CEF Monthly Review
January 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. 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:

Hi, Diane. Thanks for having me. Appreciate being here.

CEFA:

Tom, you recently published your report for December 2020, which covers over a 600 closed-end and interval funds. How did investment markets generally perform in December, and what was the impact on closed-end funds?

Tom Roseen:

Well, we saw another round of record highs during the entire month of December from the beginning to the end where we hit new record highs. This is despite rising COVID-19 cases, hospitalizations and deaths. I think this really is because investors were cheering the rollout of the COVID-19 vaccine. Also, as many of us have been keeping a keen eye on the presidential election and obviously the agreement in Georgia during their runoff elections that they had as well, that people were really curious on where fiscal stimulus would be this year in 2021. I think most people were voting on the side that there would be continued fiscal stimulus. I think now we know that that is the fact.

What we saw with record highs... Again, I was saying in the beginning of the month, we saw the Russell, the Dow and NASDAQ, S&P, all these broad-based indices that we all follow, and they hit new highs. Well, this was the first time all four of those hit a new high on the same day. That was going all the way back to January 22nd, 2018. So this was a really big move. The reason I bring this up is this is what we were talking about last month when we talked about a possible beginning of a rotation. We saw small caps do better. We saw value do better. We saw international players do better. Basically, they were overpowering the stay at home stocks. So this was a pretty big change.

Again, we saw the glimmer of what was happening last month when we talked about this as well. Another trend that we saw, we saw a rise in yields, and this actually goes hand in hand with what I was just saying, more spending coming out. Certainly, we didn't see a big jump until January, but for December itself, we saw the month end, the 10 year treasury month end we saw the nine basis point increase to 0.93%, which is a big thing.

We also saw a very nice jump in oil prices, about a 7.01% in December, a rise in oil prices. I'm bringing this up for obvious reasons. Later on, we'll talk about who did well and who did not do well, but both equity and fixed income funds saw some pretty strong returns for December.

CEFA:

Now, 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, basically what we normally do is do a little review. I usually try not to spend too much time on it, but let me just talk about the returns that we actually saw for equity and fixed income funds, first for the month of December, and then we'll get down to the focused area. For December, we saw for the second month in a row, equity funds plus 3.78% return, and fixed income funds actually rose about 1.89%. That was on a NAV basis respectively. Market basis, they were 5.55% and 2.34%. Both had, again, two consecutive months of a plus high performance, but I think most interesting, and a lot of people will be paying attention, I'm going to look at just NAV base performance.

Equity funds were up 13.65% for Q4. Fixed income funds were up 5.55% for Q4, and on a year to date basis... we've talked about this over the last couple of months... equity funds finally got in the plus side column. So we saw equity funds jumped 2.34% for the year. I know that sounds disappointing, but remember we have energy MLP funds and we have natural resources funds, which were a huge drag on that average. So the 2.34% is understated. Fixed income bonds were up 4.33%.

But the real change, and to your question, Diane, world equity funds actually did the best out of the three macro groups that we take a look at for our equities. They were up 5.68%. Mixed assets were up about 3.68%, and domestic equity funds added about 3.20% in December. If we looked at the fixed income side, we saw world fixed-income funds up 3.44%. Now, this is really something I want to point out. World equity and world fixed income funds did better than their domestic counterparts. Domestic taxable fixed income funds were up about 2.05% and municipals were up 1.44%. So 98% of all closed-end funds posted plus side returns.

But again, back to your question. What we saw, basically, there was this rotation. So basically for the first month in six, we saw emerging market closed-end funds actually rise to the top. They had a really nice return, 6.61% for December. Convertible securities powered on again. They had a great month. Remember, low rates and strong equity performance is really a boon for convertible securities. They are up 6.21%. Developed market funds were up 6.21%. At the bottom side for equities, real estate funds languished a bit, up 1.42%, utilities 2.19%. Back to the 2020 theme, though, we were talking about just a second ago. Convertible securities for 2020 were up 32.64%, and the big laggard was energy MLP, which I mentioned, down 52.32% still.

Now this is a ramble, and I appreciate people staying tuned in on this. With fixed income funds, though, for the first month in seven, again, remember I was telling you that world equity funds did very well. Emerging market hard currency debt funds were up 3.54%, which, again, that is a pretty good number when you're talking about December returns. Global income closed-end funds were up 3.41%, and general bonds were up 2.2%.

Now, taking a look at the bottom side, though, we saw that the corporate debt BBB rated. Again, this is people being less conservative, more risk seeking. We saw that the BBB-rated funds, not leveraged, but the BBB-rated funds, they actually had the poorest performance. Up 0.81%, and California muni funds were up about 3.83%. So this is something we saw the conservative. I'm going to call it the favorites over the last several months, as people were concerned about interest rates in the markets and that kind of stuff. They underperformed.

Year-to-date, though, corporate debt BBB-rated leveraged funds were up 9.81% for the year, and then US mortgage funds were the laggard at 2.37% decline.

CEFA:

Is this a change from what you saw in November?

Tom Roseen:

It's the same pattern. As I was referring to a little bit earlier, rotation out of the stay-at-home stocks was probably more prominent now than it was when we saw November. But, again, it was that same pattern, but there was definitely more move on both sides of the fence, equity and fixed income, towards risk on. So that was the change that we saw.

CEFA:

Now, do you expect these trends to continue into January?

Tom Roseen:

So, probably. The reason I say that is a lot of people have been writing about the market being a little bit long in the tooth. I agree. We've had some rallies and that, but that said, if we continue out with this rollout, and just so you know, my daughter went out and got the shot. I'm not making fun of her. She's a healthcare provider, so she went out and got... was one of the first given the vaccine in our community, and she hasn't grown any third eye or a horn or anything like that.

But granted that there is no problems with the vaccine and it rolls out in safety and the like, and also the idea that President Elect Joe Biden has committed to another round of fiscal stimulus, and I think he's talking about $2,000 for every person now. I believe that we are probably going to continue on. There must be a lot of Keynesian economic people out there, because the greater government spending, on one side supply siders say it's bad, on the Keynesian side, they say this is good. So if the people are in that Keynesian thought that greater government spending is going to happen, yeah, I think we could actually continue on and push the markets to another round of record highs.

CEFA:

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

Tom Roseen:

The median discount, all closed-end funds actually narrowed about 50 basis points to 6.91%. That was better than the 12 month moving average, which was a discount of about 8.47%. In particular, when we take a look at equity funds, we saw an 81 basis point improvement or a narrowing to a 10.34% on December 31st discount for all equity funds, and fixed income funds saw about a 66 basis point improvement to 5.79%.

CEFA:

Closed-end funds often see investors engage in tax-oriented trading strategies near the end of the year. Have you seen any tax loss selling during the month of December?

Tom Roseen:

We really haven't seen anything that was really obvious. It's because of what I was just speaking about, this very strong rally. It certainly wasn't even a Santa Claus rally. It was a pretty strong movement from beginning of December all the way through the end of December. We had some ups and downs in there, obviously. So no real, strong, market changes that we saw for premium discounts, but we do know that there were some big fliers, great performance out there and then, as I told you, natural resources funds and energy MLP funds were down. So I know we're going to have seen some individual tax loss harvesting. So I do expect that maybe we'll see a change in premium discounts in January, come January month end, but nothing really obvious for December.

CEFA:

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

Tom Roseen:

They are still a bit wider than they have been in the past. Let me give an example. All funds that we're taking a look at, all equity funds and fixed income put together, as I told you, had a discount of about 6.91%. If we take a look, though, 12 months ago, which would have been 1/31/2020, it was at 4.95%. The number of funds, all funds, being at a premium was 86 on December 31st, 2020. If we look at 1/31/2020, again, 12 months ago, it was 115. So the number is a bit lower.

Where we saw maybe some similarities, we saw a degradation in equity funds. So 10.34% just recently, and if we look back a year ago, it was at 5.4%. but the fixed income funds stayed in the same area. So 12/31/2020, 5.79% just recently. 1/31/2020, 4.69%. So ballpark in the same area.

CEFA:

Which sector saw the greatest change?

Tom Roseen:

High yield closed-end funds actually saw the largest widening of discount, which is where maybe I was talking about that we may have seen individual groups doing better or worse. In this case with the widening, we see that maybe some folks were maybe selling this off, maybe taking some profits there. 128 basis points to 8.26%. But where we saw the biggest improvement or largest narrowing was in world income funds. We saw 117 basis points to 5.15%, and that goes hand in hand with the performance I was telling you about, world equity and world income funds doing better than their domestic counterparts.

CEFA:

Closed-end funds often see a pickup in demand in late December through January. Is this something you were seeing and would expect to see, given where discounts are, and following any year-end tax related trading?

Tom Roseen:

So, again, this is not as obvious, but I do expect that we'll see some action. But this is going to happen after everybody gets past that wash sale period. So they're going to keep an eye and make sure that they don't have any tax avoidance, right? Because really, they're doing tax loss harvesting. They're thirty days plus one. So I think we will see a change as we look into the market, and of course, I think it will be dependent on where the market goes over the next 30 days as well. If there's a little bit of dip, maybe we'll see some buy-in, and then maybe see some discounts actually narrowing again as well. But again, it's going to be, in particular, not in the mass groups. Probably see it in the individual classifications.

CEFA:

Tom, we've completed the election cycle and we look forward to 2021. Are there sectors among closed-end funds where investors may find particular opportunities, given where those funds are trading relative to their historical averages?

Tom Roseen:

We do have a couple of classifications that we'll be keeping an eye on, some of it maybe not based on just where they have been trading, and then one other that probably has focus in that area, with the idea that we will have increased spending. That has been a commitment from a President Elect Joe Biden that we'll have more infrastructure spending and we'll have raising of taxes and the like, but more inflationary opportunities.

I think investors could be keeping an eye on loan participation funds. That's what we call the leveraged loan fund category. I know the Fed came out recently... I think it was the Chicago Fed... came out recently and basically said that they didn't expect inflation to rear its ugly head anytime soon. I think they were even talking a year from now or two years from now. But I do believe that we have seen turning the corner, and so I think people will be looking at something that adjusts if inflation starts going up and interest rates start to rise, something that will compensate there.

Also, I think because of the tax changes that we will probably see, I think that people may have an interest in looking back at the muni bond fund group as well. They've been putting money to work there for quite some time, but I think what people will be doing is keeping a keen eye on what changes are proposed in the tax laws and what is actually being rescinded from the prior tax cuts. So that'll be an area.

Last piece, and I think this is related to more of your question, remember I told you energy MLP funds and natural resources funds got crushed in 2020? I'm still a little bit off on the energy MLP funds because there're have been some legal changes going on in that group and the like, but natural resources funds may be a play. They're down 28.78% for 2020. Of course, if we have a lifting of the restrictions because of COVID, more flying, more travel and the like, where they can start getting some response in demand for oil...

Also, we just saw recently that OPEC plus basically was restricting the production for the next two months. We may see a bump in there as well. Oil prices are still below 50. They could stay that way for a long period of time as well. But again, if we get this movement from the COVID vaccine and people start doing more traveling and more supply is needed, we may get a little play out of the natural resources area.

CEFA:

Tom, you also follow interval funds, which typically offer a limited, quarterly liquidity to investors. How have interval funds generally performed over the course of 2020?

Tom Roseen:

In some cases, there was a push. I've gone over a couple areas that seem to be more focused in either having more interval funds or at least an equal bet on general funds. Here's one group, real estate funds. There are actually a more interval funds than there are the traditional closed-end funds, 29 versus nine. But we see that the interval funds actually did a better job mitigating losses for the year. This is a one-year return. Still down 1.64% for the real estate funds on the interval fund side, but down about 7.60% on the traditional closed-end fund side. So there might be some opportunities there.

Of course, we've got to make sure that one's not looking at residential real estate versus commercial real estate, so we have to keep an eye on what the portfolio manager in our team is actually creating. General bond funds has a fair split. 29 for interval, 24 for the traditional closed-end funds. There, they underperformed pretty significantly. Interval funds had a 3.13% return, while the traditional closed-end fund had almost a 7% return. So almost a doubling in that one.

Loan participation. Now, I brought that up a little bit earlier. Here's where we have a perfect split. 28 and 28. 28 interval funds, 28 traditional. Loan participation funds have done a better job for the year. Only up about 2.33% versus 1.07%. So there has been a little bit of a change as far as that goes. The last one, and I haven't really brought this up on prior conversations, but remember I told you that global bond funds did well? If we take a look at global income funds, there's only four interval funds versus 13 traditional, but we see that the interval funds had a 7.33% year to date return 2020 for the interval group, and a 3.68% return for a conventional closed-end funds.

So again, this is one of those areas where global income, you have to take a look at what they're doing. Are they focused in a particular country or a particular region? How broad based are they? Are they doing investment grade versus maybe higher yielding? So we need to keep an eye on that, but certainly there are opportunities for people to invest in the interval fund space.

CEFA:

As we start the year 2021, how would you see investors best utilizing interval funds and their income-oriented portfolios?

Tom Roseen:

Again, I think that people will be using this. It's one of those things where you want to look for opportunities to get a higher yield. You want to find stuff that has at least some sort of non-correlation with the existing stocks you have in your portfolio, or fixed income pieces you have in your portfolio, so you can increase return. So I think we do see investors looking for this as the opportunity to increase yield and opportunity to invest into private placement and private bond offerings. This is that opportunity, is to get into that space. So again, I wouldn't go whole hog into this, but I do believe this is an opportunity for investors to get in an opportunity for a long buy and hold investment that has yield opportunity.

CEFA:

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

Tom Roseen:

Diane, thanks for having me. Appreciate it.

CEFA:

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