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- There are many attractive features of closed-end funds; one of the biggest is yield. Understanding the many available yield calculations is vital in picking the right fund.
- Quite a few closed-end funds have a managed distribution policy; using only the standard yield calculation in fund analysis may not provide all the needed information.
- While there are a slew of yield calculations from which to choose, the annualized yield, income-only yield, and 12-month yield calculations are the most common measures found online.
- Knowing the differences between the calculations and being able to compare and contrast each with the others help us understand the workings of the fund and how to make more-informed investment decisions.

A Yield by Any Other Name Would Smell As Sweet . . . ? Comparing Yield Calculations for Closed-End Funds

Foreword

*The Closed-End Fund Center uses Lipper data exclusively, and our Web site is the only place where you can simultaneously view two yield numbers: **income-only yield**, which refers only to the true income components making up the yield and which does not include any redistributed capital, and **distribution yield—**the total amount of all distributions made, regardless of their nature. We feel these two pieces of information are critical for understanding the true return from funds, especially those with managed distribution policies.*

Users of the Closed-End Fund Association Web site have asked how our data calculations compare to methodologies used to express yield on other Web sites and in print media. The following is a detailed explanation of various yield calculations.

Closed-End Fund Association

Introduction

Investors are attracted to closed-end funds for a number of reasons: professional portfolio management, diversification, the convenience of trading through an exchange, liquidity, the ability to buy the funds at a discount, and of course—and perhaps related to the last point—relatively high yields. Investors buying funds based on yield or dependent on regular distributions need to know the yield calculations that provide the investigative results necessary to truly assess the funds under consideration. There are many yield calculations that can be downloaded or calculated for a given security. Generally, we look to yield calculations to identify the current return on an investment, which is usually expressed as an annual percentage rate.

The question frequently arises as to which yield calculation one should use. And of course the answer is: it depends on what you're looking for. The different yield calculations can each give us a little piece of the puzzle. One calculation provides a yield based on all distributions passed through by the fund (income and capital gains), another may adjust the denominator by capital gains over a given period, and yet another may give us an annualized yield based on the most recent income-related distribution. Understanding the information relayed by the different calculations is very important to help us understand what the yields signify and how they can be used.

Annualized Distribution Yield (Current Distribution Rate)

The annualized distribution yield reflects the most recent income or dividend distribution—which is annualized and then divided by the most recent market price. A few of the Web sites commonly used for closed-end fund research use this yield calculation. An example follows for **General American Investors Company, Inc. (NYSE:GAM,** semiannual distribution frequency**).** GAM paid a dividend distribution on November 8, 2006, of $0.361393 per share. Ignoring the long-term capital gain of $2.638607 per share on the same day, the fund's distribution yield on May 31, 2007, was 1.78% ([$0.361393 x 2]/$40.63).

There are two assumptions made in this calculation. The first assumes the most recent distribution will be constant. The second assumes both payments will be made. In the case of GAM in 2006 neither was true. GAM made only one income dividend distribution; the other semiannual payout in 2006 was another long-term capital gain in the amount of $0.138 on January 26. And in the 2005 calendar year, when two income dividend distributions were made, they were radically different. This is not a negative reflection on GAM (a closed-end equity fund with a primary goal of long-term appreciation) but an issue with the annualized distribution yield methodology.

For a fund that does make regular and similar payouts the annualized distribution yield in fact does provide a telling yield result. For example, **Dreman/Claymore Dividend & Income Fund (NYSE:DCS**, quarterly distribution frequency**)** paid out $0.325 in February, May, August, and November 2006 (and since inception). The fund's distribution yield on May 31, 2007, was 5.86% ([$0.325 x 4]/$22.20). If we assume the distribution amount remains the same, the annualized distribution yield gives us a fair understanding of what might come in the future.

Another area of weakness for the annualized distribution yield involves funds with managed distribution policies. A managed distribution policy is an investment company's commitment to distribute a predictable—but not guaranteed—amount of cash distribution to its shareholders on a regular basis. The cash distribution can come in the form of interest and dividend income, capital gains, and/or return of capital. And here is where the annualized distribution yield can be a little misleading or potentially strongly overstated. If an investor is looking for a steady and consistent cash flow and doesn't mind receiving part of the flow from a return of capital, then the yield calculation provides just what the investor expects. However, because some of the payout may not be generated by the fund but is in fact a return of capital previously paid in by the investor, the annualized yield calculation does not provide the whole story.

For example, **Alliance All-Market Advantage Fund, Inc. (NYSE: AMO**, quarterly managed distribution policy**)** paid out $0.360 in June 2006, $0.322 in September 2006, $0.320 in December 2006, and $0.364 in March 2007. The fund's annualized distribution yield on May 31, 2007, was 10.13% ([$0.364 x 4]/$14.37)—quite a handsome yield for a growth equity fund. Obviously, not all the distributions came from an interest or dividend income source. To ferret out just how much was income-oriented, we could wait to see how the fund characterizes the distributions on its 1099DIV form at the end of the year, or we could look to the annual report to see how much was income-oriented.

Income-Only Yield

To understand the portion of the return actually being generated by income sources (interest or dividend income), we can take a somewhat historical look at the net investment income (NII) in the annual report and divide it by the fund's average net assets (ANA) for the period under review. This gives us a better picture of the fund's yield—as we have perhaps historically viewed "yield." AMO's September 30, 2006 annual report showed that net investment income was booked as a negative $790,821 (negative NII is common for growth-oriented equity funds; they generally do not purchase many dividend-paying or interest-oriented securities). Extracting the fund's ANA from the annual report, we see AMO had an income-only yield of minus 1.54% (-$790,821/$51,307,000). An obvious conclusion from comparing the two different yield calculations is that the entire annualized distribution yield came from realized and unrealized capital gains and possibly from a return of capital. Since a negative yield is nonsensical, the yield probably should be capped at zero on the downside.

Putting income-only yield results in perspective, we gain a great deal of knowledge about the fund. Firstly, the findings in our comparison above are neither negative nor positive, but both are informative. They show that for a person looking for a regular, steady stream of cash payments, the fund is doing its claimed job; however, the findings also show that the yield being used in many cases overstates the actual "income-generation" capabilities of the fund.

Users of the results of the income-only yield calculation should keep in mind that it is a historical snapshot of the fund for the period presented in the annual report. That can be very telling. However, if the distribution policy changes and amounts increase or decrease during the current measurement period, the yield—or lack thereof—will change as well. So, comparing the income-only yield with an annualized distribution yield or with a 12-month distribution yield provides differing results.

12-Month Distribution Yield (Market Yield)

Another shortfall of the annualized distribution yield is its inability to provide, from a historical perspective, the true yield of the fund. As pointed out above in the GAM example, there are two assumptions made for the annualized distribution yield: that the most recent distribution will be constant and that the regular periodic payments (semiannual, quarterly, or monthly) will be made. In the case of GAM neither was true in 2006. GAM's annualized distribution yield on May 31, 2007, was 1.78% ([$0.361393 x 2]/$40.63). However, as was previously stated, the fund had only one dividend distribution—$0.361393 in November 2006—along with two capital gains distributions—$0.138 in January 2006 and $2.638607 in November 2006. Yet, the annualized distribution yield assumed two dividend distributions.

Using the 12-month distribution yield calculation provides us a different piece of the puzzle. The calculation takes into account all cash payments (all distribution types) paid by the fund over the 12-month period being reviewed. For example, GAM's market 12-month distribution yield on May 31, 2007, was 7.38% ($3.00/$40.63).

By putting the puzzle pieces together (using GAM as an example), we can gain a better understanding of what the fund is really providing in the way of yield. GAM's annualized dividend yield was 1.78%, its market yield was 7.38%, and its income-only yield was 0.86% ($10,007,624/$1,162,008,000). Each piece is telling and useful in our fund evaluation process. While there are many other yield calculations, the three calculations presented here are the most common ones found online for closed-end funds. Knowing the differences between the calculations and being able to compare and contrast each with the others help us understand the workings of the fund and how to make more-informed investment decisions.

Because of the limitations (discussed earlier) with the annualized distribution yield commonly found on other Web sites, Lipper and the Closed-End Fund Association agreed that presenting the two truest yield calculations—income-only yield and distribution yield—would be the most beneficial to users of the CEFA site. And while it might have been handy to present the annualized distribution yield as well, the inclusion of a third yield measure would have added a great deal of complexity for the casual user.

Both yield measures presented on cefa.com provide users a broad-based picture of funds' distributions. For investors seeking cash payouts the distribution yield presents a fair picture of the historical yield of funds, including all distribution types during the most recent 12-month period. The income-only yield provides an accurate picture of how much income generation funds are truly supplying, even if only on a historical basis. Large discrepancies between the two types of yield, not explained by the timing differences, can be a flag for investors to dig further into funds' information to determine the sources of the yield. This is a particularly strong analysis for funds with a managed distribution policy.

Because of confusion surrounding yields for closed-end funds with managed distribution polices, the SEC has issued a moratorium on approval of new managed distribution policies until a suitable disclosure method can be devised and becomes widely understood. Until then, using these two yield measures should aid investors in identifying funds that fit their needs.