially focused on it for muni bond funds is that they're relatively tight — not crazy tight; they go to premiums regularly. But with that risk of duration, if interest rates go up more than we plan, then durations of 10, 12, 13, 15 are going to be ugly, like they were back in '21 and '22 when we actually had rates go up. So a deeper discount there protects you, because if that were to happen, the first thing to move is discounts widening — and we're picking funds today that already have wide discounts, for a couple of different reasons.

CHUCK JAFFE

You're picking funds, you're looking at these things — and I know you didn't come here without a couple of funds for us to talk about. So let's start on the muni side. What's a muni name or two that passes your analysis — which, I should point out to the audience, is what you call the “Trifecta Analysis”? You can explain how it works, but what's a name or two, and why are they passing the screens for you?

JOHN COLE SCOTT

Absolutely. Really, it's the thoughtfulness of balancing the discount risk — comparable, relative, and absolute — with the dividend risk, which can be challenging in some sectors; it's not just whether the income is durable. And then there's the sector and manager analysis: leverage, expenses, holdings — just where we have opinions about where we want to lean. For example, in many previous conversations I've said I'm overweight senior-loan funds versus high-yield right now for these reasons, and then we're picking funds that line up with that NAV-analysis thesis.

JOHN COLE SCOTT

So the first one would be a Neuberger Berman muni fund. It's basically a little over a 10% discount, its yield is 6.3% and change, and it's worth noting that, like many muni bond funds, there's return of capital — but a lower amount than the peer-group average, because that's a great way these funds have been defending against activism. At a wide discount, return of capital is like a democratized tender — less painful than if you get return of capital out of a premium. The duration is 13, which is right in the middle, or just slightly above the peer-group average. We think it's a great way to get a well-regarded manager in the space, with pretty clean access to a good story, a moderate duration, and what we believe is some discount upside as markets transpire — whether that's six months or longer, because we're patient for our income needs.

JOHN COLE SCOTT

The other one is an Aberdeen muni fund. It's an interesting story this week because it's part of an Aberdeen merger — there have been lots of mergers. You may remember they've only IPO'd one closed-end fund; the rest have been mergers and acquisitions. Basically, it's just had its distribution go up, as Aberdeen has been doing for many of their funds, from a five and low-change to about 6%. Its discount is still wider than 10%, which is normal for merging funds — you tend to get wider discounts with the uncertainty of these mergers. The leverage number is lower, at 31%, than the 41% on the Neuberger Berman fund, and there's no reported return of capital currently — but I'll tell you, six months from now we'll probably start seeing some, based on the distributions. And the duration, while it's only 10 right now, based on the merged assets we expect to be closer to 15 or 16 once the data gets updated in CEF Data.

CHUCK JAFFE

And I just have to ask, because one of them has basically no return of capital: since you talked about both, if you were picking between the two — if somebody said, “Okay, I just want to diversify with one or the other” — is there a favorite? Is return of capital part of why you might lean in one direction, even though the yield is a little lower?

JOHN COLE SCOTT

What I'd say is that the wider you are from net asset value, the more benign even an unsustainable distribution fueled by return of capital becomes — with the caveat we say all the time on this show, Chuck, that you really need to not spend all those dollars; you should reinvest a portion. That's the main factor. The other interesting fundamental difference is that the Neuberger Berman fund is roughly 75% investment-grade, while the Aberdeen fund — and the expected combined merger — is just over 50% unrated and non-investment-grade. So you're really getting a different outcome because of the different mix of investments. We found these are both around a 10% discount, both solid funds, but with very different NAVs and a little bit different stories — and merged funds usually heal six to 12 months after the merger.

CHUCK JAFFE

Well, let's move from the muni funds to the taxable bond side, because I know you've got a couple of funds there too.

JOHN COLE SCOTT

It is interesting. Most closed-end funds are high-yielding — but then, how do you define high yield? Is it absolutely high, or is it actually fueled by high-yield bonds? That's a great story here. So you have a DoubleLine multi-sector fund, which yields about 10%, with a discount around 9%, leverage of only 16%, and a duration of just 3.2. What's interesting is that it's mostly a mix of ABS and MBS, plus another sleeve of senior loans and a little bit of CLO exposure — so really a multi-sector bond fund. One thing we liked about it is that it's a wide discount for the universe, even wider than the 7.5% average, but its net-asset-value rank is six out of 24, which means it's a wide discount but it hasn't been performing badly.

JOHN COLE SCOTT

Let's go to the other side of the coin and look at a true global high-yield fund, run by PGIM. It's almost the same nine-and-change discount, a little higher yield at 10 and mid-change, the same 16% leverage, and a duration a touch higher at 4.9 — and its net-asset-value rank is actually two out of 24. One of the interesting things is that in the top holdings you see bonds from Argentina, Colombia, and Egypt. I've said it before with other funds: these are not the type of credits most of your podcast listeners probably have often in their portfolios, and this is a chance to get them at a strong discount, with modest leverage and what we think is good global upside. One caveat about that leverage: it's low for these funds, which tells me that with a steep yield curve, if they choose to, these funds can tactically add more leverage when it's benign for investors — and possibly juice their yield even higher than the current portfolio.

CHUCK JAFFE

And let's remind people that all of the funds we're talking about passed your Trifecta Analysis. The trifecta discipline — well, trifecta, three things — but explain again what those three things are.

JOHN COLE SCOTT

That we're comfortable with the discount range, which is both absolute, comparable to peer groups, and relative to itself. Then the dividend analysis, which is the blend of how sustainable it is — and, as we talked about, if it's a little too high, the discount must offset that; you also have to consider taxation for equity funds and areas like that. And the net-asset-value analysis, which is the manager, the sector, expenses, and the leverage type and structure — things like that 16% possibly growing to 25% down the road in a more benign market. We blend those together as the positions on our closed-end portfolio team, and we try to make sure we have great overall data and that we like each position. Recognizing there's no perfect closed-end fund — I've been looking for it my entire life — we can usually massage to the right allocation for our outlook at CEF Advisors.

CHUCK JAFFE

And what it leads to is kind of what we're seeing now. You've always said: when you see discounts on the index, that tells you where to look; then you dig in, and that tells you what to buy.

JOHN COLE SCOTT

Absolutely.

CHUCK JAFFE

John, great stuff. Thanks, as always, for joining me on The NAVigator.

JOHN COLE SCOTT

Always good to be here.

CHUCK JAFFE

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