CEF Quarterly Review
July 2022 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. 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, Diane. Good to be here.

CEFA:

Tom, you recently published your report for June 2022, which covers over 600 closed end and interval funds. How did investment markets generally perform in the second quarter of 2022? And what was the impact on closed end funds?

Tom Roseen:

Well, it was actually a fairly dower quarter. In fact, let me just give you a couple of statistics front to kind of paint how bad this really was. So, if we look at the first half of the year and this would be probably the only time I talk first half, we saw that the NASDAQ was down 29.51%. S & P was down 20.58%. Again, that's for the first half of the year. That's the worst first half of the year since 1970. So, the numbers are not looking that good.

After a 75 basis point interest rate hike by the Federal Reserve right in the middle of June, that's its largest rate hike since 1994, consumer prices soared to another high, 8.6% on a year over year basis. It's a 40 year high something we haven't seen for quite some time.

And certainly inflationary fears have been, and not just inflation but recessionary fears, have been on the forefront of investors' minds. So it really was kind of a dower situation. It was a horrible return period. And so our numbers are going to reflect that.

So for Q2, when we're taking a look at it, equity funds were down 10.60%. And if we take a look at that quarterly figure, fixed income funds, they were down 7.93%. That's the largest quarterly decline for either of those two asset classes for at least two years. And let me add onto that, for the average equity closed end fund for June, we're down about 6.73% and for fixed income funds down 4.54%. Both of those are the worst monthly performance we've seen since March 31st, 2020. So this really has just been a tough quarter. We're glad to get this behind us. Hopefully we got some better numbers coming at us in the quarters and years ahead.

CEFA:

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

Tom Roseen:

Well, let's do what we've done in the past. Let's talk about first the macro groups. This gives us a better picture. I told you what equities were. They were down 6.73% for June. Let's talk about the macro groups, that gives us a little better bird's eye view of what's going on.

So on the equity side of the universe, mixed asset funds, those are both equity and fixed income funds, combination of those, lost about 6.4%. It's the first month in seven they've actually been at the top of the group or mitigated losses better than the other macro groups. Domestic equity funds lost about 6.55% and world equity funds were down a whopping 7.58% for the month. Now, if I gave you quick quarterly numbers, and I am going to do that in this case, just so you get a view of this, mixed asset funds were down 11.93% for Q2.

And then if we take a look at the domestic equity funds down about 9.27% and world equity funds actually took the one, two punch down 13.34% for Q2. So again, it was just kind of a bad period, but again, there were funds in classifications that mitigated losses better than the others.

Let's go ahead and take a look at those. Real estate funds actually only were down for June 1.65%. Emerging market funds, ironically, we were down only 5.14%. I can't believe I say 'only.' It was just one of those months, it was just big down. The emerging market funds actually benefited from some late news in June that China had planned on removing those strict restrictions they had for their COVID lockdown. This has been the cause of a lot of bottlenecks in our supply chain. And so there were some rumors out there, China region funds were the top for forming funds. So there was four funds out there that were top performing funds in the entire equity universe. That's changed a little bit here recently. There's new rumors that they're going to go into another new lockdown in a different province.

But anyways, the second was again, emerging market funds down 5.14% and income and preferred stock funds were down about 5.59%. So those were the best returning funds. Now, if we take a look at the bottom with oil declining, 7.77% for the month of June, closed about $105.76 per barrel, it wasn't surprising to see energy master limited partnerships down 14.62%. That's a pretty big drop for a month. Natural resources funds were down 13.4% and developed market funds were down about 10.70%. Now, that was the view of equity funds. So let's take a look at the fixed income universe.

Same thing, go through macro groups first. For the second month in a row, munis were at the top or mitigated losses better than the other macro groups. Down 4.24%, still down a whopping 7.17% for Q2. Domestic taxable fixed income funds down about 4.42%. They've lost about 8.09% for the quarter. And then world taxable have taken really the one, two punch again, down 7.12%. and for the quarter 10.42%.

So with treasury yields rising over 66 basis points in Q2, settling right around 2.98%, they actually hit a yield high of 3.49%. That's a big number, on June 14th. So we had a little bit of reprieve in June. The carnage wasn't quite as bad as it could have been, but with the treasury yield curve inverting at both the five and seven year maturities, that is the five year was at 3.01% at the month end. the seven year was at 3.04%, but you can actually only get 2.98% for the ten year.

People are very concerned that we might have a recession and other concerns going around. So, so really it was a tough time. Maybe one of the more tougher times we've seen in a while for fixed income funds. And so people had a tendency to move towards safety or quality, and that's kind of hard to find in the closed end fund space, right? There's not a lot of treasury bond funds out in the closed end fund space. So the safe haven place were U.S. mortgage funds, 1.89% loss for the month of June. General insured municipal debt funds 2.38% loss, intermediate municipal debt funds down 2.72% and corporate triple B rated funds were down about 3.04%, but the biggest losses we saw: emerging market debt down 10.04%, high yield funds down about 7.56%, that was on a leverage basis. So really was a tough time for fixed income funds this month.

<u>**CEFA**</u>:

Is this a change from what you saw earlier in the second quarter?

<u>**Tom Roseen**</u>:

Kind of a similar trends we were seeing for fixed income funds, but if we take a look at equity funds, there were some big changes. Remember I just told you that basically we saw energy and natural resources funds just taking it on the chin. Well if I take a look, a month back, in May instead of June, energy and natural resources were on the plus side, so they were still in play. China was completely out of favor. It actually did pretty well this last month.

Again, I think people should be weary of that though, because I think in the last day or two, China has actually said some new provinces will go into a severe COVID lockdown again. And so that might impact our supply side issue. Munis though, were the safe haven bet in May. They actually had some plus side performance. This month, they were all in the red, all the classifications in the group, but they certainly mitigated losses better than the other taxable bond funds that they go against, so world taxable bond funds as well. So we really did see a change in equities, but kind of similar pattern for fixed income closed end funds.

CEFA:

Do you expect these trends to continue over the rest of 2022?

Tom Roseen:

From the point of view of volatility, absolutely. I think what most people are going to have to be wary about is in the last couple of weeks, we've actually seen people going back to the stay at home stocks. And not that they're worried about stay at home, maybe they are, but technologies have been beaten so badly that people have seen bargain opportunities. So we've seen a little bit of a jump in energy, a little bit of jump in technology and the like, those have been doing well over the last couple of weeks. But if you look back to the quarter and the end, that basically was not the case, they were still a prize. People were still trying to go after value, large company names and the like. So I think that's what the big million dollar question's going to be is, do we go with some recent runs, buying out of favor stocks, hoping that we're at the bottom, or do investors say defensive? And I think that's what the major question's going to be.

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 discount behavior for June?

Tom Roseen:

Yeah, we did. So median discount, it really wasn't as big as some of the changes we saw. We've seen a constant decline from December down until about two months ago, and now we've seen a little bit better improvement. So we saw severe widening for the first four months, and then the last two months we saw a little bit of trade off there, so a little bit improvement. Median discount for all closed end funds narrowed about 31 basis points, or improved to 7.16%. That is wider, however, than the 12 month moving median discount of 4.38%. But basically what we're taking a look at though, is that it has improved from the high that we saw in April. April 29th, we saw a high of... This is, again, for all closed end funds, I don't care, fixed income or equity, of 7.99%. So again, we've seen an improvement over the last two months.

CEFA:

Which sector saw the greatest change?

Tom Roseen:

Well, if we take a look at equity funds, basically we're taking a look at 7.22% for the equity universe as a 6/30/2022. And this is actually worse than we've seen from a year ago time period, about 4.74%. Same for fixed income. We've seen degradation over this time period, 5.19%. And it compares to July 30th, 2021 of 1.33%.

So again, we're seeing the improvement, but if we take a look at the individual groups, the taxable bond macro group saw the largest narrowing, or improvement, to its discount in June; narrowing about 98 basis points to 7.16%. National munis, they actually saw the largest widening, or degradation, of their market price to its NAV, widening about 58 basis points to 7.24%.

CEFA:

Tom, since we less spoke in January, inflation has become a more significant issue. Federal Reserve policy has shifted and markets have struggled. 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 again, maybe even referencing to what we talked about just a few moments ago. This is really one of those touchy areas. We don't know how aggressive the Fed is going to be. We're at the beginning of earnings season right now. I think a lot of people are going to keep their eyes on whether we have lower beat rates than we had expected. Certainly in the last quarter, the companies were able to come out and actually beat analyst expectations. I think all eyes are going to be on that. The banks are coming out this week and the like, so I think that's what people are going to be paying attention. The COVID lockdowns are a concern as well. The rumor right at the month end is that they were loosening everything up, and just the last two days we saw China say we're going to get real aggressive again. And, and I think the rate hikes, how aggressive the Fed is actually going to be to step on the brakes, stop a recession. Will it be a soft landing or hard landing?

So back to your question, basically, I think what we're going to see is the large caps possibly still doing well. A safe haven place might benefit these type of situations where you after large names with good steady balance sheets and the like. The U.S. mortgage funds might be something that come into play, and corporate investment grade debt funds might do better. Again, what we saw, and it seems to be that they're leaning that way, is U.S. mortgage funds did okay, utility funds, which would benefit if they could pass out those higher rates through to their customers, income preferred stocks and corporate triple B rated funds may be a place to take a look at.

But again, it really all depends where that tipping point is and that, so I'm a little concerned about saying this is a call where we should go, but it's certainly something we should be taking a look at. Do we stay on path with the defensive plays, kind of leaning that way, or is it buy the bottom? Are we at the bottom, and just kind of reaching new highs for those low periods? And if so, are we on the way back up? Could investors buy a deeply discounted fund in a closed end fund space that actually might even have some legs on it going forward? That'll be the million dollar question.

CEFA:

If Federal Reserve policy on interest rates is relatively aggressive in the near term, how do you expect this to impact closed end funds?

Tom Roseen:

So there's two points here. Obviously as we have rising interest rates, two things are impacted on the closed end fund side. At the short end, when we borrow, when we use leverage, we may have to worry about rates increasing enough, where it could either cause a fund to tailor back some of its borrowing practices and the like, because the short term rates are really what are being effected right now, that part of the curve. And when it becomes too expensive to borrow, and the expected returns coming back. So that could be something that everyone watches: leveraged funds.

And then also, if we take a look at returns overall. Again, if it's slow and steady... Which it hasn't been so far, we've seen three interest rate hikes. I think it's been a total of 125 to 150 basis point increase just this year. That has an impact, the value of our underlying fixed income securities within our bond portfolios. So that can have an influence as well. Now, if we can go sideways for a little while, and maybe even see what we saw here drop in the ten year, from 3.49% to 2.98%, we could have some capital appreciation. I'm not holding my breath on that. So those are kind of what I'm taking a look at with the rising interest rates here are coming at us.

CEFA:

Tom, you also follow interval funds, which typically offer limited quarterly liquidity to investors. How have interval funds generally performed in the second quarter of 2022?

Tom Roseen:

So they actually had a really spectacular quarter. Not too often do I use the word spectacular. The numbers are quite stark. For the quarter, interval funds... This is looking at all of them. I didn't care if they were equities or fixed income, or what classification they were in. But interval funds, about 165 of them, were able to mitigate losses over the Q2, 4.34% was their average loss. If we take a look at the conventional fund side, their average loss was 10.87%, that's about 440 funds. So I want to make sure people know it's a smaller universe, 165 versus 440, but six percentage points difference was almost the difference.

Now, if I dig down in that a little bit more, we can see that the mitigated loss is better in most cases. But if we take a look, we actually saw in real estate funds, interval funds actually had a return of 1.81% return. There was 34 interval funds in the real estate space. And the nine funds that were in the conventional fund space lost 16.44%. So there was quite a dichotomy in that. We can run down a couple other areas, but the bigger areas that we take a look at where there's a big number...

General bond funds is a little bit more in line, a little bit more realistic in the numbers. General bond funds were down by 5.96%. On the interval side, there was 46 funds in that category and versus 10.47% loss and there was 23 funds in the general bond fund category. So these type of numbers we've seen all the way through. Most of the areas that had significant focus on interval funds, in other words, a 50/50 split or near, we saw the interval funds outperform. Last one, global income funds were up to 0.39% over Q2. There was five funds in that category. And then we take a look at the conventional closed end fund side, had a loss of 11.66%, and it was 12 funds in that category. So overall interval funds shine this quarter.

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, this is again... Are we betting on a continuation of defensive stocks? And if we are.. Or secured issue, can't just say stocks, cause there's obviously bond funds in there as well... But if we take a look at real estate and utility funds, those might be areas that could be of an interest. Again, it all depends if we think defensiveness is going to go on, gas prices will continue to go back up. Although we've seen a lightening, I told you 7.77% decline in the costs of near month crude oil prices. Those could be possible bets, but here's, I guess the contrarian side of me that says we've taken some of these classifications, beaten them down quite a bit. For instance, energy master limited partnerships a year ago was a pariah. They did absolutely wonderful in 2021. Are there cases in the sector equity universe where you could find some deeply discounted funds that are selling at a deep discount, but also have gotten beaten up? So you could get a double bang for that.

The issue with that, those playing contrarian, how long will this last? I don't think anybody's able to know. So, again, it all depends if we're playing the defensive play, real estate, utilities, or do we have to go after the go-go areas and look at sector equity plays and let it run? I'm going to be impartial this time. I'm not going to weigh in like I have in other quarters. Like I said, I think we need to take a look at what happens to this earnings season that's coming to us and certainly what the Fed's going to do as far as aggressiveness and interest rate hikes going forward.

CEFA:

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

Tom Roseen:

Diane, thanks for having me. It was my pleasure.

CEFA:

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