John Cole Scott On The Potential Benefits Of Sector Swapping

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed John Cole Scott, president of Closed-End Fund Advisors and Chairman of the Active Investment Company Alliance. Read the Q&A below as John discusses how investors in funds trading at premiums can use sector swapping to turbocharge their gains. He describes a process where an investor sells out of funds trading at premiums and purchases similar funds trading at discounts, locking in profits and expanding the buying power of their money. He cites examples of how making swaps, even within the same fund family, could deliver instant advantages.

The podcast can be found on AICA's website by clicking here: https://aicalliance.org/alliance-content/pod-cast/

CHUCK JAFFE: John Cole Scott of Closed-End Fund Advisors is here, we're talking about sector swapping and moving from funds with relative premiums to buying funds with discounts, this is The NAVigator. Welcome to The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator is brought to you by the Active Investment Company Alliance, a unique industry organization representing all facets of the closed-end fund industry from users and investors to fund sponsors and creators, and if you're looking for excellence beyond indexing, The NAVigator will point you in the right direction. Joining me again today, John Cole Scott, president at Closed-End Fund Advisors in Richmond, Virginia, which is online at

CEFAdvisors.com, and we're about to dig into the firm's research, which you can do for yourself at CEFData.com. John is also chairman of the Active Investment Company Alliance, you can learn about it at AICAlliance.org. John Cole Scott, great to chat with you again.

JOHN COLE SCOTT: Always good to be here, Chuck.

CHUCK JAFFE: Today, John, we're taking a bit of a strange journey, because you're looking at funds that are in sectors that have done well, you're not making a market call or anything but you are telling people to potentially make a move, to sell out from positions of strength and victory. And some of your decision to discuss this now came out of the fact that you recently did some repair work around the house, looked at something and thought about how it was affected by inflation, and then that took you to where you were thinking about funds. You got to explain.

JOHN COLE SCOTT: Yeah, so about 21 years ago I bought a hot tub at my house and it comes due to replace both the hot tub and the deck. Just got home from the store and found out the new price I'll paying. I'm a curious human, so I went to the inflation calculator for CPI, I ran what I paid in 2004, I ran what it's going to cost me in 2024, and it is basically spot on with CPI, which reminds me that I feel we're going to keep having inflation, and that fixed-income closed-end funds actively managed are going to be a great way to build a diversified portfolio. However, I remembered those funds have done very well, the average fund's trading around net asset value with a very strong few year performance, and a lot of people might find themselves either at narrow discounts, small or even medium premiums.

CHUCK JAFFE: Indeed, we talk about it on The NAVigator all the time, how it's pretty hard to get anybody to buy funds that are trading at premiums, but if you've had really good luck and you've got a fund that's at or near a premium, why are you swapping out of it unless you're making a tax-loss sale and trying to match gains with losses?

JOHN COLE SCOTT: Usually tax loss sales don't stem from premium expansions, usually in the market, though it can always happen. Our thought here was look at a lot of the managers that have more than one fund in the same sector, so no perfect analysis but same sector, same manager in most cases. I did a total list of 10, if we get to that many in this discussion, and we looked at some average data. The average data, the yield is slightly higher in the premium funds, but higher yielding funds tend to have premiums, but you have a way lower discount, a 15% average wider discount for about the same allocation at a high level, and you've got

much more exposure to manage assets, which to me is a powerful thing as an income investor, and almost the same six-month and one-year NAV total return for these 10 funds, and you're getting essentially almost the same total credit exposure but with 15% less dollars, which is to me very powerful.

CHUCK JAFFE: Let me see if I can make sure that I understand it, which I hope means our audience will understand it. Basically we are making a sale, we're looking to stay within our fund company, although I'm not sure that's 100% necessary, where we are moving our money from a fund that has done well for us to a fund run by the same people that's now on sale. So in other words, if I have $10,000 in net asset value on one fund, I may be getting a discount and my $10,000 will be worth more, so functionally I'm profiting from the trade?

JOHN COLE SCOTT: Yeah, at a basic level, if you had $100,000 in 10 funds and you sold at net asset, you'd be gaining $115,000 of new funds you're exposed to by the complete swap.

CHUCK JAFFE: So let's put this to work. Now you mentioned that your research has 10 funds, I highly doubt we will get through all of the 10, because it's actually 20 when you consider the swaps here, so we want to let everybody know, if you want to see John's research, we'll link up everything we can, but it will also be sent to you if you write TheNAVigator@AICAlliance.org. John, you've got a list, I'll let you pick what you consider the best example to start us off.

JOHN COLE SCOTT: Well, the one that started really is the Gabelli Convertible Funds, GCV, which years ago acquired the Dinsmore funds but run by the same team, ECF, and swapping those funds is giving you basically the same manager, the same structure, the same sector, and a very good different access.

CHUCK JAFFE: We're going from Gabelli Convertible which is trading at like a 13% premium, and buying instead the Ellsworth Growth and Income Fund which is trading at a double-digit discount.

JOHN COLE SCOTT: Ten discount, correct.

CHUCK JAFFE: That's one example. Yes, they're both owned by Gabelli, but only because Gabelli bought Ellsworth. Do we have others where it's Nuveen and Nuveen, abrdn and abrdn, PIMCO and PIMCO?

JOHN COLE SCOTT: Well, we have BIT is a BlackRock taxable bond fund trading at around net asset value, you've got BTZ, it's a six discount, same manager, same sector.

CHUCK JAFFE: So you're profit in that deal is moving from a fund that's at about net asset value to one that's trading at a six discount. Let's run down some of these other firms, abrdn?

JOHN COLE SCOTT: Abrdn, this is a little bit harrier but there's FOC at a 62% premium, it's a more global bond fund, and you have FAX in a more Asia-Pacific focused fund at about an 8.5% discount.

CHUCK JAFFE: So the Global Income Fund is trading at nearly a 62% premium, obviously the bigger the premium, the more you would think you would want to do this strategy. Is there a number for you that always makes it worthwhile? If you've got a fund that, congratulations, it's ridden up to a nice premium, is there a point? Because some of these are relative premiums, which means they're basically right around the premium-discount line, but is there a number for you where if we cross this, I'm out for sure?

JOHN COLE SCOTT: I would say things that we use at CEF Advisors for our clients is anytime that you're over a peer group average, which is one of our data points that we look at very actively, where every fund sits versus their peer group average, we're wondering why we own it when it lives above that number. So we generally like the net asset value total value return to be the same or better than the peer group average and the discount to be an average 2 to 3% percent wider, in some markets we're able to get 4 or 5% on average wider than peer group average. So if you're getting similar NAV performance, better discounts, it's more tailwinds, less headwinds, and it really takes being wider than average to get that ability.

CHUCK JAFFE: One of the firms that I see on your list is PIMCO, but PIMCO, almost all of their closed-end funds in certain sectors trade at premiums. Does this work if you're going from, I got a big premium to I got a small premium?

JOHN COLE SCOTT: It is. So PDI currently trades at a 12% and mid-change premium, and PFN, which is again almost the same asset allocation but not perfectly is a 3.5% premium, you are getting 10% more net assets to stay in a PIMCO taxable bond fund, I think that's a worthy, worthy trade. Because here's the thing, when markets hit a bumpy patch and discounts expand versus they've been narrowing, we see a much more downside volatility on things the higher they live above net asset value. We've seen things go from a 20-30% premium down to a 10% plus discount in less than a week, just from market dividend and other craziness.

CHUCK JAFFE: How important is it to have a certain width of that spread between the two funds? For example, on the list, and again for anybody who wants to see it directly and wants it sent to them, TheNAVigator@AICAlliance.org, send an email requesting John's research, I notice you've got two Invesco funds on here. The one at the premium, which is their Senior Income Trust, is trading at an 8% premium, the one that's at a discount, their High Income Income Trust is a very narrow discount, it's like 3.5%, less than that. So is it more about the spread between the two than it is about the level of discount and premium?

JOHN COLE SCOTT: It is, and again I would argue that we would not be rotating necessarily into VLT if we happen to own VBR today for our clients, but we meet investors and advisors all the time that love a manager and love their holding, and I'm trying to give them the right behavior to be comfortable making these changes of selling. Again, if you own the funds on the premium list, you should be excited, you've outperformed the average fund on a premium expansion, it's the best time to sell because you over-won. I'm just giving you a chance to take the profits and to not change the asset allocation and even the manager.

CHUCK JAFFE: Just to be clear here, it might be more important for the consumer audience to go, "Oh, I'm sticking with a BlackRock," or a Nuveen or what have you, because it may be what their advisor's most into, it may be what they're most familiar with. But for you running portfolios, does it truly matter? I mean, could you shop around? Would you shop around and go, "Okay, keep me in the same space, give me basically the same kind of assets, but get them for me at a much better price," and it doesn't matter so much if I stick with the fund company?

JOHN COLE SCOTT: Absolutely. So what we do at our firm is we do kind of a trifecta analysis, we analyze the manager, the asset allocation, the expense ratio performance over up periods, down periods, that's one third of it. The discount, how common does this fund trade versus itself, versus its peers, versus absolute levels? And then the dividend component, and we like portfolios that have more of a dividend increase story than a decrease, which means the leverage-adjusted NAV yield is generally lower, which means there's more room for increases outside of just having the sector do better. And those three things come together, a fourth thing we'll do, we'll do a correlation NAV analysis of a fund that we're looking at, and find the closest peers regardless of manager to maybe find five or 10 that act statistically like it in the same broader grouping, and at our firm that gives us a wider set of possible entry points for our clients.

CHUCK JAFFE: It's really interesting, and I bet that for those folks who are not in the industry, this is a strategy that they really haven't considered before but I bet they're going to consider it now. John, great stuff as always, I'm sure we'll talk again soon, thanks so much for joining me.

JOHN COLE SCOTT: Always great to be here, Chuck.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. And I am Chuck Jaffe, and you can check out my work and my hour-long weekday podcast at MoneyLifeShow.com or wherever you find your favorite podcasts. To learn more about closed-end funds, interval funds, and business-development companies go to AICAlliance.org, it's the website for the Active Investment Company Alliance. And remember, if you want to check out the research we talked about today, you want to write to TheNAVigator@AICAlliance.org. Thanks to my guest John Cole Scott, he's the president of Closed-End Fund Advisors in Richmond, Virginia and the chairman of the Active Investment Company Alliance. His firm is online at CEFAdvisors.com, and their data which you can dig into is at CEFData.com. John is on X or Twitter @JohnColeScott. The NAVigator podcast is typically available Fridays, this week it was me that was a scheduling issue, but you want to make sure you don't miss it whenever it comes up, so follow along and subscribe on your favorite podcast app. We'll be back next week with more closed-end fund talk, until then, happy investing everybody.

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