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How Corporate Actions in Closed-End Funds Can Potentially Boost Portfolio Performance

As corporate actions become more common, investors in closed-end funds (CEFs) have more opportunities to potentially improve portfolio performance — especially if they stack the deck in favor of discounted funds, says Active Investment Company Alliance Chairman John Cole Scott.

Rather than ignore corporate actions such as tender offers, liquidations, rights offerings, and dividend policy changes, thoughtful responses to these events can potentially provide investors with alpha opportunities, Scott said on the August 30, 2024, NAVigator Podcast.

Scott, who also serves as President of Closed-End Fund Advisors and CEFData.com, supports this assertion with 12.5 years of data tracking corporate actions and $870 billion in fund assets across 797 closed-ended management companies, which include traditional CEFs, business development companies, tender offer funds, and interval funds.

> A **corporate action** is any activity, voluntary or mandatory, that brings material change to an organization and impacts its stakeholders. Typically, such activities must be approved by the organization's board of directors or shareholders.

Tender Offers

Tender offers are a public solicitation to all shareholders of a corporation to sell their stock at a set price, typically at a price above the publicly listed company's current stock price.

According to Scott, tender offers have occurred 178 times over the last 12.5 years across the universe of funds that CEFData.com tracks. Scott says most investors and financial advisors don't actually tender their shares, saying the average acceptance rate is 46%.

To make the case for doing otherwise, Scott dug into the data. He noted that about $10.3 billion in funds were offered for tendering over the last 12.5 years and that each tender offer averaged about $60 million. "The average tender is about 98% of net asset value, and in the past 12 months it's been 98.5% of NAV," Scott added.

Turning to discounts, a key feature of CEFs that many long-term CEF investors often use to their advantage, Scott said the 178 tender offers he tracked had an average 11% discount 90 days before the announcement. He continued: "One day prior to the announcement it was at a -10% discount … one day after it was at -9% … [and] one day prior to expiration, it closes again to just -7.9% on average. That's a 3% discount tailwind if you overweight funds that might or could do tenders, and if you oversubscribe it's about a 4.1% tendering alpha."

"So, just by stacking the deck in your favor for tenders, there's a 7% discount tailwind," he said. "You'll never get them all, but it's a great opportunity to put … extra performance in your portfolio."

Liquidations and Open-Endings

Again, looking at the same 12.5-year time period, Scott tracked 117 open-ending or liquidation events and the status of fund discounts relative to event announcements:

- 90 days prior: -8.4% discount
- 1 day prior: -5.6% discount
- 1 day after: -2.08% discount
- 7 days after: -1.52% discount
- 7% alpha opportunity with 40% before the announcement

"We don't like funds to go away, but if you overload your deck in discounted funds you're more likely to end up with tenders and liquidations because of activism or frustration from the fund sponsor," Scott said. "[Data for liquidations and open-endings show] another 7% alpha opportunity and 40% before the announcement," he added.

Rights Offerings

A rights offering, or "rights issue," is an appeal to existing shareholders of a corporation to purchase new, additional (and potentially transferable) stock shares at a specified price — typically discounted relative to the current market price.

Using the same dataset, Scott identified 127 rights offerings and related fund information:

- 90 days before expiration: 6.7% average premium
- Day of expiration: -4.7% discount

- 90 days after expiration: 0.17% premium
- -11% relative alpha then a bounce of +5%

Investors and advisors need to be particularly "thoughtful, organized, and focused" when responding to rights offerings, Scott said. Looking at the data, he said those that don't oversubscribe or trade around the risk may end up with negative alpha.

"If you were to rotate out and get back in … you can maybe get a 5% reversion," he said. However, he cautioned against engaging with fund sponsors that regularly issue rights offerings, urging investors and advisors to review each sponsor's history for such events.

Dividend Changes

-10%	1075 Events
Average cut	-20.8% discount
90 days before announcement	-3.8% discount
1 day before announcement	-5.2% discount
1 day after announcement	-6.3% discount
90 days after announcement	-8.2% discount
Alpha	-4.4%

+10%	799 Events
Average increase	+23.4%
30 days before announcement	-10.1% discount
1 day before announcement	-9.8% discount
90 days after announcement	-7.8% discount
Alpha	+2%

When analyzing the same dataset for dividend changes, Scott applied a 10% cutoff for both dividend cuts and increases. The average fund experiencing dividend cuts resulted in a -4.4% negative alpha and those experiencing a dividend increase (there were far less of those) generated a 2% alpha.

"Again, another reason to be overweighted in funds with more conservative policies based on the ecosystem," Scott said, referring to the dividend cut data. "There are 415 funds; you don't have to own all of them. You can be selective and have a good, diversified portfolio and reduce some of these risks as well."

As to the dividend increases, Scott said "everyone receives the additional payout on these overpaying funds right now when they increase their dividends."

"You've got to be thoughtful about living off that money, but it is a powerful tailwind to help make the portfolio [perform better]. Closed-end funds average 8% a year. You've got to use these tailwinds [thoughtfully] and make a little bit more money without taking extra risk," he said.

Listen to the August 30, 2024, NAVigator Podcast and visit CEFData.com to learn more.

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