Closed-End Fund Discounts Narrow Significantly

Once Ugly Ducklings, Junk Bond CEFs Trading at Near-Record Premiums

New York, February 13, 2001—Closed-end funds often trade at discounts to the assets in their portfolios, but the average discount has been cut in half since mid-December, according to Lipper, the leading provider of mutual fund information. The share prices of the more than 460 closed-end funds (CEFs) that trade on a stock exchange stood at a median discount of just 5.8% on February 9—down from 11.5% on December 15, 2000. The median discount of 5.4% on January 31 was the narrowest since April 30, 1999.

Taxable high-yield funds moved from an already-narrow discount of 1.4% in mid-December to a record premium of 11.2% on February 2, due in part to declining interest rates and diminished fears of a looming recession. And junk bonds aren't the only category with funds trading at a premium to their net asset values (NAV). Some 24% of all CEFs now trade at a premium, up from just over 10% on December 15.

“Closed-end fund investors seem to have realized that department stores weren't the only places to find discounted merchandise in December,” said Don Cassidy, senior research analyst at Lipper. “The market is very effective at ensuring that bargains don't stay that way for long. Many of these funds are now trading at close to their full asset values for the first time in nearly two years.”

“Several factors drove the narrowing of discounts,” Cassidy continued. “Prices of municipal bond closed-end funds got hit hard by tax-loss selling in December, and investors soon saw the bargains and outstanding tax-free yields that had been created in that sector by this ‘December/January effect.’ And in an environment in which interest rates have fallen sharply, the steady income from many CEFs begins to look attractive to risk-averse investors.”

Domestic equity funds have also seen discounts sliced by more than half, from 12.6% as of the end of last year, to 5.7% at present. The Federal Reserve Bank’s recent moves to lower interest rates have had a major impact on domestic equity CEFs, approximately 40% of which invest in interest rate-sensitive asset classes such as preferred stock, convertible securities, utility stocks, and real estate.

Closed-end funds, unlike mutual funds, do not redeem their shares daily from holders on demand. Most, but not all, CEFs trade on a stock exchange, offering daily liquidity at prices that may vary from their underlying net asset values reflecting supply and demand for their shares. Other CEFs conduct tender offers to offer liquidity to shareholders at share prices at or very close to the fund’s NAV. CEFs are regulated under the Investment Company Act of 1940. The more than 500 funds in the closed-end universe represent a total of $144 billion in common shareholder assets under management.