RiverNorth’s Browne: Muni Bond Funds Look Cheap And Promising Now

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed Jonathan Browne, Senior Investment Analyst at RiverNorth Capital Management and Portfolio Manager on five of the firm's municipal bond closed-end fund-of-funds. Read the Q&A below as Jonathan says that the headwinds that made for big struggles in the muni bond space have shifted to become tailwinds, creating opportunity despite the strong recent rebound among muni bond funds. Browne says that the rising-rate cycle had led to discounts reaching the 12 to 15 percent range – a level previously only reached during financial crises – making munis about as cheap as they had ever been. Now, even after a run of more than 30 percent, muni closed-end funds are at the 70th percentile of cheapness, with "quite a bit of room to run."

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

Dig into current investment strategies, the latest trends, and new developments in the closed-end fund industry at the Active Investment Company Alliance’s Annual Roundtable. The event now in its sixth year is Wednesday, November 13th in New York City, and will combine informative panels, engaging speakers, and valuable networking opportunities with leaders in closed-end funds, interval funds, and business-development companies. AICA events are known for their high-quality advisor-centric content and for enabling meaningful discussion and interaction with the top minds in closed-end funds. Advisors can get seven

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CHUCK JAFFE: We're talking municipal bond closed-end funds and why they're looking good now with Jonathan Browne, senior investment analyst at RiverNorth Capital Management, this is The NAVigator. Welcome to The NAVigator, where we talk about all-weather active investing and plotting a course to financial success through closed-end funds. The NAVigator is brought to you by the Active Investment Company Alliance, a unique industry organization representing the full spectrum of the closed-end fund business from investors and users to fund sponsors and creators. If you're looking for excellence beyond indexing, The NAVigator will point you in the right direction. And today we're looking in the direction of muni bond closed-end funds with Jonathan Browne, senior investment analyst at RiverNorth Capital Management, where he's portfolio manager for five municipal closed-end funds, and I need to disclose that one of them, RiverNorth Managed Duration Muni Income II is in my portfolio, that's RMMZ, but to keep this short so that we don't run out of time just giving out the names of the funds, the others are RMM, RFM, Robert-Frank-Mary, RFMZ, and RMI. You can learn what's behind those ticker symbols and about RiverNorth itself by going to RiverNorth.com. And you can learn more about closed-end funds, interval funds, and business-development companies by visiting AICAlliance.org, the website for the Active Investment Company Alliance. And two people who will definitely be learning more about closed-end funds are the winners of our contest to celebrate the five-year anniversary of The NAVigator. Two weeks ago, John Cole Scott, chairman of the Active Investment Company Alliance put up the prize, two copies of the 1991 book co-authored by his father George Cole Scott, that was the first real attempt to popularize closed-end fund investing. It's called *Investing in Closed-End Funds: Finding Value and Building Wealth*. To be entered to win the book you had to tell us when closed-end funds first started trading on the New York Stock Exchange, and I have to say we had both more entries and more wrong answers than we get in a lot of our contests. The right answer was 1893, and the people who got it right and got their entries in and are winning the books are James in Huntington Beach, California and Colby in Houston, Texas.

Congratulations, guys, we will send the books out in the next few days. Now let's get to the business at hand on muni funds, Jonathan Browne, welcome to The NAVigator.

JONATHAN BROWNE: Thanks, Chuck, for having me back. Glad to be here.

CHUCK JAFFE: Let's talk about where you see muni bonds right now, because for a while you've been saying it's the sweet spot, that it's a great opportunity. So help us understand, when we say it's a good opportunity, there's mathematical reasons on valuations as to why you particularly like this space right now.

JONATHAN BROWNE: Yeah, that's correct. We really like the muni closed-end fund space right now, we think it offers investors a good additional source of alpha above and beyond just traditional muni bond portfolios. But before we go into some of the details and mathematics behind that, I think it's important to understand where munis were and how they got to this point, and so over the last few years muni closed-end funds have had quite a wild ride. What normally is a relatively benign or low-volatility asset class, given the aggressive rate hike cycle of the Fed, we really saw municipal closed-end funds which have longer durations, get hit. In 2022 and 2023 it wasn't uncommon to see many of these muni closed-end funds trading down 20 or 30%, of that we saw discounts widen out from almost net asset value to some of the widest levels we've ever seen. Municipal closed-end funds at the end of 2023 were trading at between 12 and 15% discounts, and historically we had only seen discounts at those levels back in 2000, 2008, and then for a few days in 2020 during Covid. At that point it made sense why investors were shunning municipal closed-end funds just given the hit to their capital, but we were really pounding the tables saying that the sell-off was overdone. We kind of felt that we were at peak negative sentiment in the asset class, and we thought that there was quite a margin of safety with discounts being that wide, so probably for the last year we have been really pounding the table saying that municipal closed-end funds from certainly a mean reversion standpoint or a discount narrowing standpoint offered tremendous value. Flash forward over the past year, municipal closed-end funds are up around 30%, we've seen those discounts go from the 99th percentile of cheapness, again that 12-15% discount, to today we're looking at discounts being around 6% on average. So we've been very pleased with the direction that municipal closed-end funds have moved and the gains that they've produced, with that being said, we still think there's quite a bit of room to run. We're still wider than historical average looking back over the past 25+ years, and we're seeing a lot of tailwinds, or I guess I should say headwinds from the past that are now shifting to tailwinds. For example, the Fed hiking cycle we think is behind us, we just saw the Fed lower rates by 50 basis points, so that should be a net positive, we're seeing the yield curve continue to steepen from deeply inverted levels which ultimately should be a net positive for borrowing costs and municipal closed-end funds, and then we've also seen a shift in sentiment. Just looking at [inaudible 0:06:49] data, I believe we've seen 13 weeks of municipal inflows into mutual funds, and so we anticipate that type of sentiment could persist and continue to move discounts back to historical averages or even closer to net asset value. And so even at a 6% average discount, that's still roughly the 70th percentile of cheapness over those last 25 years, so we think there's room to run just purely on a mean reversion basis as sentiment continues to move in the right direction.

CHUCK JAFFE: Yeah, 70th percentile of cheapness sounds pretty good to anybody who's saying, "I want to be able to buy in and get a bargain." We're also however at a spot where we're expecting to see a rate cutting cycle. How have munis, and more importantly muni closed-end funds, typically performed when rates were falling? Because it's been a long time since they've been in this kind of environment.

JONATHAN BROWNE: Yeah, looking back over the last few rate cutting cycles, munis have performed very well. We've seen discounts continue to narrow in towards that net asset value, obviously each cycle has its own uniqueness and we'll see what this one plays out. But just going off of the few examples that we have to reference, we think that generally a rate cutting cycle should bode well for municipal bonds, and in particular municipal closed-end funds as you see those discounts narrow.

CHUCK JAFFE: If we're at the 70th percentile of cheapness, heck, if we got to the 50th percentile they would still be good. Is there a level where you go, "Yeah, okay, they might still be cheap but historically they're not there anymore and I'm less interested," or it's much harder to find there? Help us understand in terms of, if we see the right things happen, obviously we'll see a pickup, it won't be historically cheap anymore, at what point are they not so attractive because they might be discounted but not very discounted?

JONATHAN BROWNE: That's a little bit of a tricky question to answer, again each cycle is unique in its own right. However, historically as those discounts tend to get towards net asset value, most investors of closed-end funds would think that that's a time where maybe some of the alpha from discounts has sort of run its course. Now with that being said, being investors across the space, that's assuming a parallel shift that all munis narrow, right? But how we view the world is we think that there still are going to be certain opportunities, so just because the average may be narrowed doesn't mean that there's not still certain muni closed-end funds out there that are still trading at relatively attractive discounts. And so an active investor in muni closed-end funds, even if discounts do narrow inside their historical averages, with the right research and time spent, can still find interesting opportunities in specific closed-end funds that are maybe trading wider than average. Or another alpha opportunity that we haven't discussed yet is there's a host of corporate action opportunities or activist opportunities in the space to take advantage of and capitalize on.

CHUCK JAFFE: How much, if at all, is the uncertainty of the election at least a theoretical wildcard in the muni space? We have some idea of tax policies but not a lot, do you have any worries at all in terms of how things might change or be impacted by the outcome of the vote?

JONATHAN BROWNE: There's definitely uncertainty around the election, markets thus far haven't really shown much concern about the results of the election. We're seeing S&P at all-time highs, credit spreads about as tight as they've been, but it's prudent to always at least try to understand what risks are in the near future, especially surrounding the election. And as you pointed out, within the municipal space, tax policy is something that could have a fairly dramatic impact on the space. So we're not trying to predict what the election outcome is going to be, but we're cognizant to be aware of what those results look like and what that could mean for the muni space and also municipal discounts.

CHUCK JAFFE: Jonathan, great stuff. I really appreciate you taking time out to join us, we're going to watch how it plays out and talk to you again down the line. Thanks for coming on The NAVigator.

JONATHAN BROWNE: Thanks for having me, Chuck.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. And yup, that's me, why don't you check out my show on your favorite podcast app or by going to MoneyLifeShow.com. To learn more about interval funds, closed-end funds, and business-development companies go to AICAlliance.org, it's the website for the Active Investment Company Alliance, and they're on Facebook and LinkedIn

@AICAlliance. Thanks to my guest Jonathan Browne, senior investment analyst at RiverNorth Capital Management, portfolio manager for five municipal closed-end funds. Learn more about those funds and everything the firm does at RiverNorth.com. The NAVigator podcast is new every Friday, make sure you don't miss an episode by subscribing on your favorite podcast app. We'll be back next week, and until then, happy investing, everybody.

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