# CLOSED-END FUND REVIEW

SECOND QUARTER 2019

**JEFF MARGOLIN**
Senior Vice President
Closed-End Fund Analyst

## SECOND QUARTER 2019 OVERVIEW

After a very solid first quarter of 2019 when the average Closed-End Fund (CEF) was up 11.8%, the momentum continued in the second quarter with the average CEF gaining 2.8%. Through the first half of the year, the average CEF is now up 15.1%. It continues to be a broad-based rally across most categories of the CEF marketplace. While Equity CEFs were up on average 0.6% during the second quarter (and are now up 15.9% for the first half of the year), it was the fixed-income funds that on average provided the biggest gains. Taxable Fixed-Income CEFs were up on average 4.0% for the second quarter (and are now up 15.7% for the first half of the year), while the average Municipal CEF gained 4.3% (now up 14.2% for the first half of the year). (Source: Morningstar. All data is share price total return).

As is often the case, several factors contributed to the solid performance many CEFs earned during the quarter. A more dovish Federal Reserve (Fed) clearly benefited fixed-income asset classes which in turn helped the performance of many fixed-income categories of the CEF marketplace. Municipal CEFs benefited from strength in the underlying asset class of Municipal Bonds as the BAML 7-12 Yr. Municipal Index was up 2.4% for the quarter. Several other key Taxable Fixed-Income indices were up for the quarter which also helped boost performance of Taxable Fixed-Income CEFs including the BAML Investment Grade Corporates Index up 4.3%, BAML Preferred Index up 3.0%, BAML High-Yield Bond Index up 2.6% and the S&P/LSTA Leveraged Loan Index up 1.68%. (Source: Bloomberg)

Average discounts to net asset value (NAV) ended the second quarter at 5.9%. While average discounts have narrowed from the 9.6% level at the beginning of the year, they remain wider than the 20-year long-term historical average of 4.8%. (Source: Morningstar)

## OUTLOOK FOR REMAINDER OF 2019

As discussed in the first quarter 2019 CEF commentary, from my standpoint the continued dovish tone expressed by the Fed creates a favorable backdrop for the CEF structure. In my opinion, investors will be more inclined to consider investing in CEFs if they believe short-term rates (and therefore borrowing cost for leveraged funds) are likely to be stable or declining. Indeed, more recently the Fed has even strongly signaled it is poised to reduce the federal funds rate which would lower the borrowing cost for many leveraged funds and help stem the tide of distribution reductions many funds have endured the past 3 years as the Fed was increasing the federal funds rate. While average discounts to NAV have narrowed significantly from the 9.6% level they began the year at and are now at 5.9%, I continue to believe there will be further narrowing of discounts as the year progresses and as sentiment continues to improve for the CEF structure given the more dovish Fed.

A more dovish Fed, coupled with our Economic Team's continued forecast of 3% GDP growth for the U.S. economy in 2019, plus a recently revised higher year-end 2019 target of 3,250 for the S&P 500 Index, leads me to continue to favor U.S. equity, senior loan, limited-duration multi-sector fixed-income and Municipal CEFs as core holdings for diversified CEF investors. I also believe Master Limited Partnership (MLP) CEFs, Preferred CEFs and funds with exposure to European blue-chip stocks are attractive satellite positions in a diversified CEF portfolio.

U.S. general Equity CEFs are up 16.2% YTD through the first half of the year. Given our Economic Team's bullish forecast for U.S. equities and forecast for solid U.S. GDP growth, I continue to believe the backdrop for U.S. Equity CEFs remains a good one and that is primarily why I believe they should be part of a diversified CEF portfolio. (Source: Morningstar)

On the fixed-income side of the equation, I continue to be a big believer in blending categories of CEFs that have different risk characteristics as a way to generate a high-income stream but also create balance in a portfolio.

Attractive tax-free yields, wide average discounts to NAV of 6.73% (as of 6/30/19 according to Morningstar) and a more dovish Fed are the three primary reasons I continue to advocate that investors have exposure to municipal CEFs. However, even though the Fed has become more dovish and is poised to reduce the federal funds rate, I also strongly believe it is important to balance the duration risk associated with many leveraged Municipal CEFs with shorter duration, credit-sensitive CEFs including Senior Loan and limited duration Multi-Sector Fixed-Income CEFs.

Senior Loan CEFs are up 13.6% YTD (Morningstar) and despite the potential for the Fed to reduce the federal funds rate (and therefore reduce the income on floating-rate loans), the fundamentals for the senior loan asset class remains sound. Indeed, according to S&P, the default rate for the S&P/LSTA Leveraged Loan Index was only 1.34% as of the end of June which is less than the 2.92% the Index has averaged since 1999. With the backdrop of a low default environment, I continue to believe Senior Loan CEFs can be a very effective way to generate a high income stream from a low duration, credit-sensitive asset class. Moreover, when blended with longer-duration municipal CEFs, they can help reduce the duration risk in a portfolio. I would be less inclined to have exposure to Senior Loan CEFs if our "Macro" call of continued U.S. economic growth in the 3% range was reduced sharply. However, that is not the case and that is why I still believe Senior Loan CEFs should be included as part of a diversified portfolio of CEFs.



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First Trust Advisors L.P.
1.630.915.6784
www.ftportfolios.com