Lipper's Apr-May Closed-End Fund Market Review

Tom Roseen, Head of Research Services with Refinitiv Lipper and author of the Fund Market Insight Report which provides in depth monthly commentary on the closed-end fund market and the Closed-End Fund Association discuss Tom's insights on February's closed-end fund market action. The podcast audio can be heard here.

Tom Roseen

CEFA: **Welcome to CEFA Insights, your source for closed-end fund information and education, brought to you by the Closed-End Fund Association. My name is Diane Merritt. Today we are joined again by Tom Roseen, Head of Research Services with Refinitiv Lipper and author of the Fund Market Insight Report, which provides in-depth monthly commentary on the closed-end fund market. We are happy to have you with us today, Tom.**

TR: Hi Diane, it's great to be with you.

CEFA: **Tom, you recently published your report covering April 2020. You study over 500 closed-end and interval funds regarding performance, premiums and discounts, and corporate activity. Since we spoke last month markets seem to have improved. What has been the general impact on closed-end funds, and does the activity in closed-end funds reflect what is occurring in the broader market?**

TR: You know, as we've talked back before, we've talked about closed-end funds or open-end funds or securities in general, it really doesn't matter in this case. Investors cheered the Federal Reserve's commitment to do whatever it takes. They were also excited to hear about the soft reopening that's been created in several states, where several governors have at least partially opened up part of their economy. And also they have had declining hospitalization rates. And so I think this was a big boon for the month. And then also, we kept our eye on crude oil. Because it continued to slump because of global demand, but also I think the storage facilities, the shortage of storage facilities, actually came into play. And we'll talk more about that, but really we had a very strong month. Take a look at it, the NASDAQ was up 15.45%, best return since 2000. Dow Jones Industrial Average was up 11.08%, strongest since 1987.

So even though we had disappointing news, basically from nonfarm payrolls, we saw 11-year low of 701,000 new people were on the unemployment lines, 4.4% unemployment rate. I think most of us knew that it was going to be well above 10% and that that's been recently confirmed, but overall it was a very good month not only for equity funds, but it was an okay month for fixed income funds as well. And we can certainly go in more detail on that.

CEFA **Your data breaks out closed-end funds into over 20 classifications. What classifications were the best performing for the month, and which sectors struggled?**

TR: Well, let's take a look at the macro groups first. Closed-end equity funds were up 12.23%. That was the best one month performance since April 2009. If we drill down we can see where the play came from. Domestic equity closed-end funds were up 13.74%, spectacular for a month. World equity funds were up 9.88%, even mixed asset closed-end bonds were up 9.49%. But despite what we saw, again, and like I told you, oil was down 3.42%, closed at $19.78. I think a lot of investors saw that the market threw the baby out with the bathwater. And so our top performance on a nav basis, which was our laggard last month, energy MLP funds were up 43.67%, phenomenal. However, I do want to let everybody know that those are still down 63.74% year to date.

So we're not out of the woods there, but certainly I think especially closed-end fund investors saw some buying opportunities. Natural resources funds were up 24.17%, pretty much the same thing. And then on a nav basis we saw sector equity funds up about 11.85%. And we think this was predominantly a gold play, so to speak. Gold was up 7.02%, if you looked at the near month of futures for gold, they were a big play. But on the bottom we saw March's winners become April's losers, and nobody really lost. Real estate funds were still up 2.77%. That was the smallest performer. Utility funds were up 7.90%. So really, I don't think it was anything bad here at all to take a look at. On the fixed income side we saw that the yield curve did flatten slightly at all maturities, with the exception of the very shortest, one-month, rose about five basis points. All the other ones declined a little bit.

We all know that with the yield it's inverse to price, so we saw some pretty good numbers. Fixed income closed-end funds were only up 0.73%. However, we need to break that out further. Domestic fixed income funds were up 3.50%, world income funds were up 3.22%. But we've had another bad month from muni bond funds, they closed down 3.08% for the month, with all nine qualifications suffering declines. And if we take a quick look at the leaders and laggards, we see corporate debt, triple B rated funds. People were willing to go out a little bit more on the yield curve, and a little bit more risk. The leveraged group took in about 5.4%. As far as returns go, corporate debt, triple B rated funds unleveraged were up 4.67%.

And even loan participation funds, these are leveraged loan funds that people might call, Lipper calls them loan participation, were up 3.96%. Good number. But if we take a look at the bottom, again, as investors were evaluating liquidity issues and unfunded pension liabilities, and even a decline in local sales revenues and the credit worthiness of municipalities, investors were still scared off by being in municipals. So New York munis saw the biggest decline, 3.62%. High yield munis saw a decline of about 3.61%. So while it was up for risk areas, equities were up, taxable bonds were up, munis took it on the chin this month.

CEFA: Is this a change in what you saw from March?

TR: This is a 180-degree turnaround. Literally what was winning in March was losing in April. And I think many of us expected it, because it was such a big difference. The only exception was muni bond funds. And again, as I was just saying, muni bond funds really took it on the chin. Keep in mind though, it wasn't as bad as what we saw in the prior month. In March we saw being down, munis as a whole 8.24%. Now we saw another decline of 3.08%. So really if we're talking, and everybody should put this in perspective, this is a monthly figure. We're looking at 10%, 11% down from munis, which is really something that has not been expected or even seen for many, many years.

CEFA: Are you seeing these trends carry over into May?

TR: You know, despite the Labor Department reporting April nonfarm payrolls actually getting worse, I think we're at 20.5 million jobs that were lost, unemployment rate jumping to 14.7%, much more in line with what most analysts thought was going to happen in this meltdown, markets are still in rally mode. So there has been a significant change for the month of April. And now as we've come into May and we're halfway into May, as of May 8th, that was this last Friday, the NASDAQ was up 2.61% so far month to date. S&P 500 is up 0.60%. We do see the Dow down slightly, 0.06% as a minus, and Russell, the Russell 2,000 is doing fantastic. So this is something that we're keeping an eye on. If you asked me two months ago whether I thought we would see an upward market when we have an unemployment rate that is much higher than we've ever seen, at least in modern day right now, I'm a little taken back. But yes, so we have seen a continuation of what happened in April and May.

CEFA: Closed-end funds can trade at a premium or a discount to net asset value. What were the trends in premium discount behavior?

TR: So the median discount for all closed-end funds actually narrowed, or improved 42 basis points to 9.36%. If we take a look, though, at the individual groups, we see equity funds actually widened a bit, worsened, if you will, gotten wider. 10.98% was basically where they ended up, about a 14 basis point increase. On the fixed income side, though, we did see an improvement, 58 basis points, and it declined to 8.53% for the month.

CEFA: And how do premiums and discounts compare to their historical averages?

TR: Well, right now if we're taking a look at April 30, 2020, we see that they are still wider than they had been a year ago. And actually it's 13 months ago, I'm going to do a comparison of April 30, 2019 versus April 30th 2020, just because of the idea of, "Sell in May and go away." So we're going to do month to month picks. Basically a 9.36% median discount for all closed-end funds right now versus a year, 13 months ago, 7.58%. And if we take a look at the number of funds trading at a premium to their nav, most recently in this last month we had 68 that traded at a premium, versus 417 that were trading at discount. If you go to back to 2019, 84 were trading at a premium. So almost 20 more, and 393 were trading at a discount to their nav. So we have seen a continuation of wider discounts, I think people are still very concerned with where the market is and where it might be going.

CEFA: Which sector saw the greatest change?

TR: Well, we saw the largest narrowing actually occurred in world income closed-end funds, a 277 basis points improvement to 7.50%. But the largest widening, and I told you the equities had a widening, but the largest widening were represented in what we were talking about before, the big loser this month, national munis. They saw about 128 point widening of their discount to 7.81%.

CEFA: Tom, with areas of the market improving, are there sectors where investors may find particular opportunities given where those funds are trading relative to their historical averages?

TR: You know, I think there are a couple areas that investors should keep an eye on. And it all depends how much risk they were willing to take. For instance, I would not have been the one jumping into energy master limited partnerships last month, but look how well they did. Just has to do with risk aversion. But with the Fed expanding its municipal bond buying program, and also in its lending facilities, include highly rated, and I think we need to pay attention to that, smaller counties and cities, which initially were excluded from their prior commitment. I think there are some opportunities, especially for people looking for tax exempt income, in the muni bond area. Now, keep in mind, that said, we need to be very selective. Because we don't know if a municipality is going to be able to pay back its debt. I know a lot of municipalities out there are talking about unfunded pension liabilities, or even schools coming there and saying, "We have to cut our budgets because of the sales tax revenue going down."

So again, I want to take that in a point. And if we take a look, though, going forward, I think that we're going to still be paying attention on the equity side to quality issues. Basically, what's the next shoe to drop? We're almost finished with the Q1 earning season, and when it all gets done we're expecting about a 12% decline in expected earnings for the S&P 500 constituents, with about 430 of the 500 actually already reporting. 67.4 have beat analyst expectations, according to definitive data, but again, these are lowered expectations. So I think investors will want to still go after equity, because again, such low interest rates are out there, but we do have to keep in mind that they're probably going to be paying attention to quality, dividend cuts, and also, if you will, if they're providing any future guidance.

CEFA: Tom, you also follow interval funds. And we have been speaking over the past several months about how they differ from traditional closed-end funds. As the market has shifted from the middle of February to now, what has been the impact on interval funds?

TR: Well, we saw actually in April, the only two new fund offerings that came to market were interval funds. Both had existing share classes out there, so they were trying to open up the market a little bit more. The differences between the classes of shares are usually two points, minimum initial investment purchase price for that, because you're buying it literally from the fund. You're not going through brokers. Nevertheless, you're actually going to the fund itself, similar to what we do with open-end funds. And also, expense ratios are a bit different, because again, if you're willing to put $10 million down versus $10,000 down, you'll get a little different expense ratio. But we saw BlackRock Credit Strategies Fund A Share come to market, general bond classification here at Lipper. We also have some other general bond classification new fund come out with, it was CION Ares Diversified Credit Fund U2 shares. So both of these basically came to market in April, but let me give you the breakout.

So here's the tally so far year to date. Conventional funds, we've seen three additional new conventional funds come to market year to date so far. We've seen four interval funds come to market, but we've also seen six mergers. And of those six mergers and liquidations, we've seen four that were interval funds and two that are conventional funds. So we're really down one by the interval standard, but the most recent issues have been interval funds.

CEFA: **Interval funds often make investments in private securities. Is it possible that these illiquid investments could present interesting opportunities if the economy is able to reopen over the coming weeks and months?**

TR: So I think that is what people are trying to keep an eye on. I think some investors resolve with illiquid assets may have been tested over the last two and a half months. Before, when you were promised a little bit higher return, a little bit better yield, I think investors were willing to actually say, "Hey, listen, I don't need the liquidity." But once we had a 20%, 30% drop in the market, I think people were a little concerned that they only are able to refund every quarter, or actually do redemptions every quarter. And even in that mode you're only able to do 5%, 10%. But I think other investors may have seen, these products may have saved them from themselves. And that is, buying high and selling low basically during this big market turmoil, a lot of people did get out of the market. And of course these funds forced that.

Let me go back to the idea, though, that if you can get into a better yielding product even though it's a little bit more illiquid, but you're still getting those distributions to come through, it makes it a little bit more palatable to some investors that they're going to get a higher yield. So I think that's one of the changes we may see in this market.

CEFA: **Tom, thank you so much for taking the time to join us today.**

TR: Diane, thanks for having me, really appreciate it.

CEFA: **And we want to thank you for tuning into another CEFA Insights podcast. For more educational content, please visit our website at www.cefa.com.**

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