CEF Quarterly Review

April Interview – Tom Roseen

CEFA:

Welcome to CEF Insights, your source for closed-end fund information and education brought to you by the Closed-End Fund Association and available on our website at www.cefa.com. My name is Diane Merritt.

CEFA:

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're happy to have you with us today, Tom.

Tom Roseen:

Thanks for having me, Diane. Good to be here.

CEFA:

Tom, you recently published your report for March 2021, which covers over 600 closed-end and interval funds. How did investment markets generally perform in March, and what was the impact on closed-end funds?

Tom Roseen:

It was a moving month. It was certainly a little more volatility than we may have expected, but the broad base indices were all up. But we continued on with that rotation that we've been talking about over the last two or three months. Basically, we saw the Dow Jones Industrial Average post the strongest returns of about 6.62%. And the NASDAQ was a relative laggard, up about 0.41%. But we got to put that in perspective when we're taking a look at the numbers.

I mean, if we look at the one-year period, you remember this is from March lows of 2020, the Dow Jones is up 50.48% and the NASDAQ is up 72.04%. So they have one month where the NASDAQ underperformed. We certainly expect it.

But as I was saying, we saw a continual rotation out of and maybe not selling the stay-at-home but certainly not bidding them up, into cyclical. So this rotation continued as the treasury yield began to stabilize. We saw a huge jump in the treasury yield this month, a 30 basis point jump. We ended up at 1.74%, and that we haven't seen since January of 2020. So that's a really high number.

But it started to ease down, started to tame a little bit. We had great news. 379,000 new jobs were added. This was against analyst expectations at 210,000. So really, this was a good month to take a look at things.

The Dow recorded a record high. They were at 32,000. Then they jumped within five days, fastest 1,000 point gain, over the 33,000 mark. And this was really on four things. Well, first of all, we all know the $1.9 trillion spending package got passed, basically covering Biden's interpretation of what needs to be spent for the COVID-19. We had a better vaccination rollout distribution. The Fed basically said it's going to do whatever it takes. In fact, it plans on keeping interest rates low for a very long period of time, and their game is full employment. And then, the last piece is people were anticipating the announcement, and that more talks on the industries anticipating, the infrastructure proposal that's going to be out there.

So how this helped close-end funds? About 80% of all closed-end funds were in the plus column. We saw 84% of the equities in the black, and we saw about 78% of all fixed income funds posting plus side returns. So it really was a strong one. Overall, let me give you a quick breakout. So equity funds had for the fifth month in a row, plus side performance, NAV based for the month of March was 2.77%. On a market basis was up 4.03%.

So that was a really strong month. For the quarter, it's up 6.36%. Now, if we take a look at fixed incomes, we remember the last month we had some negative returns, wasn't bad but we had negative, so for 11th month in 12 plus side returns on a NAV basis. Fixed income funds were up 0.45%. On a market basis they were up a handsome 2.08%. And then for the quarter, and I'm not going to give you a NAV and market in that, but for the NAV basis for the quarter was up 1.01%. So overall is good month.

CEFA:

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

Tom Roseen:

Let's take a look at equities first and I always give this macro view first so we have an idea who leader, who laggard was. For the third consecutive month, we saw Domestic Equity closed-end funds at the top of the charts, 3.72% return. Followed by World Equity closed-end funds up 1.73% and then Mixed Asset funds up above 0.76%. Those are those 60/40, or they have a combination of fixed income and equity and whatever the breakout is. And how this factored out though is we saw energy related funds come to the top. And if we take a look, we saw February's laggard, for the first month, by the way in 15, go to the top of the charts. Utility closed-end funds were up 8.33%. Energy MLP closed-end funds continue to have their tear up about 7.77%. And Natural Resources funds were about 4.99%.

Now at the bottom was the darlings over the last several months in we had interest rate issues and with the interest rates basically staying the same and equities going higher, we saw convertible securities just smoking. They had a kind of ugly month down 3.12%, but if you take a look at the year to date and stuff like that, they're still up very, very strong. So the big loser and actually the only negative was convertible securities, but this is coming off a very strong quarter and a very strong year. Now, if we take a look at the opposite side and we pay attention to fixed income funds, despite that 30 basis point increase in the 10 year Treasury that I told you about, and general steepening of the yield curve, most of the classifications were in positive territory in the fixed income universe.

Keep in mind again, 30 basis point increase, 174 basis points is basically 1.74% is what the 10 year Treasury rose to. And the highest, like I said since January, I can give you a date, January 23rd, 2020 was the last time we saw a yield that high. So we really had some fairly good returns because if for everybody listening we all know about that inverse relationship as yields rise, usually the value of our stocks decline. People are betting yes to the decline, but we'll get more yield out and we'll be able to compensate for that decline as well. So what we saw for the second month in three is munies actually rise to top up 1.01%. And certainly I can see the reason why. We're talking about new taxes coming on board and increased spending for infrastructure. So certainly that played into them having a pretty strong month.

Domestic taxable fixed income funds were about 0.23% and world income funds were the only loser down 0.87%. Now how that happened, emerging market hard currency debt funds were down 2.01% and global income funds declined 0.42%. But on the plus side, we saw people in search of yield basically shunning any of the higher quality, really wanted yield. High yield munies are at 1.13%. General insured munies were up 1.07%. And if we look at the taxable side, High Yield closed-end funds were up 0.66%. And High Yield Leveraged closed-end funds were up a 0.47%. So overall it was still a very good month for fixed income. Even though again, we had this steepening of the yield curve and a couple of negatives here and there.

CEFA:

Is this a change from what you saw in February?

Tom Roseen:

It is. We saw a greater focus towards cyclicals. Natural resources obviously did well. And we saw that rotation I was talking about out of the safe haven plays for fixed income. So we saw that the Triple B rated funds were the ones that took it on the taxable side, on the chin so to speak. The worst negative return that was reported was a Triple B rated, not the Leveraged, but the just Triple B rated debt funds. They were down 1.09%. So a little bit of a change, a continuation of what we were doing, but a little bit more focus away from quality.

CEFA:

Do you expect these trends to continue into April?

Tom Roseen:

Well, I do. While the Fed doesn't see inflation running out of control, the bond market is certainly betting against that bet. They think that inflation is going to cause more interest rate increases to occur. And with that said, we really had a decline in interest rates. We'll talk a little bit more about that later on, but quality issues, we'll probably get a little bit more attention as interest rate and taxes start to increase. So we had some good news at the beginning of the month of April, 916,000 new jobs in March. So I imagine volatility is going to kick up and if we take a look and then in the absence of a Black Swan event, I think we could continue on with what we're doing, better vaccination distributions, reopening of the economy, this all spells to a pretty good summer.

Although we are in a time of what a lot of people say we'll be coming to in about a month. Sell in May and go away. We'll have to see what happens as people get into those summer roles. Our vacation is going to happen to like, but back to your initial question, yeah, I think we're going to continue on, but I think volatility will be there and people keep a keen eye on, for instance, this Johnson & Johnson, a recall or at least the stop. It's not a recall, but to stop a vaccination for a while, while they evaluate the blood clots. But if vaccination distribution continues to go well, reopening of the economy continues on. There's no reason to say that this economy has any reason to stop rallying, nor the market.

CEFA:

The way closed-end funds trade in relation to their net asset value is an important consideration for many investors. Did you see any specific trends in premium and discount behavior for March?

Tom Roseen:

We did. And we saw a real improvement. I haven't seen discounts this low in quite some time. So let me give you an example. We saw the median discount for all closed-end funds, again that is income and equity together. Improve about 97 basis points to trade against the NAV for the market price at a 4.63% discount. And that's quite an improvement. It's narrower than the 12 month moving average median discount of 8.03%. And if we take a closer look and look at equity funds, they had declined 131 basis points, will improve by 131 basis points. Their discounts as of March 31st was at 6.80%. And fixed income funds had 144 basis point increase or improvement, I should say really declined, but improvement in their discount to 3.50%. So we haven't seen that low for quite some time.

CEFA:

How do current premiums and discounts compare to their historical averages?

Tom Roseen:

So if we take a look at it, give you a big picture. So on April 30, 2020 that's a year ago on April 30th, we had discounts, we had about 60 funds that were in premium territory. And if we take a look at March 31, 2021, this last month, we had 114. So really the number of funds trading at a premium has increased quite a bit and even just from one month to the next. So if you recall on February 26, when we were talking last time, there was only 90 funds that were in premium territory so that was improvement of 24, but let's get into the specifics. Basically on April 30, 2020, we saw all funds at a 9.36% discount. Now we're at 4.63.%

Equity historically was at 10.98% now we're at 6.80%. And then fixed income was at 8.53% on April 30th, 2020. And then on March 31st, it was a 3.50%, a discount. So we've seen a big, big change and there are some contrarians out there that might be listening they're saying, "Wow, that is really, really an improvement." And it really is. But obviously we have to take into account with happened in the markets and all the stimulus has been passed over the last several months. And I don't know if this is a contrarian dream or not, but certainly we've seen a rapid improvement in the premium discount territory.

CEFA:

Which sector saw the greatest change?

Tom Roseen:

National munies saw the largest improvement in their discount. 229 basis points. It dropped down to 2.87%. And single state munies saw the smallest improvement. Nobody saw degredation in their discount. So six basis points are for single state munies to 6.07%.

CEFA:

Tom, equity markets have had a good first quarter, but we've seen longer term interest rates tick up. And some investors are raising concerns about the potential for inflation with the degree of economic stimulus we are seeing. Are there sectors among closed-end funds where investors may find particular opportunities given where those funds are trading relative to their historical averages and how do you see the direction of the markets?

Tom Roseen:

So this is actually a tough one. We're in that period of time, we're all going to be looking forward to the quarterly earnings coming out. We've had some stimulus. Again, as I said earlier, there was no reason to not think that with all the stimulus going on, that we won't have it. The only concern I think people have right now is the tax situation. If taxes are raised, will this hurt profitability at the corporate level? So I think people are keeping an eye on that, but really the things that we have to take a look for, loan participation funds did not do that well in March. I think people even though we saw 30 basis point increase in treasuries, I think the people were sitting back and saying, "Well, the Fed says it'll do whatever it takes to get the job done."

The loan participation while they did very well for the one-year period of time, actually even for the quarter, they didn't do well from March. So that's something we should probably keep an eye on, but basically with tax inflation, as of recent concern, low participation in muni bond funds, certainly both of them have done fairly well recently. Are probably two areas that people will focus. Again, let me just give you a rundown. We saw that on March 31, the 10 year Treasury was at 1.74%. Now it's on April 9, we've seen a decline in it to 1.64%. And actually today, just a couple of days later at 1.69%. So we have had a decline in that. So I guess I would keep an eye on that, but certainly those are two areas that people can benefit if in fact taxes go up. And if in fact the inflation rate takes a jump.

CEFA:

Tom, you also follow interval funds which typically offer a limited quarterly liquidity to investors. How have interval funds generally performed in the first quarter of 2021?

Tom Roseen:

We've got to keep in mind it's the number of interval funds versus conventional close-end funds is different. So we have 151 interval funds that we're tracking. We have 467 conventional closed-end funds. But we take a look at it when we're looking at all the funds, whether they're equity or fixed income. The average return for an interval fund was 2.79% while the closed-end funds, conventional closed-end funds were at 3.48%. But I'll tell you some of the things that you have to keep in mind when you're taking a look at this is what groups that are in. For instance, natural resources funds had a great run of 16.05% for the quarter, but there are no interval funds in this space, right? So we're piling a 16.05% against nothing. So this is where we get a little bit of difference in numbers when we're taking a look at those domestic versus non-domestic funds.

But if we take a look at sector equity as an example, we see that in the sector equity space is about seven interval funds, 17 conventional closed-end funds. The interval funds were up 6.07% while in the sector equity space, the conventional closed-end funds only had a plus 2.54%. So here we see sector equity funds outpacing. And then if we look at the general bond fund group, basically it's much heavier towards the interval fund side, about 44 funds versus 23 on the conventional space side. We see that the general bond funds were up 2.47% while the conventional closed-end fund in that space was up only 1.05%. But that's the opposite. When we look at real estate and loan participation, they underperformed in the real estate funds. So really overall, I think to answer your question, it was a mixed bag.

CEFA:

What asset classes or investment strategies do you believe offer the most interesting opportunities for interval fund investors in the current market?

Tom Roseen:

Well, so again, I think that when you take a look at it, we have to look at where the offerings are. So the three biggest classifications on Lipper side, right, where we're taking a look at interval funds versus the conventional closed-end fund space. We see real estate funds are dominant in the interval and fund space about 33 versus nine. The general bond funds are 44 interval funds compared to 23 conventional closed-end funds. And then loan participation funds are 27 and 28. So these are three places that people could take a look into these, but we have to keep in mind we're asking about quarter or even year to date time periods. When we're looking at interval funds, we're looking at the ability to invest into private placements, whether it's on the equity side or whether it's on the fixed income side.

And we have to be willing to go on a longer term than lets say even a quarter or maybe even a year. Again, liquidity is low and they only offer a quarterly refunding where you can go in there and actually do redemption. And that's going to be for a limited amount of the assets. So this would be a long buy and hold piece where you're hoping to get yield in all three of these have a special place for yield. Real estate funds on the equity side, general bond funds and the bond fund side of course loan participation, if you want to call it the inverse relationship to the yield curve something that actually does better when inflation is going up, all three of these are something that you can take a look at. Again the caveat is we need to be very cautious that we aren't going to need this money in a short time period.

CEFA:

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

Tom Roseen:

Diane it was my pleasure. Thanks for having me.

CEFA:

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