CEFA:

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

Tom Roseen:

Thanks for having me, Diane. I appreciate it.

CEFA:

Tom, you recently published your report for September, 2020, which covers over 500 closed-end and interval funds. How did investment markets generally perform in September, and what was the impact on closed-end funds?

Tom Roseen:

Well this is first month since we had the great crash, March, the COVID related crash in March, that we've actually had negative returns. We've seen the NASDAQ, we've seen S&P, we've seen a whole bunch of securities, even the first part of this month actually hit new highs. But I think investors felt this was getting a little long in the tooth, even though we had a great spectacular run-up in tech and stay at home stocks, investors shrugged off the increase in non-farm payrolls for August. And I know a lot of people are going to say, "What are you doing bringing up August?" You have to remember, this is what drove September. We had 1.4 million new jobs added, and let's say regained. And the unemployment rate dropped from 10.2% in July to 8.4% in August. And so September, people were saying, "This is good".

But a rising number of COVID cases, the continued Sino-American trade conflict, and particularly with the uncertainty of the upcoming November elections, I think had a lot of people concerned. And so again, they took those hard won profits off the table. And how this played out was basically in September, equity funds lost about 2.5% on a NAV basis. But on a market basis, they lost even more, 4.89%, not too unusual in that area. Fixed income funds did stay on the positive side, but only to the tune of 0.02%. But we'll take a sixth month of positive returns. On a market basis, they were down to 0.62%.

But let me talk, because this is the quarter, right? So quarter three, we still are positive. Third quarter returns for equity funds. This is going to be NAV only, 3.81% for equity funds. Fixed income funds were up 3.63%. And while year to date they're still, again, this is going to be equities first, still down 9.36%. I think we're going to have, as you and I talk a little bit later on here, energy master limited partnership and natural resources are the reason they're down so large. Fixed income funds are only down year to date 1.06%.

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?

Tom Roseen:

Well, in the past when we've talked about the macro groups, this is how we put like funds together. We have classifications, but we want to group those so we get a big picture. So we've broken the equity funds down into mixed asset, world equity, and domestic equity. And I gave it to you in the order of their ability to mitigate losses. Mixed asset funds lost about 1.19%. Those are usually convertible securities, and income preferred stock funds. World equity funds were down 1.80%. But remember I told you a little bit about energy master limited partnerships, and certainly the natural resources funds taking it on the chin, domestic equity funds were down 3.21%. Now in this group, though, if we take a look, we saw real estate funds actually only lose about 0.46%, and income and preferred stock, remember I was telling you guys about the mixed asset funds, they were down 0.97%.

But at the very bottom of the barrel, when we take a look at the domestic equity funds being dragged down so severely, energy MLP funds basically lost 11.80% for the month, and natural resources were down 9% even. Now taking a look at fixed income funds, is not quite as dour. Basically what we saw is domestic fixed income funds were up 0.3%, muni bond funds were down 0.16%, and world taxable income funds were down 0.93%. And if we take again a breakout of those, people were basically in a risk averse mode.

It wasn't necessarily totally risk off or too risk averse. We saw US mortgage funds rise to the top, returned about 0.92%, pretty handsome for one month return. Loan participation funds, so people were really concerned about inflation for the second month in a row, they were up 0.8%. but at the bottom of the barrel, when we're taking a look at emerging market, hard currency debt bonds were down 2.72%. Corporate debt, triple B rated, again, people just taking their foot off the pedal a little bit, down 0.79%, and high yield leveraged funds were down 0.49%.

CEFA:

Is this a change in what you saw from August?

Tom Roseen:

It is. It's the first month since we had the COVID related market crash that equities actually witnessed a downside performance. And investors appeared to be a little bit more focused on inflation, even though, even a month earlier, they did the same. Last month, loan participation funds actually were among the top performers for August and September. That continued. But yes, from an equity standpoint, again, this was quite a change, a 180 degree change, as far as returns went from positive for five months in a row, to I'm going to say pretty solid negative returns.

CEFA:

Are you expecting these trends to carry over into October?

Tom Roseen:

I do. Until we get done with the election in November, I think all eyes are going to be first of all on unemployment. The employment numbers have been, came in pretty strong this month already. But it was at a slower rate than before. Again, I think when you're still talking about 1.2 million new jobs and the like being added, I think that's still a good thing. But again, slower. COVID cases, and people are calling the double whammy of having flu season and COVID cases. I think people are going to keep an eye on fall and see what happens there. And of course there's been a lot of unrest in the streets. And again, I think people are just going to wait to see what happens with the November election. So I do expect a lot of volatility to be around.

CEFA:

Investors often monitor how closed-end funds trade in relation to their net asset value. What were the trends in premium and discount behavior for September?

Tom Roseen:

Well, with the market decline, I don't think anybody would be surprised that I'm going to say the median discount for all closed-end funds basically widened by 80 basis points. The average closed-end fund, and this is both equity and fixed income, traded at 9.36% discount to its NAV, right? So its market price was below its NAV price by about 9.36%. And it is worse, much deeper, much broader, much wider, whatever term you want to use, than our 12 month moving average median discount of 7.98%. Now, if we take a look at the equity and fixed income break, and I think that's important because I think most of the problems are in the equity side as far as deepening or widening the discounts, equity closed-end funds basically widened about 144 basis points to close the month out at a 13.36%, as far as the median discount goes. And fixed income funds, they did also widen about 40 basis points, but to I think a more comfortable 7.60% discount to its NAV. So that's the story on that side.

CEFA:

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

Tom Roseen:

We are a quite a bit higher than we were. Again, I gave you all funds discounts, and the equity and fixed income give you the same as far as 10/31/2019, so literally one year ago, versus 9/30, a couple of days ago, all closed-end funds were at a 6.36% discount on 10/31/2019, but 114 of those funds, out of almost 600 actually, and actually it's a lower number because I'd be including interval funds there, which don't have a premium or discount, but 114 were at a premium. On 9/30/2020, we were at a 9.36% discount, and only 63 funds were trading in premium territory.

Now the main thing I want to point out, I'm not going to go through each one of them, but on the equity side, we went from 6.38%, and the fixed income was 6.36%, so they were very close, but we saw that equities went from 6.38%, 54 trading at a premium, to 13.36%, almost a doubling, and only 22 funds trading at a premium. So that was quite a change, that we've seen. And again, most of it's been with people I'll say fleeing the equity area, during this time of uncertainty,

CEFA:

Which sector saw the greatest change?

Tom Roseen:

Municipal bond closed-end funds saw the largest narrowing, or improvement of their discounts in September. Only 13 basis points. They went to 7.33% as the median discounts for that group. But on the flip side, we take a look at world income funds, remember I told you that emerging market hard currency debt had a tough time, so we saw world income funds actually witness the largest widening in discounts, 239 basis points, but only to 7.95% discounts. Certainly the equity discomfort is still much higher than even the riskier world income funds, as well.

CEFA:

Tom, areas of the economy continue to improve, but there are still some economic uncertainties, and we have an election in just a few weeks. With that backdrop, are there sectors where investors may find particular opportunities given where those funds are trading, relative to their historical averages?

Tom Roseen:

There are. And again, as I've said in the past, it all depends how much risk you're willing to bear. At some point these markets will probably turn around, and then when I say these markets, keep in mind that we really had a tech and stay at home rally. We haven't really seen a rally in other areas. I think the bond funds are, because the Fed recently came on and said, "Listen, we don't plan on raising rates for maybe a few years", that I don't think people have to worry about too much spike in interest rates, so to speak, that would actually cause the rally in bonds to go away. But I still think people, in the short term, medium term, are really still looking at solid balance sheets, highly rated quality issues.

Now that said, if we take a look at some of the areas where there is potential, if we take a look for instance, real estate funds, people are still looking for income, so income potential. Real estate bonds are still down 8.07%. Now the problem here is that we all know that New York and a few other big states are having problems in their commercial real estate space, but we're hearing great news as far as new signings of single family homes, new home sales are up. So it all depends what side of the fence you're on. Are you willing to go ... In that area, utility closed-end funds basically are down 13.31% for the year to date period so far. So there is an opportunity there.

Now on the safety side, which I was talking about, and maybe even on the inflation side, if you think we're getting inflationary, which the Fed said they're going to allow interest rates to run a little bit hot, or I should say the economy to run a little bit hot, and not too worried about pulling the plug, putting any stoppers on. US mortgage funds did pretty well this month. And they're down 6.38% for the year so far. And loan participation funds, which again, has been pariah as of late because people have not wanted to necessarily bet on inflation, they're still down 4.79%. But on the pure contrarian place, and if you really want to buy some deeply troubled areas, and again, I personally, I'm a little concerned with these areas because I don't know where they're going, energy master limited partnerships are down 61.8% for the year.

Now if anybody's even considering that, they have to go look at some of the most recent changes in taxation and some of the other areas. There is a reason why these guys were down so much. The other area is natural resources. Who knows what oil and gas is going to do here, now? Right now we're talking about it down 40.24%. And on the fixed income side, if people are willing to take chances, emerging market debt is down 8.86% year to date. So these could be potential buying opportunities. But I will tell you this, I am not very sanguine on these points, on these classifications, but it's certainly, from a contrarian play, there is some opportunity, I guess, for upside.

CEFA:

Tom, you also follow interval funds, which typically offer a quarterly liquidity to investors. How have interval funds generally performed over the first three quarters of this year?

Tom Roseen:

It's been a somewhat of a tale of two cities. If we take a look at it, again, I told you we have about 605 funds out there. 126 of those are interval funds. 476 are actually conventional closed-end funds. If we take a look at it though, and I look at domestic equity funds, and I'll give you an idea of just a couple of groups, a couple of classifications, where we know that the funds have almost equal number within the classification. If I give you, let's say, an XYZ fund beat their conventional closed-end funds, there's only one versus 20 or 25 or even 50, that's not fair. So domestic equity funds on that side, we saw that they actually mitigate losses better on a year-to-date basis, down 5.29% on domestic equities. That's not a classification, that's that macro group I was telling you about, that's 42 funds versus the other funds in that domestic equity group, keep in mind that we have energy MLPs and the like in there, down 17.50%, and there's 115 funds.

So they've done better, but let's get down to the classification level where we've seen it. Real estate funds actually did outperform. We see about 29 real estate funds in the interval fund space. They were down 4.61%. So they have mitigated losses better than some of the other conventional closed-end funds, which were down 18.10%. Now here we had 29 interval funds versus 10 conventional funds. So that's quite a difference, but again, real estate outperformed. But on the sector equity side, we saw an under-performance by interval funds.

They were down 1.13%. There's seven funds out there. And then if you take a look on the conventional fund space, we saw that the sector equity funds actually were down 1.46%, and there were 17 funds out there.

So a little bit of difference. We had same thing on the domestic taxable fixed income side, about 68 funds are considered interval funds. They had a return of minus 2.58%, versus conventional funds that had a return of minus 0.31%. 111 funds there. So the main winner in that area was the loan participation funds. They were down 2.71%, there's 27 funds in that group that call themselves interval funds, versus about 30 funds that are conventional closed-end funds. They were down 6.64%. So I have other examples of negatives, but I don't want to draw this out too much.

CEFA:

With interest rates likely to remain at the current low levels, can interval funds be an interesting option for investors looking for higher yielding investments?

Tom Roseen:

They do. They have the ability to allow me, you, and other people to actually go into some of those private placement investments that are very much less liquid, and that's a good thing in some ways, because they can get a higher yield, a higher return. So yes. But you have to be a buy and hold person in this. And I've talked about this before. And a lot of the funds say they will do periodic redemptions, usually it's quarterly, some are semi-annually, some are annually, but most of them are quarterly. And then they say up to five to 25%. In those lines, it also says, subject to the manager's opinion, or ability to actually do those types of redemptions. So it is a double-edged sword, and I think you have to be able to understand that you may not be able to redeem.

So the one nice thing about this, and again, there's that double-edged sword part, is you won't have to worry about the fund having to sell into pressure. A lot of the stuff is illiquid, a lot of the stuff hopefully is being marked to market on the right basis. But they certainly won't have to sell like open-end funds to meet redemptions and the like. And of course they can turn off the redemption spigot if they want. But on the other thing, and you may not be able to redeem when you want, but it does take the emotion out of the equation. You really aren't going to be given the choice to jump, even if the market does an about face here shortly,

CEFA:

Some investors may be concerned about increased market volatility with the election coming up, and COVID-19 continuing to impact the country. How do you see these funds benefiting an investor if they are concerned about market volatility?

Tom Roseen:

Well, I think that's it. I think that's probably, if you're worried about an increase in market volatility, what I was just saying was probably the main point. I'm able to get into this fund, and this is where the problem is, I may not be able to get out when I want, but again, a lot of time investors actually get out at the wrong time. They actually sell at the bottom and they buy at the top. And this will lock in that ability for you to sell at a whim. But on the flip side, again, investors have to be concerned that if they want to get out, or need to get out, they may not be able to get out. But again, it takes out that emotional aspect, and certainly I do not have to worry about the fund having to sell into those pressures.

CEFA:

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

Tom Roseen:

Diane, thanks for having me. I really appreciate it.

CEFA:

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