CLOSED-END FUNDS:
A Little Understood Path to Income

Investors increasingly seek dependable income as global economic growth slows and U.S. interest rates languish at historical lows. But where can you find income in today's low-yielding environment? Under the radar for many investors are closed-end funds (CEFs), which deserve a close look for their potential to generate steady, high income and complement a core fixed income portfolio.

ATTRACTIVE INCOME POTENTIAL

Closed-end funds are generally designed for regular cash flow. Because of their unique closed structure and ability to use leverage, CEFs offer potentially higher distributions than traditional income investments. In fact, the average yield for fixed income CEFs is 6.20% and the average yield for equity CEFs is 7.18%, compared to the 2.24% yield on 10-year Treasury Notes and 1.21% on CDs.[1]

AVERAGE YIELD

FIXED INCOME CEFs	EQUITY CEFs	10-YEAR TREASURY NOTES	CDs
6.20%	7.18%	2.24%	1.21%

[1]Source: Thomson Reuters Lipper. As of November 14, 2016

To acquire and retain clients, most advisors need to demonstrate the ability to create income and manage an income stream, particularly for their clients who are approaching or in retirement.

"We use CEFs as a complement to a core fixed income portfolio to generate high, steady income for our clients," says Scott Weingarden, JD, CFP®, CIMA®, vice president – Investments of The Starner Group at Raymond James.

"Recognizing that there may be volatility in the share price, we hold CEFs for the long-term. Even if the share price didn't move, we can take advantage of the high, consistent income CEFs provide, which is hard to get elsewhere. CEFs also work well for our high net worth clients who are looking for tax-free income," continues Weingarden.

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OPPORTUNITY TO BUY AT A DISCOUNT

A CEF's capital and number of shares are fixed once it completes its IPO. At any given point in time, a CEF's share price may be trading above ("premium") or below ("discount") its NAV. Over time, CEFs tend to establish premium/discount trading ranges, and these ranges can dictate the "fair value" of a CEF.

"From time to time, there can be profit-making opportunities by purchasing funds when their discounts to asset value widen beyond their historical trends. For these reasons, we have utilized closed-end funds as part of our asset allocations in order to help diversify client accounts over multiple asset classes, styles, regions, and strategies – typically picking up dividend income along the way," says Frank Abella, president and CEO at Investment Partners Group.

DIVERSIFICATION AND EXPANDED INCOME OPTIONS

CEFs can help investors achieve their income goals while maintaining diversified exposure across asset classes. Given the absence of daily inflows/outflows, the CEF structure also provides flexibility to invest in opportunistic and/or less liquid securities, allowing portfolio managers to employ certain strategies not typically available in comparable mutual funds.

The closed-end fund industry has historically focused on bonds, dividend-paying equities, real-estate, and geographically-concentrated vehicles. In more recent years there have been additions of funds offering other strategies such as covered call writing, asset classes such as master limited partnerships, and income-oriented products such as business development companies.

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— **Frank Abella**
Investment Partners Group

"Having these additional choices can potentially further diversify a client's asset allocation and spread risk," says Abella.

All investing comes with risk – whether it's market risk, sector risk, geographic risk, company-specific risk, just to name a few.

"The best way, in our opinion, to mitigate risk generally is through good-old-fashioned balance and diversification," explains Abella. "So, to that end, we've found that judicious use of closed-end funds can sometimes help manage the risk of investing by offering professionally-managed, diversified portfolios of long-duration assets which frequently trade at discounts to the value of the funds' underlying holdings," continues Abella.

WHY INCLUDE CEFs IN A PORTFOLIO?

In summary, CEFs help address a number of issues facing investors and advisors, including a need for income, concern about retirement, and uncertainty about interest rates. Granted, CEFs are structurally more complex than ETFs and open-end mutual funds, but the potential benefits may compensate. Financial advisors and investors who take the time to learn more about CEFs will discover a relatively unfollowed and often mispriced segment of the market. And as mentioned, CEFs are generally designed to generate regular cash flow across a wide spectrum of investment objectives.

CEFs:

- Income-focused investment strategies
- Trade on the exchange just like stocks
- Provide opportunities to buy at a discount
- Can invest in less-liquid investments and markets
- May use leverage and are able to borrow to a greater degree than open-end funds, potentially enhancing returns

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WHEN IN DOUBT, SEEK PROFESSIONAL GUIDANCE

Like with any investment vehicle, it is advisable to seek the guidance of a financial advisor who understands your unique needs and objectives, providing advice on how CEFs may fit into your portfolio as your financial landscape evolves.

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Understanding the Risks

Closed-end funds trade on exchanges at prices that may be more or less than their NAVs. There is no guarantee that an investor can sell shares at a price greater than or equal to the purchase price, or that a CEF's discount will narrow or be eliminated. CEFs often use leverage, which increases a fund's risk or volatility. The actual amount of distributions may vary with fund performance and market conditions. Past performance is no guarantee for future results.

Disclosure

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