CEF Monthly Review:

March 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. 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:

Good to be with you, Diane. Thanks for having me.

CEFA:

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

Tom Roseen:

Well, investors, actually had three things that they focused on in February. First of all, was the improvement in vaccine rollout that was important to the economy and it was important to investors and of course, important to the world as a whole, but they also focused on President Biden's $1.9 trillion coronavirus relief package, and it is getting nearer to being completed. Recently it just passed the House and it's going to be put forward to the Senate. And so people were keeping a close eye on that. And of course, with that idea, this improving vaccine, people being able to travel more and the like, we saw an issue of reinflation. A lot of people talking about inflation, but really I think a lot of people are, it's true that interest rates are so low, talking about inflation at this point is a little bit crazy, but reinflation, I think is the term people are using.

So we had a great start to the month of February, the NASDAQ and the Russell 2000 and S&P 500 and the Dow all hit new highs. It was just a party that just kept on rolling, but then we had reality set in. And that is, when we start opening up, things may become inflationary in nature. And so what we saw was the 10-year treasury yield actually jumped to numbers that we haven't seen for quite some time, at least nine, 10 months, but we saw that it rose to 1.54% on February 25th. It actually closed the month out at 1.44%. That raised a lot of attention, because we were just hovering around 1% last month. And of course if you get an additional 44 points on, it's a big deal. But this was also kind of a rough ending, a rough landing, it was exacerbated by near month crude oil prices rising 14.46% for the month to end at $59 75. And again, that's kind of that inflationary thing. So we're looking at two things.

The impact that higher borrowing rates will have on corporations, and also this heightening in the yield curve or steepening of the yield curve causing maybe investors on the equity side, jumping ship and going back to bond funds. So we still had very positive returns. We saw that the Russell 2000 returned about 6.14%. And then the Dow has been for many months, the NASDAQ still remain in positive territory, up 0.93%. And how that panned out to the closed-end fund universe, we look at equities as a whole. They had a 2.43% return, fourth month in a row they've had plus side performance. And that was on a NAV basis. On a market basis, they're up a whopping 4.85% for the month.

But on the fixed income side, this kind of inflationary concern caused investors to, if you will, bid down some of the paper out there. Fixed income funds overall loss is about 0.52%, not a lot, but it's the first month in 11 that they've seen negative returns. And on market basis, we were at about 0%. Might've been a little bit negative I'd have to go out like four decimal places to find out that it was slightly negative, but about 0%. So that's how it panned out for the closed-end fund universe so far.

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 as I've done the past let me just give you a quick summary of kind of the macro groups, this is rolling them up into kind of groupings that make sense. So on the equity side, we had domestic equity funds. Second month in a row did very well, 2.75% in fact, if we take a look at all equity funds overall, 82% of all closed-end fund equity funds were on the plus side. World equity funds returned about 2.25%, and then mixed asset funds returned about 1.54%. But if we take a look on the fixed income side, we only had about 47% of all closed-end funds actually put up plus side performance, first month in four that we've actually seen negative returns in this group. But at the top of the group, we saw fixed income domestic taxable funds actually stay on the plus side, 0.76%. And again, this is the first month in four that they've stayed at the top of the group.

Prior to that, we had some rotation going on, we've talked about in the past. But world bond funds suffered a little downside performance, losing about 0.45% on that basis. And then muni bond funds actually took it on the chin, 2.22% decline. This is the first month in four that they've suffered negative returns. Now, if we break that down in what you were asking though, on the equity side, we saw that for the second month in a row, Energy Master Limited Partnerships actually rose 6.91%, the second month in a row. Makes sense. I told you that we had this big rise in oil futures. Natural resources funds also did very well, up at 6.89%. And at the bottom of the barrel, we saw some of the dividend payers, this is kind of the area where people might jump ship a little bit, maybe move back to bonds, except for the only negative performance in the equity universe down 1.94%.

And then we'll take a look at the fixed income side for the first month in seven, we saw high yield leveraged funds rise to the top, a return of about 1.02%. loan participation funds, those funds that actually take account of floating rates and rising interest rates benefit from that, up 0.94%. But at the bottom we saw California Municipal Debt Funds take the biggest black eye, down about 2.71% for the month.

CEFA:

Is this a change from what you saw in January?

Tom Roseen:

It is. While we saw energy and financials actually do well in the past, they were the top performers. We've talked about rotation, that certainly continued in February. So energy and financials did very well. And the dividend payers, as I just mentioned, actually took a little bit of a beating and they weren't shunned really. But again, they didn't lose a ton of money, but this is where the kind of interest sensitive issues struggled a bit as investors became more focused on what bond funds could do if the interest rates continue to go up. But the real change that we saw was in the fixed income space. In the past, investors were kind of playing it safe. Staying in governments, staying in municipals, kind of doing safe haven plays, triple B investment grade debt bond funds and the like, but this is where we saw kind of the biggest losses. As I told you, muni-bond funds suffered the biggest losses that they've seen in four months, but I didn't kind of indicate all nine municipal bond fund classifications were in the negative. So this was kind of a big change from what we saw last month.

CEFA:

So do you expect these trends to continue into March?

Tom Roseen:

I do. Earnings season is at an end. So right now people are going to pay attention to COVID financial aid coming out, focus more on economic data, certainly pay attention to interest rates and prices. We're going to keep a close eye on oil and gas and the like. So I think this is something that people are going to be paying a lot more attention to, and they're going to be looking for reasons to prop up the market. So at the last part of the month, we saw a little bit of negativity enter the market. We saw a little more volatility come in, and I think we're going to continue on with that for a little while as we kind of look for a stabilization point. And again, certainly until we can start getting new corporate earnings back out as well. So again, it'll be very economically sensitive.

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 February?

Tom Roseen:

We did. We saw a really stark narrowing of discounts on February 26th. Obviously, we saw it on a daily and weekly basis, but we're looking at kind of that exact closing value between the NAV and the market price. If we take a look at all closed-end funds, they saw a narrowing of about 169 basis points to 5.60% as far as the discount goes. So that's a pretty big move. Equity funds, if we take a look at it as a whole and not breaking it down into domestic or any other types, 202 basis points down to 8.11%. And we saw fixed income closed-end funds actually see a narrowing of about 119 basis points to 4.94%. So these are all fairly big changes that we saw.

CEFA:

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

Tom Roseen:

So if we take a look at last February, and that would be 13 months back as we all know, February 28th 2020 through February 26th, that was the last trading day in 2021. We saw that there was about 90 closed-end funds trading at a premium this year versus a year ago, only 61. So that was a pretty big change. But if we take a look at it, basically we saw that all closed-end funds, as I've talked about, I've taken out all and then equity and then fixed income. They narrowed quite significantly, but really they only dropped about 8.08% a year ago.

And so we saw a discount and now we have it at 5.6% discounts. So really we're seeing quite a change. So in that 13 month time period, this is some of the biggest discounts that we've seen in quite some time. Breaking that out in the equity and fixed income equity, it was at 8.11% recently versus 7.72% in February of 2020. So we're still a little bit higher in that area, but where we saw the big change was in fixed income. Fixed income discounts have narrowed considerably, 4.94%. I told you about a little bit earlier, versus 8.38% a year ago, 13 months ago, actually on this. And this is again, one of the largest discount average, actually it's the median for that group that we've seen in quite some time.

CEFA:

And which sector saw the greatest change?

Tom Roseen:

As I mentioned, the equity funds saw a 202 basis point decline, or narrowing in their discounts, or improvement, I should say, in their discounts. But if we're taking kind of looking at rather a broad-based group and go to some of the narrow groups, single state municipals actually saw the biggest narrowing, 186 basis points to 6.13% on February 26th.

CEFA:

Tom, equity markets have had a pretty good start to the year, but some investors are raising concerns about inflation. 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:

There are, and obviously many people will keep an eye on, for instance, natural resources and energy MLP funds and the like, but keep in mind, we've had several months in a row that they've done spectacularly well. Looking at world equity funds, and I think a lot of people are changing their focus now from kind of the US model, looking at the Amazons and Googles and the Alphabets or whatever, looking at kind of those stay-at-home tech stocks, now they're saying, listen, a lot of the world didn't participate in this recent rally, at least not as well as the US, so world equity funds are still trading in the double digit area. So, when we take a look at their discounts, they're still at minus 10.80%, and they actually dropped about 157 basis points in February as well. So they've seen an improvement in their discount, but if we take a look at it, it's still trading below the discount from last year, significantly below. So I don't want to put too much emphasis on it. About a year ago when we took a look at this it was between 15% and 18% discount.

Now we're at 10% in the world equity arena. But again, it's something that people are keeping an eye on. And when we take a look at returns, and we look at year to date returns, I think that's kind of the story that we're taking a look at, developed market funds did not participate in much of this rally as we've seen in some of the top performers. Year to date, they're only up to 0.27%. And emerging markets are only up about 1.91%. So I think there could be some opportunity there, but again, if we started having inflationary concerns and if the central bank starts shutting off this easy money, we could have some problems there as well. So people have to take that very cautiously. But if we take a look at the fixed income side, I think we see also some opportunities in the emerging market debt funds, local currency group, basically they're down 2.79% year to date. It's only a two month time period. But again, I see possible opportunities in those spaces.

CEFA:

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

Tom Roseen:

Well, they've actually had kind of a mixed review. If we take a look at the domestic equity side, we see that the average interval fund had about a 2.42% return. If we take a look at the conventional closed-end fund on the domestic side, again, we saw about 4.69% return. So really, a better overall grouping in the traditional or conventional closed-end funds group. But again, this is a little bit different when you're taking a look at the number of funds that are out there. I'm doing a little bit of a apples to oranges comparison, for instance, natural resources funds don't have any interval funds out there. So they were missing out on that huge rally I was talking about. In fact, natural resources funds were up about 10.61% for that year to date time period I was talking about. But if we take a look then at real estate funds, they did underperform a little bit, 1.77% versus the conventional closed-end fund, about 2.70%.

But flip side, if we take a look at the sector equity funds grouping, which has a lot of the financials in there, they out-performed, 3.71% versus 1.55% for the conventional closed-end funds. And then one last comparison as well, where we saw a little bit of a difference is we look at general bond groups. Basically we saw the general bond groups, and this is where interval funds have one of their biggest showings, about 44 interval funds compared to 25 conventional closed-end funds. They outpaced about 199.6 basis points. Let's call it 2% return versus a 1.23% return for the conventional group. So it has been a bit mixed bag, but again, if you're selective, you look at it and you dig deep, you can find some pretty strong performance in the interval fund categories as well.

CEFA:

Are there a particular asset classes or investments strategies you believe make sense for an investor to consider in an interval fund structure?

Tom Roseen:

There are. And again, we've talked about this in the past, and I want people to really understand that there is an illiquid side to this, and this is why they have the benefit of sometimes going into private placements, whether it be on the equity side or the bond fund side, and in order to reach that you and I cannot get out of these funds on a regular basis. In fact, most only have a quarterly refunding. And during that quarterly redemption period that you can get in, they usually set it at a limit of 5% or 10%. So when you want to get out, you may not be able to get out.

But that said, if you are in a long buy and hold position, and you are looking for yield, or you're looking for opportunities to be in some different private placements on the equity side or bond fund side, this is where I think the long-term investor could actually gain some benefit, again, if they have that long focus. But again, the caveat emptor is the major issue is that you may not get out in the timeframe that you want to get out and so you have to take that with a large amount of concern if you're looking for liquidity.

CEFA:

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

Tom Roseen:

Dianne, thanks for having me.

CEFA:

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