CLOSED-END FUND REVIEW

FOURTH QUARTER 2022

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FOURTH QUARTER 2022 AND 2022 OVERVIEW

Following three consecutive quarters of negative total returns for the average closed-end fund (CEF), CEFs rebounded during the fourth quarter and posted an average return of 6.4%. It was a broad rally in the fourth quarter with the average equity CEF returning 9.3%, fixed-income CEF returning 4.9%, municipal CEF returning 4.4% and taxable fixed-income CEF returning 5.1%. Equity CEFs benefitted from the 7.6% return for the S&P 500 Index during the quarter. Fixed-income CEFs benefitted from positive total returns from several key fixed-income indices for the quarter including a 3.9% return for the S&P National AMT-Free Municipal Bond Index, a 4.1% return for the iBoxx USD Liquid High Yield Index, a 3.1% return for the iBoxx USD Liquid Leveraged Loans Index, a 1.9% return for the S&P U.S. Aggregate Bond Index and a 4.6% return for the iBoxx USD Liquid Investment Grade Index. (Source: S&P)

Despite the positive fourth quarter for many CEFs, the 2022 full year total return data for most CEFs was still firmly negative. Indeed, for 2022 the average CEF returned -18.0%. Equity CEFs returned -12.7%, fixed-income CEFs returned -20.6%, municipal CEFs returned -23.2% and taxable fixed-income CEFs returned -18.7%. For the year, concerns about the potential for a global recession, rising short-and long-term interest rates and stubbornly high inflation data clearly took its toll on the global equity and credit markets which contributed to the negative total returns many CEFs posted for the year. Indeed, there were only two categories of CEFs tracked by Morningstar that posted positive average total returns during 2022: Commodity CEFs + 0.7% and MLP CEFs +25.2%. Every other category was down on average by at least 10%.

Many CEFs Continue to Trade at Wider than Average Historical Discounts to Net Asset Value (NAV)

Average discounts to net asset value (NAV) widened to -8.1% at the end of the fourth quarter from the -7.5% level they ended the third quarter of 2022. Average discounts to NAV continue to be wider than the 10-year average discount to NAV of -5.5% and are significantly wider than the -2.3% level from which they ended 2021. Average discounts to NAV for equity CEFs widened to -8.8% at the end of the fourth quarter from the -7.4% level they end the third quarter and are wider than the 10-year average of -6.9%. Average discounts to NAV for taxable bond CEFs narrowed to -7.3% at the end of the fourth quarter from the -8.2% level they end the third quarter but are wider than the 10-year average of -4.5%. Average discounts to NAV for municipal bond CEFs widened to -8.1% at the end of the fourth quarter from the -7.0% level they end the third quarter and are significantly wider than the 10-year average of -4.3%. (Source: CEFData.com)

While in the short term it can be frustrating for CEF investors to see average discounts to NAV continue to widen, I continue to firmly believe that the widening of average discounts to NAV can potentially create compelling long-term total return opportunities for investors who are patient and dollar cost average.

Outlook for 2023

Given the challenging environment and mostly negative total returns many CEFs posted in 2022, many CEFs investors are likely happy 2022 is over. As 2023 commences, there are two factors that I believe could potentially lead to better overall total return performance for diversified CEF investors in 2023:

1. The End of the Federal Reserve (the Fed) Raising Short-Term Interest Rates: One of the negative factors and biggest headwinds for many CEFs in 2022 was the Fed aggressively raising short-term interest rates. This led to higher borrowing cost for leveraged CEFs which in turn, led to many distribution reductions last year. I also believe the Fed raising short-term interest rates creates a negative sentiment towards the CEF structure as I believe there are investors who shy away from the structure during period of rising short-term rates. However, at this point in the tightening cycle, I believe the Fed is likely closer to the end than the beginning of its tightening phase. I believe if the Fed stops raising short-term interest rates during the first or second quarter of the year, it will improve the backdrop for many CEFs as borrowing cost will no longer be trending higher. This should potentially lead to more distribution stability, and I believe more investors will be inclined to invest in closed-end funds.

2. Compelling Valuations: As discussed above, the valuations for many CEFs are compelling as average discounts to NAV are wider than long-term averages. While it is difficult to know exactly when average discounts to NAV will begin to narrow, I believe should the Fed indeed signal they are nearing the end of their tightening cycle, that investors will look to take advantage of the attractive valuations available in the secondary market for CEFs and we could see discounts begin to narrow.

While 2022 was a challenging and frustrating year for diversified CEF investors, I continue to firmly believe periods of enhanced volatility can potentially create attractive long-term buying opportunities for investors who dollar cost average across different categories of the CEF marketplace including but not limited to diversified equity CEFs, preferred CEFs, municipal CEFs, below investment grade high-yield CEFs and senior loan CEFs. An aggressive tightening cycle coupled with stubbornly high inflation data made for a difficult backdrop for CEF investors in 2022. However, if the Fed is indeed closer to the end than the beginning of its tightening cycle and if inflation trends lower in 2023, I believe the backdrop for diversified CEF investors could improve this year. I believe this remains a compelling time to take advantage of the compelling valuations (see above) and distribution yields (average CEF has a distribution yield of 8.8% as of 12/31/22 according to Morningstar) available in the secondary market.

Source for CEF performance: Morningstar. All performance is based on share price total return.

Past performance is not a guarantee of future results.