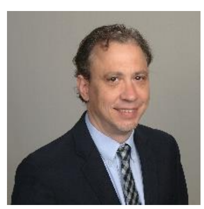
November 2022 Live Event-AICA Fall CEF/BDC/Interval Fund Bootcamp and Roundtable Panel #8; “How to Analyze & Trade CEFs: An Institutional Perspective”

Wednesday, November 16, 2022

John Cole Scott, CIO at CEF Advisors and Founder of CEFData.com, moderates the eighth panel of the AICA November 16th, 2022 live event; “How to Analyze & Trade CEFs: An Institutional Perspective”. Read the transcript below to hear the discussion among Mr. Scott and panelists Mark Milner, Senior Investment Strategist with Parametric, Rob Shaker, Chief Investment Strategist and Partner with Shaker Financial Services, and Steve O’Neill, CFA and Portfolio Manger with RiverNorth.


John Cole Scott


Mark Milner


Rob Shaker


Steve O’Neill

To view the rest of the conference events and panels go to:
https://aicalliance.org/aica-event/aicanyc2022/

John Cole Scott: As the tech people are getting final things settled, I’ll just say I love all of our panels, but this is a chance for me to invite some of the folks that are also institutional investors in closed-end funds to chat about what they’ve learned, what they do. And I’ll tell you, if you don’t know yet, all three of these guys do a closed-end fund portfolio differently, and that’s a great thing because you’re going to hear lots of different ideas and different perspectives. I do appreciate you guys sticking around all day to hear this session.

We're good to go. All right, so hello, my name is John Cole Scott, I probably don't need much of an introduction here. I'm excited to lead this panel. And to start it off, I would appreciate if everyone just really give us, besides your name and firm, a sense of your background, your firm's background, and I would say the ways you put closed-end funds into investment products or portfolios. Want to go first, Steve?

Steve O'Neill: Hi, my name's Steve O'Neill, I'm a portfolio manager at RiverNorth. I used to be a banker, and we lent money to closed-end funds and I thought that that was an interesting investment vehicle. My partner and I, well, I was not a founding partner, but my partner started a firm which was closed-end fund trading, and we built an arbitrage business and a long-only business. The idea on the long only side is we're not smarter than BlackRock, but if we can buy BlackRock at a discount, we're going to outperform. And so we use closed-end funds for just asset class exposure and we try to generate alpha by timing discounts in the market. And I've been trading closed-end funds, sitting in front of the same Bloomberg screen since 2007.

Mark Milner: Awesome, thanks Steve. Mark Milner with Parametric, most of you may know Parametric as a custom index, direct indexing provider. We do also have a closed-end fund solution, which we call our Enhanced Income Suite, that's been around for coming up on 10 years now. There was initial research before that, everything of course at Parametric is research driven, but really our main focus again is income, it's the income generation that closed-end funds provide. So that's really our main focus and creating, we've heard that multiple times today, that paycheck replication, that cash flow for the investors. And taking advantage of the unique parts of the asset class, obviously capturing discounts, especially when they're wider like they are these days.

Rob Shaker: I'm Rob Shaker, I'm with Shaker Financial, we manage separately managed accounts for a variety of clientele, all almost exclusively with closed-end funds. Our main strategy is what we call discount capture. We're actively managed accounts and so we will get into a position at a wide discount, looking to flip it at a narrower discount, and then reallocate it into a different closed-end fund. And in that way we're able to be a little bit additive to a more buy-and-hold situation than you would have through closed-end funds.

John Cole Scott: Very good. And to keep extending this conversation I always think it's helpful to say how many funds in an example allocation, because there's different strategies here, do you consider diversified? Do you want to start with that, Rob?

Rob Shaker: Yeah, depending on the size of the client, as I said, we'll have anything from a couple hundred thousand to a couple million in an account, we'll like to have maybe on the equity side sort of 10 to 15 and on the bond side five to 10 at least. Closed-end funds tend to move, there'll be movements, and sometimes especially if you get to bond funds, you might have preferred bond funds widening while senior loans are narrowing. And so you just get a better overall balance if you're able to diversify through different parts of different asset classes.

John Cole Scott: Mark?

Mark Milner: Yeah, I think our quoted materials say 40 to 70 names for diversification. That's just what we do, but we do things a little bit differently because we're of course diversifying across asset classes. We run roughly a 50-50 equity/fixed-income blend, and then sub asset class diversification underneath that. And so just having that wide diversification forces us into holding more names than maybe Rob would hold. You can certainly obviously achieve diversification with fewer names, but at a larger institutional scale, that's the number that we typically end up.

Steve O'Neill: Sure. I guess I would say I think closed-end funds are diversified, like if you buy NEA, there's a couple thousand bond issues in there. So I don't know if you really need to buy BlackRock's biggest fund, Nuveen's and Invesco. I feel like each one is diversified. But to Mark's point, when you're building multi-asset class portfolios, you're going to build a number of different funds because each one represents a different asset class. And so I don't think it's a bad thing if you just had a couple closed-end funds in your portfolio, as long as they were diversified. There's some equity names that are more concentrated and we've got Rivian risk on a look-through basis you don't want to think about, but most funds are really diversified, especially the fixed-income funds.

What I would say though is in practice what do we do? In practice we're probably open to trading most closed-end funds every day, which means 30-40 funds that we're trading just around. To manage a target saying we want to be X% munis, we'll just keep rotating around that. But I do think that if you're a do it yourself investor, a couple is pretty good, but if you want to take it to the next level there's a lot of trading opportunities. And so that kind of lends itself to more of an accordion feature, a more volatile, the more names you're adding to the portfolios things calm down.

John Cole Scott: Interesting, and if you want to maybe answer the next question as we think about discounts. Obviously if you're into listed closed-end funds discounts are a factor. And this question, the goal is going after real discounts. And when I say real, I mean discounts where there's a reasonable chance, there's more discount volatility in the sector or in the sponsor versus I'll say fake discounts. There's some funds, and we all know them, that have very narrow discount ranges that rarely move. So how do you think about those two discounts, and where do you get your analysis from? This is for Steve to start.

Steve O'Neill: Sure. I would say any level 1, level 2 security portfolio, it's a real discount. I agree with what John's saying, some funds just don't move, like US general equity funds, the old school names, they never move. Is that a real discount? It is real because those are level 1 assets, but I think a fake discount would be if a fund's got 20% level 3 assets you can say, "Well, I don't know about that discount," there's a fair value question. But I think in terms of what you want to bet on, maybe if the goal is to try to generate alpha trading closed-end funds, what you don't want to see is a 10-year average at 13%. That's, I would say fake value not fake discount.

Something that we learned really early, if the four of us said, "What's the best bond fund?" We'd look at leverage, and we'd look at fees, and we'd look at tracking error versus the benchmark, and we'd say, "This is the qualitative score. The discount must narrow because it's so good." That's irrelevant, it's really what other people like. And so I feel like closed-end fund trading is what is popular to investors, and frankly that's yield.

And so everything we do, we have this collective view of how to analyze closed-end funds. But you got to kind of look at it the other way, what's the retail experience? What's the dividend stability? What's the coverage? Those things matter to those investors. So you want to trade names that you think other investors will come back to, not necessarily what you fundamentally score as the strongest closed-end fund.

John Cole Scott: So you bang your fist and you go, "This is the best fund, why won't it narrow!?"

Steve O'Neill: Yeah, exactly.

John Cole Scott: All right, Mark, do you want to stab at that question?

Mark Milner: Yeah, I think Steve definitely hit the equity piece, that's certainly part of it. Yeah, part of it I guess has to do with historical or relative discounts. Obviously you don't want something that's trading in a tight band. When we come to asset class diversification, that gives us a little bit of a, maybe not an edge but that's one way to think about it. Because obviously if something is trading at a discount relative to peers, a greater discount relative to peers, there's something worth noting there, it doesn't mean it's worth investing in. But certainly reviewing things on a comparative basis both historically and both with peers is certainly a good opportunity.

And then I think too, broadly just closed-end funds in general, like we've seen this year with discounts basically across every asset class blow out, that creates an opportunity as well. I'm not saying you throw out all of your analysis, because we are systematic and rules-based investors, but you certainly get more opportunities that way in a market environment like this than like you had last summer when discount were exceptionally narrow.

John Cole Scott: Thank you. Let's see, so Rob, maybe talk more about your investment process. Yes, it's quantitative, but would you call it diversified, focused, tactical, systematic? What would really be the talking points to say, "This is how we're different"?

Rob Shaker: I guess if there's something we're different about it's that we're a little bit agnostic about once we diversify, where we're going to diversify. So for example, going in, I wouldn't care in a client account if they happen to have an international bond fund or a preferred bond fund or multi sector, because what I'm really looking for is where is it going to be discount-wise two weeks, three weeks from now?

The idea being if you can buy a bond fund when it's 1% wider than where you think it's going to be, and then sell it when it's narrower 1% than where you think it should be, you just made 2%. And so in that interim period, while you're waiting around for that movement to happen, as long as you're diversified, do I know what's going to do better, international or preferred bond funds next month? I don't, and I don't pretend to. I'll try and stay diversified while I'm doing this.

We're all quant based, right? We don't pretend to be super tactical and know that this is the best bond sector fund to be in for the next two months, but we'll stay diversified. We're not going to have all my clients, for example in the last week, preferred bond funds were probably, by what we were looking at metrics, the best place to be in terms of where we could get some good discount movement. But that doesn't mean all our clients are just in bond preferred funds, we have a limit that they can only have one of those because we want to keep them diversified.

But the main idea being, John would joke sometimes, he would say, "Between these two large caps, which fund do you like better?" And I'm like, "Well, what day is it?" What are the discounts today as compared to tomorrow? Because I don't know who's going to do better next week NAV wise between ADX and CDT or TY, I just don't, and I don't pretend to. But I can have a good idea and a fundamental belief as to who was going to narrow more and who is going to give me more of a discount movement that I can capture over that time.

John Cole Scott: Okay. Mark, do you want to really quantify how you guys feel you're different in the role of closed-end fund investors?

Mark Milner: Yeah, it actually touches on both what Rob and Steve talked about. So obviously on the discount side, so systematic and rules-based investing, so we're ranking and screening the entire US listed closed-end fund universe, bucketing in the various asset classes to create that diversification, that forced diversification, and then rebalancing back to target weights on a more or less regimented systematic schedule.

We do that for a couple of reasons. One, because obviously these funds are kicking off a lot of cash, we want to be invested so we're redeploying that cash. And then to take advantage of those discount opportunities like Rob was talking about, so we want to be able to capture those larger discounts. Now obviously some of them aren't always perfect, that's the question from before. But the research that we've done has shown that rebalancing into funds with a larger discount tends to be an alpha generator over time.

And again, over time being the key because we're a long-term focused investors, we want to buy and hold closed-end funds at a discount, similar to Rob. I think we probably hold them a little longer than he does, but we're willing to buy them at a discount. If you think about it like buying a bond, pay less, pay 85, 88, 90 cents on the dollar and sell it for 98-96 cents on the dollar down the road, and all that time you're willing to just collect that income. And that's really what the main focus is again of the strategy, we want to generate that income, that cashflow for those investors. That's really what our hallmark is.

John Cole Scott: And Steve, do you want to chime in as well?

Steve O'Neill: Sure. Let me think of something new to add to this conversation. I guess I would say collectively as institutional investors, we're dedicated to the space, the four of us up here. Our firm is 20 people, and 10 of those people touch the investments, so we've got a data team at RiverNorth that breaks out every closed-end fund and tells us what the asset class exposures are and the best way to hedge it, and that feeds into a model. We've got another team looking at balance sheet information so we know which muni funds look the best and a selloff based off leverage ratios.

And then our trading team, we face the market every day on 30-40 securities, we get a lot of market intel that way. And I feel like that's just what any institutional investor would do. I feel like the ideas that we come up, we're like, "Oh, yeah, we all like NEA, it's a big Nuveen bond fund trading at a 10% discount."

John Cole Scott: You must like NEA.

Steve O'Neill: I do like NEA, I mean, it's $3.5 billion. But I would say institutionally I think that's a common theme, and I think why it works for all of us is there's just not that much competition there. A lot of people come in the closed-end fund space and the discounts are wide but they're not really sure which one to buy.

But I feel like if you dedicate the time systematically or trading-wise or fundamental ranking, you just kind of sit back and you always know what to do because you've been thinking about the funds all the time. Which I think is collectively our unique advantage, which is this is what we do every day, and so it's not a weekend hobby to invest in closed-end funds. I think there's a lot of alpha in just knowing more than the average trader out there.

John Cole Scott: Helpful. And so the other side of closed-end funds that we talked about so far is yield, and I know we've talked about this at great length. Steve, if you can maybe talk, muni funds is the largest bucket, if you want to wander, you have a chance. Dividend coverage, dividend changes, how do you think about that when you are an owner of a fund and there's a change either direction, and if it's on your target list either direction.

Steve O'Neill: Yeah, briefly I guess it goes back to what we think other investors will think about that. As fundamental investors we know what the asset class return is, we know what the costs of leverage are, we know what the fees are, and so we can pretty easily determine what the real earnings power of the muni fund is. Now there's nuances in terms of what the book yields are across the portfolios. So if a fund was cut from 5.5% to 5.25% I would say, "Okay well, that's pretty much in line with what I thought it could earn anyway, so I'm not that surprised, I don't care." But if I think others will care, if the discount's not wide enough to absorb that, then we would want to trade around that.

I think munis are actually the safest place because most of the time they're pretty much paying out what they earn, and so it's rare to have big changes. Whereas on equities, and sorry if I'm stealing somebody else's point here, it's kind of a managed distribution like, "I think we can earn 9%," and then you're in a bear market and they're like, "Actually we didn't earn that at all, we're at 5%, we better cut it to 7%." Those sort of changes can be really impactful. But I feel like with munis, even if you didn't have all the resources and all the data, you could pretty much rest assured that what the payout ratio is pretty close to what they're actually earning, and so you rarely see big cuts in muni space.

John Cole Scott: I do want to chime in a little bit on that, as of course we all know muni bond funds have cut dividends a fair amount this year. And so you have to, the caveat of the fact that that was not that they were withholding income but they had a change in their leverage cost. And so dividend changes are common there, but I would agree, they're probably the purest form of a fund.

All right, now Rob, it's going to be a different answer, I know. How do you think about dividend cuts for equity closed-end funds at your firm?

Rob Shaker: Well, okay, to start with, and the reason John was laughing is we're very agnostic to yield and dividends. We operate in a world where all we're focused on is total return, and so to us we don't care that they're paying yields. We're going to reinvest that when the dividend comes in anyway when we do our next trade. So the fact that an equity fund would say that they are yielding 8%, to us we find somewhat laughable at one level. Because yes, they will put 8% dividends into your account, but they're not returning 8% next year because they say they're yielding 8%, because they're going to move with the market.

And so in general we recognize that for a lot of people, and one of the reasons closed-end funds are so popular is because of the yield, so for a lot of people it makes a big difference. In this fund that said it was going to pay 10%, now they're paying 6%, I kind of banked on them paying 10% in how I was going to manage my client so I gotta get out of that and get into something else. So we're there for that, we recognize it, and a lot of times it's a great trading opportunity for us.

Typically the other guy who trades with me, Dan will say, "Pretty much dividend cut plus two days." Let them sell off for about two days, off the dividend cut as people are rotating and forced out of rotating. Because anytime anyone's a forced seller, you want to be a buyer. But you kind of want to be a buyer when they're finishing up their forced selling so you might be able to get a bargain on it. But yeah, we're not particularly set on the concept of yield, more on total return, but we know that it exists. And it exists for very valid reasons for other people, it's just not what we focus on where we are.

John Cole Scott: And again, I'm not asking everyone these questions. If I'm not asking you to answer and you want to, you guys know you can always jump in. Mark?

Mark Milner: Is that an invitation?

John Cole Scott: No, I just want to make sure you know because you know, are there rules? There kind of are rules.

So another big part of listed closed-end funds is the evolving trend of rights offers and tender offers, they work in very different ways. And so Mark, as you look at the portfolios and imagine them, as you're thinking about what you own, how do you think about the probability/possibility of rights offers and tenders? And then again, you're sitting on a position, maybe it's a mid-size for your clients and you get that unexpected notice of rights offers or tenders offers, what's your thinking around those two actions for closed-end funds?

Mark Milner: Yeah, I would actually almost echo Rob's view on yield, so it's not really that impactful or important for us. It's not really something that we're focusing on, we're not spending a lot of time on. Yeah, so I'm not buying something hoping for that, I'm not buying something looking at that. Again, we're systematic, so that shouldn't show up in some sort of systematic screening and ranking process. That being said, obviously when you talked about the surprise rights or surprise warrants or something like that, then it's a managed removal or transition process.

John Cole Scott: But I'm guessing that you do tender all shares and you evaluate the rights offer?

Mark Milner: Yeah, we definitely do not openly discuss our corporate actions policies unfortunately.

John Cole Scott: The first compliance no, that's okay.

Mark Milner: Yeah, we are at the behest of our semi-new mothership Morgan Stanley. So we do have some slightly different rules now to play with, so that would be one of those.

John Cole Scott: I should have asked you three years ago, I got it.

Rob Shaker: Just in case people don't know or aren't familiar with this tender offer concept, it's important to know that not everybody tenders. So when you see this thing that says, "Oh, you get 5% back at NAV or NAV minus two," you might be like, "Oh, that's 5%, it's not even really worth doing." Well, enough people do that, that if you tender all your shares a lot of times you get 15 or 20%, and that's significant.

So I would just sort of throw that out because that was something I was surprised that when I first started doing these things. I was like, "How is not everyone?" You might have a 10% tender starting at a 10% discount, and all of a sudden only half the people did it. Just something to think about.

John Cole Scott: I will agree, because tenders you get the cash back and you can always choose the next day to buy more of it if you want. Versus rights offering, if you don't have the cash on hand and want to sell something, you may not have the more capital to deploy. Steve, do you guys look at that deeply?

Steve O'Neill: Yes, although I'm going to ask a question of you.

John Cole Scott: Okay.

Steve O'Neill: Do you think tender offers can have an intermediate term impact on discounts? Once the tender's over do you think it just widens back out?

John Cole Scott: Were you here for panel one?

Steve O'Neill: No.

John Cole Scott: Okay. Clearly. So yeah, it is definitely my firm belief that tender offers don't materially change the long-term discount trading of a discount fund. However, when you're trying to cure pain, they're some of the pieces you can use to show investors that you're sharing the pain.

Now the challenge, if it's a very small fund, you're killing the fund slowly with papercuts. So yes, do we over subscribe our tenders? Absolutely, because it's math. And then we often buy it back soon after, or occasionally we'll change our minds because we're allowed to.

Steve O'Neill: All right, I'll do a quick answer to your question. Rights offerings I feel like are great, we often participate in those. We will buy next to nothing and we'll oversubscribe a gazillion times. And if we don't get it, fine. And if we do it's gravy and we're really happy about it. And so I'd say that, if you look over our portfolios you can kind of see one to the next, us finding participation.

In terms of tenders, I would agree. I think it's actually not as good as it used to be, the fives are now 10s more for us than 15s. But I feel like people totally miss, I mean there's a tender offer now for 50% of a fund, everyone's getting all their money back. And so those big ones can be really impactful. I think there's enough of us that grab the little ones, but there's not enough of us, if it's a 25% tender or higher, you get a lot back. And so I think that those are underappreciated.

I think Western had some big ones in their high-yield funds two years ago, those were home runs. Eaton Vance as well. So when you look at a tender, I guess my home tip would be a 5% one is not going to be life changing, but some of the bigger ones, you can get pretty much all out.

John Cole Scott: Yeah, I think we're looking at the fives saying we might get 10, and then at 98% of NAV we can possibly make 1% alpha outside of any taxes or any other factors.

Steve O'Neill: [inaudible]. I think it's a great way of adding additional value to clients. I just want to bifurcate the size difference.

John Cole Scott: Appreciate that. So on our prep call one of the conversations I really enjoyed was we were talking about those big volume days because there's so many days where things were very boring in the closed-end fund world. You know that NAVs are moving and discounts are moving, sometimes the same direction, sometimes different. What are you doing when you're trading at your firm, when you're assessing those big days? Whether it's just fundamental in the market or maybe structural by the actual ticker itself. And let's see, who should I start with? I'm going to pick on Mark.

Mark Milner: I probably have the least impact, or the least thing to say on this topic, because really again we're systematically rebalancing. So the chances of us making some sort of intraday pivot to a systematic strategy with asset allocation and sub-asset allocation targets is, I'm not going to say zero, but it's about as close to zero as possible. We've made our decisions already, so big moves during the day could be outside of the closed-end fund universe driven. Certainly we've seen that a lot this year. It could just be Rob trading his portfolio, moving his book, and so he's impacting things for me. That's certainly a possibility too. But yeah, again, pretty low impact for us.

John Cole Scott: And do you ever look at the NAV and even attempt to consider what it's doing intraday? Or are you just focused on discounts and the systematic process we keep discussing at your firm?

Mark Milner: Yeah, very little. It's going to take a pretty large movement and something in a pretty wonky smaller fund, so not NEA. Which by the way, I think we're all contractually obligated to own. But yeah, it would have to be something small, a small fund with a big movement.

John Cole Scott: Parth would be appreciative of that, as well as Dave Lam, so yes.

So Rob, I'm adding to this conversation because we've talked for years on this topic. Big NAV days, big discount days, I know you guys do some work on NAV estimations. Maybe if you want to talk about your approach to NAV estimations and how you react to big NAV, big discount days.

Rob Shaker: So I guess there's two concepts here when you're talking about big movement days, and I guess what would be up days and down days, but we'll start with the up days and just in general. So what we do is we track individual closed-end funds that are holdings so that we can model in real time what they're doing, so that on the big up days or something like that, we can look for that extra little alpha by finding something that may not be moving as it should. Because sometimes the market goes up 2% and everyone's like, "Oh, so every equity fund is up 2%." Well, on the up 2% days, the divergence between somebody who might be tech-heavy, it could be significant.

But I think that's a lot because it's all we do, so we have all these models and we're staring at it. But in general I think the more interesting one you can do without having to have models is what about the down 2% days? What about the big down days? Because it comes with big movements and it comes with big volume, but it comes with something else which is fear. We were talking a little bit earlier, it's on the fear days where the things widen, all the bond funds widen 2%. They narrow back on the quiet days, no one's there.

But it's those big down days that all of a sudden all of the bond funds are on sale. And you don't really need a model for it, you can see it. People are just dumping them and dumping them all of a sudden. And sometimes it just happens at two o'clock, right? They're kind of holding in, they're kind of holding in, and then all of a sudden, two o'clock the thing you were looking at is now down 2.5% and you're like, "It's a bond fund." And so anyway, that's something.

On the big down days we find things to become much less rational than on the big up days. On the big up days, I actually think we get smaller volumes in closed-end funds than on a normal day.

John Cole Scott: So Steve, I know you guys also have a very rigorous approach to thinking about discounts, and NAV, and market price movements. Maybe you can add some color to Rob's approach and how you maybe do it differently, or similar, whatever you want to share.

Steve O'Neill: Yeah, sure. I guess I would first off agree with Mark. I mean, closed-end fund trading, the reality is, intraday we're not saying, "Oh my gosh, a 10-year move, 10 basis points, we've got to change our allocation to munis." But I do think opportunistically, what we do is we have different pools of capital. If it's an arbitrage strategy, on a big down day the NAVs are probably widening out too, that doesn't mean we're like, "Oh my gosh, we need more fixed-income exposure," because we can hedge it out. But we might trade a lot because the discounts are widening, to Rob's point.

And so I think it's kind of important. I don't think many managers make big intraday market calls on asset allocation, I wouldn't say it's a non-zero chance for us. But I would say every discount move, we're going to be really active in that. And so if discounts are widening on a big down day, like Rob, we're estimating discounts for pretty much all the funds, and so we have an un-pause trade test. And so we've got 100 munis that we might just start unpausing half of and saying, “We want to accumulate the selloff and buy into the discounts.” And we’ll either hedge out the NAV or we’ll sell cash bonds in the muni markets so we can get the closed-end funds.

Volatility I feel like is a really big gift for closed-end fund traders. Obviously the asset class is important, but if you’re shifting from cash bonds to closed-end funds, or long closed-end funds, short ETF, that volatility is kind of what we look for. And so big up and down days, we stay really busy.

John Cole Scott: I know Dan Silver on my team, we always chat. We always love stable NAVs and high discount volatility.

Steve O’Neill: That’s the secret sauce. Find the lowest NAV with the highest price volatility, that really is the secret sauce.

John Cole Scott: So do we have all the same names in our portfolios? Is it NEA?

Steve O’Neill: You do not want to trade volatile speculative tech funds, you want a discount, trade NUV. That’s the perfect example of an unlevered muni bond fund, lowest daily NAV change, high price changes. A fund like that is the perfect type of fund to day trade closed-end funds. Sorry, I keep plugging Nuveen vehicles.

John Cole Scott: RiverNorth, paid for by Nuveen.

Steve O’Neill: Nuveen is the granddaddy of closed-end funds, so it gets recognition.

John Cole Scott: Very nice. And again, this kind of was touched on earlier but I really find it interesting because there’s a handful of closed-end funds that don’t do a NAV daily. And many closed-end funds have the level 1 and level 2 assets that are easier to produce a confident NAV. I know, Steve, you already touched on this earlier, but I’d like to give a chance for anyone else, or you to add color, how much confidence do you have in a daily NAV-NAV from a listed closed-end fund? Anyone? I’m going to let whoever, who wants to jump in?

Mark Milner: I’ll shamelessly plug you, how about that? You better have good data, right? So if the fund‘s striking a daily NAV, it better be a correct NAV and it better be updated, so you better have good data source. I’m not going to slam other data sources out there. John’s firm has excellent data. But as far as funds that don’t, either that’s just the way they operate or tend to have issues, those are just things that typically just make it on our restricted list or exclusions list. We would rather trade in liquid things that we can actually quantify, so thank you.

John Cole Scott: We do our best. We talked about it. There are days where our data team will find three different NAVs from four different sources. And Dan Silver on my team is a guy that does a lot of the QA to make sure people like you are happy. It's always interesting when the fund sponsor's website isn't always right.

Mark Milner: It's not. And you know what, Dan is very responsive at six AM, so thank you Dan.

John Cole Scott: Cool. Anyone else, again, want to talk about NAV? Really it's the core of what closed-end funds are. Any other?

Rob Shaker: I don't think probably most people follow it as tight and care as much about the little half of a percent, but I will point out for what it's worth, that on big bond movement days you can't trust the daily bond NAV because they lag. One way you can tell this is going to happen is for example, if there's a huge day where high yield bond funds are moving dramatically, you can look at something like junk. And junk might be up a percent and a half, but junk IV which is actually measuring the NAV of it will only be up half a percent or three quarters of a percent. Because the underlying things haven't ticked, right?

So that night your closed-end fund high yields might report something, but it's not all of the impact of what just happened. So the next day, if it was sort of flat, you'd get a little bit more follow through. Like I said, you'd have to be playing a pretty tight metric to really worry about that, but it is something that we've found. Like I said, we model daily the equity funds, and we'll pretty much come in very close. We try to do bond funds, and it's we find it impossible just because you don't know how many of the underlying things actually ticked that night.

John Cole Scott: You can be following your fair market values marks for the NAV as a fund and a board, and still not have a proper price that updated for NAV, that makes sense. Good.

So I've got a couple more questions. I like where we are timewise. I'd like to say, we always love crystal balls at publicly recorded conferences. You know, I go back and listen to what we did three years ago. If you were to say what you think will happen to the structure, the sectors, based on what you think should happen in the next year. Next year we're in this building or another one doing this panel, what do you think we've done? I'm going to start with Steve.

Steve O'Neill: Hmm, I'm not sure I'm going to answer the question that you asked.

John Cole Scott: Okay, you're allowed to it.

Steve O'Neill: Because I was imagining a different question and thinking of my response to that one. But in terms of a crystal ball, I'm going to make an obvious comment. I think discounts on closed-end fund 2.0 will narrow. I think it's kind of ridiculous, those funds, you can just put in an Excel model, divide the year by the discount, and they're attractive. And when you compare those annualized minimum levels of alpha compared to term trusts historically, they're all really high.

In the past, 1.5 annualized alpha was pretty good, and now you've got a lot of these funds that are trading at double-digit discounts, you're still nine or 10 years out but that's pretty high. And so I would say the 2.0 closed-end funds, people probably hate them more than the 1.0 just based on when they were launched, it was just a bad point in the market cycle. But I think it's completely under appreciated. If you told somebody, I won't name this ticker.

John Cole Scott: We know what you're talking about.

Steve O'Neill: This ticker at a 17% discount will terminate in 2030. They'd be like, "Oh, that's pretty interesting. You get this portfolio with at least 200 basis points of alpha." That negates all the fee conversations. It's pretty interesting how wide they are. I think it'll be telling to see where everything trades in the new year once all these tax-loss selling opportunities are over. But I think closed-end fund 2.0 are really underrated in the market today.

John Cole Scott: That was one of my bonus questions, so thank you for answering it. Mark, would you like the answer the actual question? No?

Mark Milner: No, I'm going to actually answer the tax-loss harvest, and then I'm going to talk about the rest of this year. So I'm going to be like Steve and not answer your question.

John Cole Scott: I'm just going to leave.

Mark Milner: Maybe I'll dip into 2023 at the end, but let's go backwards first. So my hope is that, I would assume it's the same as these two gentlemen up here, is that people use the rest of this year as an opportunity that if you are going to be tax-loss harvesting, use it to rotate either into similar funds or into other sectors or industries, and capture the discounts that are available. Especially in some of the quality funds that are on sale. Obviously we've seen everything go on sale this year. Certainly things have narrowed a little bit in October, but still a lot of good quality on sale, so use that as an opportunity.

And then don't wait till the last minute if you decide you really want to tax-loss harvest or tax-loss rotate. I'm going to trademark that. So do it now and take advantage of it, don't wait till the end of the year. Especially we talked about the diversified US equity funds that pay the annual dividend, our dividend capture friend I'm sure is super excited about that. But plan around the distributions, plan around obviously trying not to trade during ultra-low volatility weeks like that week between Christmas and New Year's when everyone's trying to reshape their portfolio. So that's what I would like to see. I would like to see people stay in closed-end funds, not just dump it and go to cash or go buy an undervalued stock.

And then looking into next year, I again don't have a crystal ball, we're all usually wrong anyway. But I would think that we're not going to see the pronounced discount widening that we've seen this year, and I would like to think that performance will be better than it was this year. Those are bold calls, I realize.

John Cole Scott: Usually when you have the worst closed-end fund years, the performance relative to non-closed-end fund strategy then have the best. I know that Rob and I have talked a lot about his record in that. So Rob, I'm going to pretend I asked you a question and then you're going to--

Rob Shaker: I'm going to crystal ball you.

John Cole Scott: And you're going to answer question you want.

Rob Shaker: I'm going to go straight to the crystal ball, but it's going to start with this premise that the Fed is not going to do something ridiculous and cut rates back to zero again. So that's all, not a huge pivot. That being said, a crystal ball is bond discounts are going to narrow, and they're going to narrow significantly, and maybe even back to where the average is over par again.

One of the things I think that people don't really think about that often is the fact that what if we get back to where just the Fed rates are stable? I was talking with John earlier, this is the first conference in a decade that I've been to that doesn't have a panel called "How to Invest in Bonds in a Rising Rate Environment". Everyone's always been, "Oh, I'm so scared of bond funds." "Suze Orman says don't get into any bond funds." Nobody wants a damn piece of any bond fund because someone's going to say, "Interest rates are going to rise, don't you know that, idiot?"

And you might get to the first time where it's like, "Oh, okay, they're paying good rates, they're stable, they're steady, we have a slow-growth economy that's not having a lot of defaults," that was the era and the basis for when closed-end funds used to trade above par, bond funds. And I think since that time we actually have more people interested in them, so we have a higher demand side. Play that back for me in a year.

John Cole Scott: We will. We'll text it to you. So at this point I've always got more questions, but I want to hear your questions. So David Tepper?

Audience: I'm sure you guys manage much, much more money than I do in closed-end funds. How do you address the issue of trading liquidity? Do you have a minimum trading volume per day that you won't look at a fund that trades less than that? And then secondarily if you care to answer, can you give a ballpark figure of what your typical turnover is?

John Cole Scott: So the question is, how do you think about liquidity for closed-end funds? Do you have a threshold? And then if you're willing to share turnover perspective. And I will let you guys choose the order.

Rob Shaker: We don't have any steadfast rules. Turnover, we shoot to do 4 to 5 times annually, the account, but I think we come in at a little more like three to four times. But since we're separately managed accounts, we don't want to have any particular outsized position in an account compared to average daily volume of a given fund. But we're not afraid to have a legitimate size of a fund even if it is above the average daily volume of it.

John Cole Scott: And I will say, because I know the way you work pretty well, you actually allocate to your accounts on a turnover basis, so it's not like you do pro rata trading or full allocation. So the least turned over clients get the fresh batch of trades, and so it's a very unique way to approach a larger separate account business with liquidity issues.

Rob Shaker: So based upon what I was explaining, our alpha, our additive I like to call it, is based upon this discount capture. And so the thought being that every time that we sell something that's above and then replace it, that's where you're getting your alpha. So we're trying to normalize that across all of our accounts.

John Cole Scott: Perfect. Mark?

Mark Milner: Yeah, I'll just give the real quick answer I guess. Typical turnover range is kind of call it high teens and maybe a low discount, low vol-environment to upwards of mid to high 30s, 30%.

John Cole Scott: That's a lot of trades.

Mark Milner: Yeah, it's a fair amount of trades but obviously different than Rob. Obviously Rob is a lot more active than we are. But yeah, again, long-term buy and hold type strategy. And then on the liquidity side, yeah, we do have liquidity minimums, that's really I guess a risk-management function. We want to be able to buy, and more importantly be able to get out of or sell funds, especially on bad days if we think there's better opportunities.

Audience: What are those levels? Is it an average volume, like do you have a number?

Mark Milner: Typically it's about a million dollars ADV.

Steve O'Neill: I would say, I guess it depends where you hold them. We manage eight closed-end funds at RiverNorth, so we buy closed-end funds, we manage closed-end funds, we put closed-end funds in closed-end funds. And so it wouldn't bother me if it was a $200 million market cap high yield fund. If it scored well and I liked it, then I would say, "Okay if there's liquidity I'd buy it because I don't have to worry about providing a daily NAV to investors on the way out." That said, I think you should get paid more to own less liquid funds. And so yeah, oftentimes when the world's crazy like it is now, I feel like liquid funds are trading on top of illiquid funds, and so you generally wouldn't need to go there.

But I'd say if I was just managing an open-end mutual fund or an SMA, I might have a similar view. I probably don't want to trade something that's got less than $500,000 of daily dollar volume. But I think, at least the way we're structured, we've got a lot of different homes that have different liquidity profiles. But I would also say just looking at the ADV can be really misleading. Without throwing out numbers the way we trade because we have a lot of closed-end fund exposure, it's at least once a week that I see a closed-end fund trade at one-year volume. Yesterday there was a muni fund that traded five-year volume. It was just two institutional investors just getting together and it just looked like big cross trades.

And so I feel like a lot of times people look at a fund and say, "Oh man, this is five or six thousand shares a day." Depending on how you trade, if you put in 50,000 shares in the dark, you could just get filled in a second. You'd be like, "Whoa, I didn't expect that to happen." But it does. We, at our size, owning roughly around a billion dollars of closed-end funds, turnover depends on the account. You can really move if you're participating in the market, in the lit market, the exchange market, working with your broker friends, there's a lot of liquidity out there, but it's not necessarily obvious if you're just looking at screen liquidity or historic price.

I think there's oftentimes a lot more people that want to trade than connect. And so coming back to, I think it's hard to rule out any funds, $50 million funds, $100 million funds, those are pretty small, but I would really consider any fund as long as you feel like you can hold onto it. To Mark's point, if somebody's going to ask you to sell or you feel like you're going to be forced to sell, then you want to protect yourself and own larger names. But if you've got patient or longer term capital, I think each closed-end fund should be appreciated. There is big inefficiencies, big firms don't generally like to trade $200 million funds, so you can generally get better discounts there. So if I was a lot smaller, I might start there.

Mark Milner: John, can I ask a question?

John Cole Scott: Sure.

Mark Milner: All right, so along these liquidity lines, how do you guys deal with the seasonality? Because obviously we see serious ADV declines in the summer. For those that may not know the "Sell in May go away", I think every closed-end fund trader except for the three of us and our teams go to Martha's Vineyard or wherever your local vacation spot is. So how do you guys adjust your trading patterns in the summer to deal with that? And are you obviously taking that into account and how do you deal with that seasonal liquidity?

Rob Shaker: Well, unfortunately as my wife can attest to, we don't go away in the summer and I'm still in front of the damn screen. Especially on Fridays, we call them the Hampton Friday's. You'll see that and it gets a really good opportunity for us.

I think what you guys were sort of alluding to before, my biggest concern, because of who my clients are, I'm never going to make a call and say, "We have to sell all of this. We have to sell our Ireland fund even though no one wants to buy it." But the fear is what if a bunch of my clients say that? What if they get really fearful? I don't get the seasonality from them, so for us that's an easier time.

We might not get as much intraday trading, but those dislocations, right? Because, it's a sad life, that's what I live for. That dislocation of a trade where somebody came in and sold $200,000 worth of some fund and is like, "I'll take a 1% lower than where it was," and I happen to be staring at it and I bought it. That happens a lot more on Friday afternoons in the summer, you're absolutely right.

John Cole Scott: Absolutely, and I would also say that I often find in some of the more basic commentary on closed-end funds, the concern about trading. All of you are right, I manage the least out of the four of us, happy to do that for our clients. But yes, there is often times you can do a weeks between the bid-ask just even with a block desk at TD. That's not even calling up a specialized trader or [inaudible]. So I would say the one key to say I think we all can share is there's more liquidity than you might realize, but you have to be patient and you have to be focused. We're at the end I'm pretty sure, but I want to make if sure if there's a simple question.

Audience: Yeah, when you don't find a block, what's your strategy to trade in and out of positions? Are you just over the day TWAP or VWAP, or percentage of volume or something more advanced than that?

Steve O'Neill: I'll try to be brief. I guess I would say that the closed-end fund market has a lot of interchangeable funds, where pretty much all the muni funds are down 24% this year. There's a couple that have more high-yield flavor, they're down more. And so if you take a step back and you say, "A lot of these are pretty similar, and what my goal is reducing muni exposure," what we do is we just throw out 20 lines and we see who's filling. Or say, "Well, the goal was to sell X dollars today," and we didn't know it was going to be ABC, maybe we get lucky, like to Rob's point, somebody's bidding up ABC and we're like, "Oh, how lucky are we?" And that's the one. And so I think if you just had one fund it's a lot harder. I'll come back to that, which contradicts my initial point, what's the diversification?

John Cole Scott: We are recording this.

Steve O'Neill: I do think muni fund might be enough, but as a trader you want to have those sort of things, and so whatever the market's hungry for that day you can sell into that. But at a technical level, I think dark pool, I think a lot of liquidity has moved to the dark pools. And so we’ll sit in a dark pool and we’ll do a discount estimate. We’ll say, “We think the NAV of this fund equals these five parts ETF, and so that equals up 25 basis points.” We’ll sell at a 6% discount all day and our market price just moves off that discount target.

We sit in the dark pools, I also think more industry participants should be going to specialized brokers. I feel like that really facilitates trading volume. I might say, “I want to reduce 6%,” and Mark might be like, “That’s crazy, munis are so cheap and we’ve made a top-down call to own the asset class.” And he’s super excited, and I’m making a short-term trading call and he’s making a long-term call. I think the brokers facilitate larger blocks between institutional investors. But again, I think the short answer is spread the venues, whether you’re working with your broker, whether you’re doing lit market, dark. And it helps to own a couple funds, because you never know, if you think they’re similar, which one’s going to have the liquidity on any given day.

John Cole Scott: All right, Jim?

Audience: Quick question. I’m just curious, when you talk about these specialized brokers, how much do you pay them?

Steve O’Neill: I’m definitely not going to disclose.

Audience: What’s your range? It used to be maybe three?

John Cole Scott: I’ll just say that I know that, and I don’t know anyone’s negotiated rates, but I know it’s common in the current market to pay around a penny a share.

Steve O’Neill: I would say everything’s benched against almost free. If you’re trading with whatever electronic brokerage firm, it’s pretty close to free, we’re talking in mils. And so a penny is a huge amount relative to 30 mils. I think it’s less than what many would think.

Rob Shaker: But just to be clear, you can do a lot just on thinkpipes.

John Cole Scott: Assuming you’re at TD Ameritrade, but yes.

Rob Shaker: Yeah, or something like that, pretty simplistic, layering up. But like you said, having a whole bunch of different things will have the 20 guys that are looking to sell. And we generally walk into the day with sell first, stay flat. So then we’ll buy it later because you can only sell what you have, you can buy anything. And so just by layering it up in the normal sort of way things get done, you can do a lot of volume.

John Cole Scott: Good. So these guys I think are going to stick around for some drinks. I'd like to get us to the next stage. And just to make it simpler I'll just say 30 seconds of closing remarks.

We would not exist without presenters, without audience, and without the support of the community. It is so beautiful to be back in person, I thank each of you for being here. The vendors, you've done an amazing job to capture this content for all of us. Jane, the financial journalist, to create more stuff. So stay, mingle, enjoy, and we are I think looking to do this in either April or June again up here in the city, so mark your calendars.

Recorded on November 16, 2022.

Click the link below to go to the home page of Active Investment Company Alliance to learn more:

https://AICalliance.org/