



CLOSED-END FUND REVIEW

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FOURTH QUARTER 2023 OVERVIEW

Following a difficult third quarter of 2023 which saw the average closed-end fund (CEF) lower by -3.98%, many CEFs rallied sharply during the fourth quarter. Indeed, the average CEF returned +9.54% for the fourth quarter. It was a broad rally with equity CEFs returning +8.46%, municipal CEFs returning +13.09% and taxable fixed-income CEFs returning +8.11%. (Source: Morningstar. All data is share price total return). During the quarter, equity CEFs benefitted from the +11.68% return in the S&P 500 Index and the +9.82% return in the MSCI ACWI ex USA Index. Taxable fixed-income CEFs benefitted from strong returns in several key fixed income indices including the +7.07% return in the ICE BofA US High Yield Constrained Index, the +6.82% return in the Bloomberg US Aggregate Bond Index, the +6.62% return in the ICE BofA Fixed Rate Preferred Securities Index and the +8.10% return in the Bloomberg Global-Aggregate Index. Municipal CEFs benefitted from the +7.10% return in the ICE BofA 7-12 Year US Municipal Securities Index. (Source: Bloomberg)

The very strong fourth quarter helped propel CEFs to achieve a solid year with the average CEF returning +10.55% for 2023. The double-digit gain for the average CEF in 2023 was welcome news after a very difficult 2022 which saw the average CEF return -18.0%. Equity CEFs finished 2023 up on average +12.10%, municipal CEFs returned on average +3.96% and taxable fixed income CEFs returned on average +13.81% for 2023. (Source: Morningstar. All data is share price total return)

Despite Fourth Quarter Rally, Average Discounts to Net Asset Value (NAV) Remain Wider Than Historical Averages

While many CEFs rallied sharply during the fourth quarter, average discounts to NAV remain wider than historical averages. While I recognize many CEF investors remain frustrated that average discounts to NAV remain wider than historical averages and did not narrow in 2023, I also continue to firmly believe that these wide average discounts to NAV can potentially create compelling long-term total return opportunities for investors who are disciplined, patient and build diversified CEF portfolios during this period of wide discounts. Moreover, if the Fed is indeed finished raising short-term interest rates for this cycle (more on that in concluding section of commentary) and potentially reduces short-term interest rates in 2024, I believe we could see average discounts to NAV narrow meaningfully in 2024 particularly in longer duration fixed income CEFs including municipal, preferred and investment grade corporate bond CEFs.

Average discounts to NAV remained quite wide and widened slightly during the fourth quarter. The average CEF was at a -9.63% discount to NAV as of 12/29/23 which was slightly wider than the -9.58% average discount they ended the third quarter. Average discounts to NAV continue to remain significantly wider than the -1.95% level from which they started 2022 and meaningfully wider than the 10-year average discount to NAV of -5.85%. Average discounts to NAV for equity CEFs ended 4Q23 at -10.82%, wider than the 10-year average discount of -7.13%. Average discounts to NAV for taxable bond CEFs ended 4Q23 at -5.62%, wider than the 10-year average discount of -4.91%. Among these broad categories, the widest discrepancy between current discounts to NAV relative to the long-term average remains in the municipal CEF category where average discounts to NAV ended 4Q23 at -12.41%, wider than the 10-year average discount of -4.90%. (Source: CEFData.com)

Outlook for 2024

The message in our most recent CEF quarterly commentary pieces has been to encourage CEF investors to remain patient, disciplined and to take advantage of the wider than average discounts to NAV by dollar cost averaging across several different categories of the CEF marketplace. The reason this was a key theme in previous commentary pieces is because it has been my contention that once the Fed did indicate they were likely done raising short-term interest rates for this cycle that we would see the backdrop improve for many CEFs and CEF investors would be rewarded. During the fourth quarter the Fed did signal they are likely finished raising short-term interest rates for this cycle (and could even begin cutting short-term interest rates in 2024) and many CEFs did indeed react very favorably to this development, leading to very strong total returns for the fourth quarter. The sudden shift in sentiment towards CEFs and sharp positive turnaround in performance that many CEFs experienced during the fourth quarter is an important reminder that sentiment can shift very swiftly with CEFs, and price discovery can occur quickly as well. This is precisely why our previous CEF commentary pieces encouraged CEF investors to stay patient and dollar cost average through the challenging environment in 2022 and challenging environment seen for parts of 2023.

As the first quarter of 2024 commences, I believe valuations remain compelling as many CEFs continue to trade at discounts to NAV which are wider than their historical averages. If the Fed is indeed finished raising short-term interest rates for this cycle or even begins cutting interest rates this year, I believe the backdrop for many CEFs- particularly leveraged fixed income CEFs including municipal and preferred CEFs- would continue to improve throughout 2024. I continue to believe this remains a compelling time for CEF investors to dollar cost average across many categories including but not limited to diversified equity CEFs, municipal CEFs, preferred CEFs, and high yield CEFs.

One final potential positive for many CEFs in 2024 relates to the increase in demand we could see for CEFs if overall interest rates decline and yields on competing income-oriented investments including CDs, money market funds, U.S. Treasuries etc. also decline. If competing and alternative rates are lower in 2024, investors may be more likely to consider the CEF structure given the very high and attractive distribution rates that exist in the secondary market for CEFs. Indeed, as of 12/29/23 the average CEF had a distribution rate of 8.25% according to Morningstar.

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

Past performance is not a guarantee of future results.

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