CLOSED-END FUND REVIEW

SECOND QUARTER 2020

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SECOND QUARTER 2020 OVERVIEW

After an extremely difficult first quarter for the financial markets and closed-end fund (CEF) structure (see here for more details https://www.ftportfolios.com/Commentary/Insights/2020/4/23/first-quarter-2020), CEFs rebounded during the second quarter but—on average—still remain lower year-to-date (YTD). The average CEF increased 15.04% during the quarter but remains lower by 11.91% YTD. All of the broad CEF categories tracked by Morningstar had positive total returns during the second quarter. The average equity CEF was up on average 24.45%, taxable fixed-income funds were up 15.26%, all fixed-income funds were up 9.87% and municipal funds gained 3.90% on average (Source: Morningstar. All performance is based on share price total return).

Equity CEFs benefited from the significant rally in global equities during the quarter. The S&P 500 Index rose 20.54% during the quarter, while the MSCI All-Country World Ex U.S. Index returned 16.12%. Many key fixed-income indices also rallied sharply during the quarter as they benefited from aggressive actions from the Federal Reserve (Fed). Indeed, the ICE BofA High-Yield Bond Index was up 9.54% during the second quarter, the S&P/LSTA Leveraged Loan Index increased 9.70%, the ICE BofA Preferreds Index was up 6.95% and the ICE BofA 7-12 Yr. Municipal Index rose 2.98% (Source: Bloomberg, as of 6/30/20. Index performance is based on total returns).

POSITIVE BACKDROP FOR CEF STRUCTURE

As the second half of 2020 commences, the backdrop for the CEF structure remains very positive in my view, for two primary reasons:

1) Valuations: Average discounts to net asset value (NAV) remain much wider than long-term historical averages.
2) Accommodative Fed: On June 10th, the Fed indicated that it doesn't expect to raise short-term interest rates until at least 2023. The Fed funds rate remains very low at near 0% (See here for our Economic Teams commentary on this issue https://www.ftportfolios.com/Commentary/EconomicResearch/2020/6/10/loose-and-staying-loose).

While a fund's average discount to NAV is not the only factor to consider when investing in a CEF, from my standpoint it is one of the key factors to consider as I believe the price we pay for any security is important and should be part of the evaluation process. To that end, despite narrowing slightly from 8.57% on 3/31/20 to 8.07% on 6/30/20, average discounts to NAV for all CEFs remain significantly wider than the 10-year average discount to NAV of 4.51% (Source: CEFdata.com). As you can see from the data below, valuations or average discounts to NAV for all CEFs, all equity CEFs, all taxable fixed-income CEFs and all municipal CEFs remain wider (or more inexpensive than 10-year averages). From my standpoint, these inexpensive valuations represent an opportunity for long-term, diversified CEF investors. I expect average discounts to NAV to slowly begin to narrow closer to long-term averages over the next 6-12 months as investors continue to take advantage of the attractive distribution yields (more on that below) and valuations available in the secondary market for CEFs.

Category	6/30/2020	10-YR AVG
All CEFs	-8.07%	-4.51%
Equity CEFs	-9.75%	-6.47%
Taxable FI CEFs	-6.54%	-3.17%
Municipal CEFs	-7.40%	-3.28%

Source: CEFdata.com

As mentioned previously, the Fed indicated that it doesn't expect to raise short-term rates until at least 2023, which will keep the Federal funds rate near 0% until at least 2023. I believe this has positive implications for the CEF structure for 3 primary reasons:

1) Roughly two-thirds of all CEFs employ the use of leverage (Source: Investment Company Institute as of 12/31/19). With the Fed indicating it intends to keep short-term rates near 0% until at least 2023, borrowing cost for leveraged CEFs should remain very low for most CEFs and help leveraged CEFs earn a positive spread between their borrowing costs and rates they can earn on borrowed proceeds.

2) In my view, investors are more likely to consider investing in leveraged CEFs if they believe borrowing costs are not going to be increasing any time in the immediate future.
3) The average CEF has a distribution yield of 8.02% (Source: Morningstar, as of 6/30/20). With the Fed keeping short-term rates near 0% until at least 2023, yields on many traditional fixed-income asset classes (including certificates of deposit and U.S. Treasuries) will also likely remain very low until at least 2023. Therefore, the high distribution yields CEFs provide will become all that much more attractive on an absolute and relative basis to investors as they look to increase yield in their portfolios. I believe in an era of very low global interest rates, demand for the CEF structure will increase and discounts to NAV will narrow as more investors are willing to invest in CEFs as they look to generate cash flow from their portfolios.

GAME PLAN FOR SECOND HALF OF 2020

While the equity and credit markets will likely continue to be volatile during the rest of the year as concerns remain about the Coronavirus and strength & speed of the global economic recovery, I continue to firmly believe the best approach for CEF investors is to dollar-cost average over the coming days and weeks across many different categories of the CEF marketplace. From my standpoint, attractive opportunities are currently present in many categories including equity CEFs, credit-sensitive taxable fixed-income CEFs (including senior loan CEFs, high-yield CEFs, limited duration CEFs and multi-sector CEFs) and investment-grade municipal CEFs.

Average discounts to NAV remain wider than historical averages, the Fed is very accommodative, and the global economy is beginning to open up again after it was shut down as a result of the Coronavirus. Lastly, after negative GDP growth during the first half of the year, our Economic Team is forecasting positive GDP growth for the second half of the year and 2021. All these factors lead me to believe the environment for diversified CEF investors is a solid one as the second half of the year commences and as we look forward to 2021.

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