Limited Duration Closed-End Funds Performing Well in 2015

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At the end of March I wrote about how, after a difficult 2014, senior loan closed-end funds (CEFs) were off to a strong start to the year in 2015. Senior loan CEFs continue to perform well this year and are now up 6.93% (as of 5/21/15 according to Morningstar on a share price total return basis). Another category I continue to advocate diversified CEF investors have exposure to is limited duration CEFs. Similar to senior loan CEFs, limited duration CEFs had a disappointing year in 2014 rising on average only 0.56% on a share price total return basis, according to Morningstar. However, just as is the case with senior loan CEFs, performance has improved in 2015 for limited duration CEFs. Indeed, according to Morningstar, the average limited duration CEF is up 3.93% on a share price total return basis as of 5/21/15. In my opinion, there are likely two key reasons for the improved performance for limited duration CEFs so far in 2015 including:

1. Investors are in the very early stages of beginning to shorten durations in their fixed-income portfolios. After years of declining long term interest rates and after years of a federal funds rate at 0-0.25%, based on comments from the Federal Reserve investors are beginning to prepare for the potential for the federal funds rate to be raised at some point in 2015. Furthermore, long term interest rates have recently been trending higher.

2. Investors are finally beginning to take advantage of the very wide and attractive discounts to net asset value (NAV) the average limited duration CEF is trading at. Indeed, as of 5/21/15, the average limited duration CEF was at an 11.02% discount to its NAV. This is significantly wider than the average discount to NAV of 2.98% they were trading at three years ago as well as wider than the average discount to NAV they were trading at ten years ago of 4.96%, according to Morningstar.

With our Economics team forecasting a slow and gradual rise for both short and long term interest rates beginning in 2015 and continuing into 2016, I continue to be an advocate for CEF investors having exposure to limited duration CEFs. The limited duration, attractive wide discounts to NAV as well as the very compelling share price distribution rates (according to Morningstar the average limited duration CEF had a share price distribution rate of 7.64% as of 5/21/15) are three key reasons I believe limited duration CEFs should be included as part of a diversified CEF portfolio.