CLOSED-END FUND review

FIRST QUARTER 2016

Jeff Margolin

Senior Vice President, Closed-End Fund Analyst

First Quarter Overview

After a difficult first six weeks of the year, most categories of the closed-end fund (CEF) marketplace rallied strongly during the second half of the first quarter. Indeed, the average CEF finished the quarter up 2.73% on a share price total return basis (According to Morningstar). At the start of the first quarter, many CEFs were negatively impacted by the significant sell-off in the global equity markets, decline in oil prices (which impacted the credit markets) and an overall palpable risk-off mentality that clearly existed among retail investors. However, by the middle of the quarter as the equity markets began to rally, oil prices firmed and some reassuring economic data was released, investors began to take advantage of the wider-than-average historical discounts to net asset value (NAV) which existed for many CEFs and performance began to improve meaningfully during the last half of the quarter.

Many of the credit sensitive CEFs, as well as the shorter-duration categories of the CEF marketplace (which were negatively impacted by the decline in oil prices in 2015), along with a "flight to safety" investor mentality among retail investors (particularly during the last half of 2015), rallied during the first quarter as investors took advantage of the attractive valuations and attractive distributions available among these funds. For example, limited duration CEFs were positive on average by 5.03% during the quarter. The average high-yield CEF was up 4.69% and, finally, the average senior loan CEF finished the quarter positive by 2.46%. (All data is from Morningstar and is share price total return data).

Average Discounts to NAV Begin to Narrow

After spending much of the third and fourth quarters of 2015 with average discounts to NAV in the high single digits and low double digits for many CEF categories, average discounts to NAV finally began to narrow a bit during the first quarter. In the third quarter CEF Commentary piece from 2015 found here http://www.ftportfolios.com/Commentary/Insights/2015/10/27/third-quarter-2015, I took a 20-year look at historical discounts/premiums to NAVs and commented on the fact that while I didn't know exactly when discounts to NAV would narrow from the historically wide levels closer to the long-term average of 3-4%, historically when average discounts to NAV were as wide as they were for as long as they had been, and distributions were as high as they were, it creates very compelling long-term total return opportunities for CEF investors. It appears as if the discount narrowing process has begun and investors who took advantage of the unusually wide discounts during the second half of 2015 are starting to be rewarded.

According to Morningstar, average discounts to NAV for all CEFs ended the first quarter at 5.83% after starting the year at an average discount of 7.86%. The average discount to NAV was 9.76% on 9/30/2015. Despite the fact that average discounts to NAV have begun to narrow for many CEFs, average discounts to NAV are, in many cases, still wider than historical averages, which is part of the reason I still believe there are many compelling opportunities for investors to take advantage of in the secondary market for CEFs. However, I do believe investors need to pick their spots more carefully and focus on categories where not only are the average discounts to NAV wider than historical averages but also the fundamentals and valuations of the underlying asset classes remain compelling. Two categories which not only continue to have wider-than-average discounts to NAV, along with underlying asset classes that I believe are currently compelling, include: U.S. Equity CEFs and Senior Loan CEFs. In fact, according to Morningstar, the average U.S. General Equity CEF was trading at a 12.52% discount to NAV and the average Senior Loan CEF was at average discount to NAV of 6.80% as of 3/31/2016.

Game Plan for Rest of 2016

After a difficult year for many categories of the CEF marketplace in 2015 (with the clear exception of municipal CEFs), it was encouraging to see many categories bounce back during the first quarter of 2016.

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1-630-915-6784
www.ftportfolios.com

As I discussed in my CEF commentary piece at the beginning of the year, found here http://www.ftportfolios.com/Commentary/Insights/2016/1/27/forth-quarter-2015, I believe investors should make U.S. Equity CEFs, Non-Levered Municipal CEFs and Senior Loan CEFs the core components of a diversified CEF portfolio. Based on our Economic Team's macro view of continued "Plow Horse" (as they describe it) U.S. economic growth, higher U.S. equity prices and a slow rise in both short- and long-term interest rates, there are four key themes I believe investors should focus on for the remainder of 2016 as it relates to investing in CEFs. The four themes include:

1. Focus on U.S. Equity Income CEFs.
2. Focus on Shorter-Duration Fixed-Income CEFs.
3. Lighten up on Long-Duration, Leveraged Fixed-Income CEFs.
4. Increase exposure to Non-leveraged CEFs and CEFs that have locked in some or all of their leverage cost.

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