CLOSED-END FUND REVIEW

SECOND QUARTER 2021

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SECOND QUARTER 2021 OVERVIEW

After a very strong start to the year when the average closed-end fund (CEF) gained 6.42% during the first quarter (https://www.ftportfolios.com/Commentary/Insights/2021/4/22/first-quarter-2021), many CEFs continued the positive momentum in the second quarter with the average CEF rising 7.83%. It was a very broad rally with equity CEFs increasing 10.64%, fixed-income CEFs rising 6.18%, taxable fixed-income CEFs gaining 6.10% and municipal CEFs increasing 6.29%. (Source: Morningstar. All performance is based on share price total return). Equity CEFs benefitted from the 8.55% increase in the S&P 500 Index and the 5.48% rise in the MSCI All-Country World Ex US Index. Fixed-income CEFs benefitted from the strength in several key fixed-income markets. The ICE BofA High-Yield Bond Index gained 2.77% during the second quarter, while the S&P/LSTA Leveraged Loan Index rose 1.47% for the quarter, the ICE BofA Preferreds Index gained 3.06%, while the ICE BofA 7-12 Yr. Municipal Index added 1.35%. (Source: Bloomberg).

Discounts to Net Asset Value (NAV) Continue to Narrow

Average discounts to NAV for all CEFs continued to narrow and ended the second quarter at -1.61%. Average discounts ended 2020 at -6.50% and ended the first quarter of 2021 at -3.94%. They are narrower than the 10-year average discount to NAV of -4.99%. (Source: CEFdata.com)

I expect average discounts to NAV to stay in the low single digit range throughout 2021 given my continued view that the backdrop for the CEF structure remains very strong. A Federal Reserve (Fed) funds rate near 0% helps keep borrowing cost low for most of the roughly two-thirds of all CEFs which employ the use of leverage. Furthermore, I continue to believe that with very low yields on traditional income investments, more investors will be looking to the CEF structure as a way to potentially increase yield and cash flow from their investments. I do think it is important to note that given the significant narrowing of discounts to NAV which has occurred in 2021, I expect more of the potential total return from a diversified portfolio of CEFs to come from distributions as opposed to significant capital appreciation. Bear in mind the average distribution yield for all CEFs remains attractive at 6.09% as of 6/30/21. (Source: Morningstar)

The Historical Importance of CEF Distributions

Albert Einstein once said, "Compound interest is the eighth wonder of the world. He who understands it, earns it ...he who doesn't...pays it." Long-term investors in the CEF structure are keenly aware of this principle as historically, the majority of the total return CEFs have provided has come from the compounding of distributions. The last 12-month period for CEF investors has been quite fruitful as the combination of very strong performance in the global equity and credit markets, coupled with meaningful discount narrowing has led many CEFs to not only earn an attractive income stream, but also significant capital appreciation. Indeed, the average CEF is up 34.1% over the past 12 months. (Source: Morningstar. All performance is based on share price total return). However, as stated above, given the fact that average discounts to NAV for all CEFs ended the second quarter at only -1.61%, I expect more of the potential total return from a diversified portfolio of CEFs to come from the distributions as opposed to significant capital appreciation. This doesn't mean an individual CEF or category of CEFs cannot earn capital appreciation along with distributions, however.

On the next page are two charts, the first chart is the First Trust Closed-End Fund Composite Total Return Price Index (UPCEFT) which is a composite index of the municipal, taxable fixed-income and equity indexes and intended to provide a capitalization-weighted representation of the entire U.S. closed-end fund universe. This index includes distributions. The second chart is the First Trust Closed-End Fund Composite Price Index (UPCEF). This index excludes distributions.

As the data on the two charts clearly show, the majority of the total return that CEFs have earned the past 5 years has come from the distributions CEFs have provided. Indeed, the First Trust Closed-End Fund Composite Total Return Price Index (UPCEFT) has returned of 55% over the past 5 years, whereas the First Trust Closed-End Fund Composite Price Index (UPCEF) has only returned 7%.

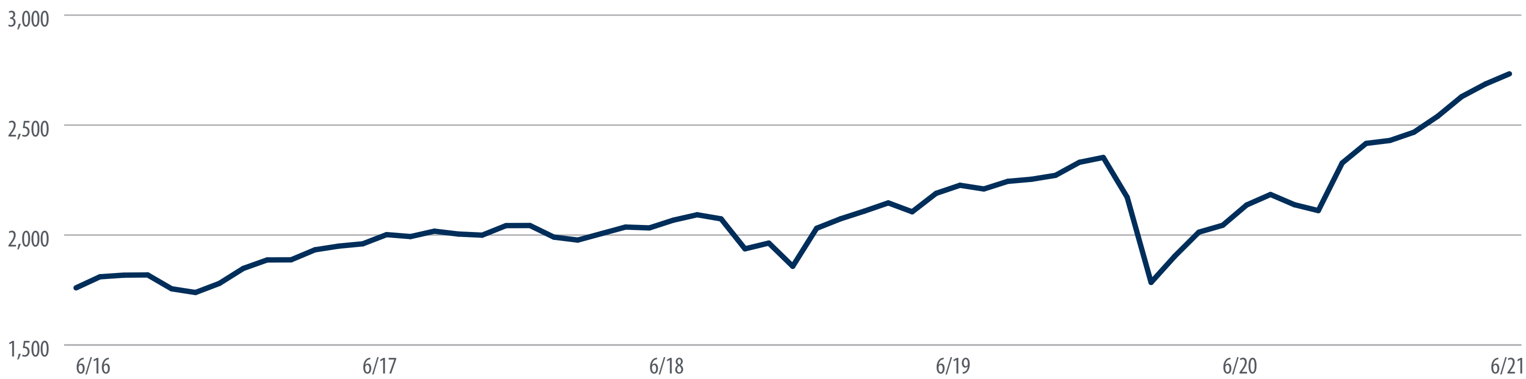
From my standpoint, the stark difference between these two charts clearly illustrates the power of CEF distributions compounding over time, which is precisely why I believe it is critical to think in terms of total return when analyzing the performance of an individual CEF or a portfolio of CEFs. In a time of narrow discounts, it is important not to lose sight of these important data points.

No Changes to 4 Favored Categories

I am making no changes to my comments from last quarter where I favored blending CEF portfolios across 4 primary areas and I would like to reiterate my comments from last quarter:

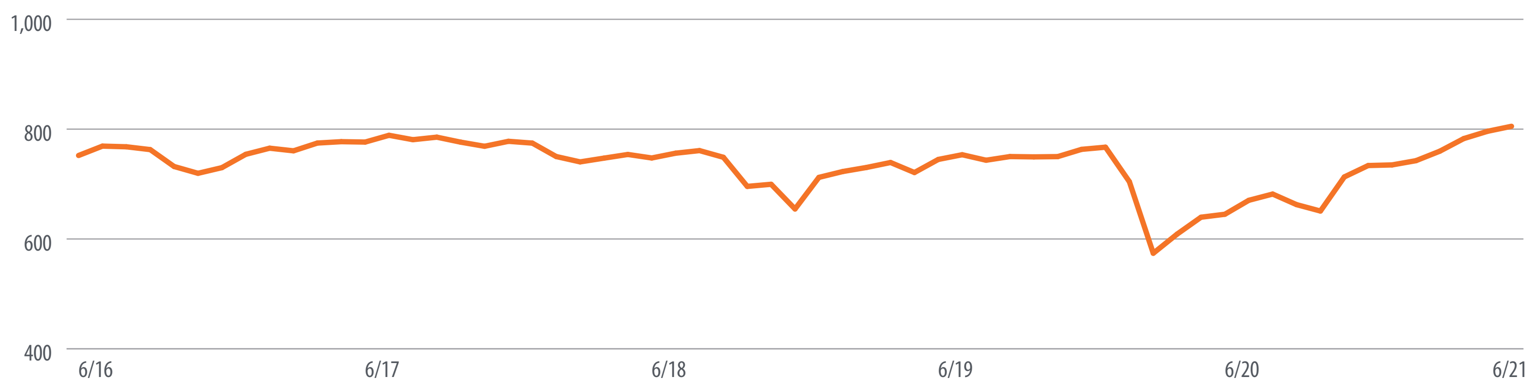
1. U.S. Equity CEFs
2. Senior Loan CEFs
3. Limited-Duration Multi-Sector Income CEFs
4. Municipal CEFs

First Trust Composite Closed-End Fund Total Return Index (UPCEFT) Dividend Adjusted Value (6/30/16 - 6/30/21)



Source: Bloomberg.

First Trust Composite Closed-End Fund Index (UPCEF) Dividend Adjusted Value (6/30/16 - 6/30/21)



Source: Bloomberg

I believe the benefit of this balanced, four-pronged approach is that it helps investors seeking a high income stream while also helping to reduce volatility because of the different risk and reward characteristics of each category.

For example, while many municipal CEFs have overall investment-grade average credit quality ratings and attractive tax-free distribution yields averaging 4.08% (Morningstar), they tend to take on a meaningful amount of duration risk. Senior loan and limited-duration multi-sector income CEFs also generate high distribution yields of 7.03% and 8.90%, respectively (Morningstar); however they tend to have far less duration risk than municipal CEFs but with more credit risk than investment-grade municipal CEFs. I believe when these three fixed-income categories are blended, it can help reduce some of the inherent risk that each category has on its own by creating appropriate balance and diversification—all while generating high income.

Lastly, with average discounts to NAV of 7.01% and average distribution yields of 6.10% (Morningstar), U.S. equity CEFs can potentially contribute high income to a portfolio but also provide a potential growth engine as I believe U.S. equity CEFs should continue to benefit from the growth and re-opening of the U.S. economy in 2021.

Past performance is not a guarantee of future results.

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