CLOSED-END FUND REVIEW

FOURTH QUARTER 2020

JEFF MARGOLIN
Senior Vice President
Closed-End Fund Analyst

FOURTH QUARTER AND 2020 OVERVIEW

Following the third quarter, when the average closed-end fund (CEF) was up 3.27%, CEFs continued their positive momentum and increased—on average—by 12.75% during the fourth quarter. (https://www.ftportfolios.com/Commentary/Insights/2020/10/26/third-quarter-2020) The significant rally many CEFs had in the second, third and fourth quarters was enough to bring the average CEF to a positive total return of 2.66% for all of 2020. While this might not seem all that impressive, when you consider the average CEF was lower by 23.46% at the end of the first quarter as a result of the initial shutdown of the global economy, the roughly 3% average total return for 2020 becomes much more impressive. (Source: Morningstar. All performance is based on share price total return).

It was a broad rally in the fourth quarter with equity CEFs rising 20.38%, fixed-income CEFs increasing 8.64%, taxable fixed-income CEFs gaining 11.31% and municipal CEFs rising 5.65%. (Morningstar). Equity CEFs benefited from the 12.14% increase in the S&P 500 Index as well as the 17.01% gain in the MSCI All-Country World Ex US Index. Fixed-income CEFs benefitted from the strong performance earned by several key fixed-income indices. For example, during the fourth quarter the ICE BofA High-Yield Bond Index gained 6.47%. The S&P/LSTA Leveraged Loan Index rose by 3.83%. The ICE BofA Preferred Index increased 4.55%. The ICE BofA 7-12 Yr. Municipal Index gained 1.84% and the Barclays Global-Aggregate Index increased 3.28%. (Source: Bloomberg, as of 12/31/20. Index performance is based on total returns).

For 2020, municipal CEFs ended the year with an average total return of 5.59%. Taxable fixed-income CEFs earned an average of 3.78% while equity CEFs ended 2020 with an average loss of 3.31%. While the average equity CEF was lower for the year, U.S. equity CEFs finished 2020 with an average gain of 8.46%. (Morningstar)

Expect Average Discounts to Narrow in 2021 as Backdrop Remains Positive for CEF Structure

Average discounts to net asset value (NAV) narrowed during the fourth quarter and ended the quarter at 6.45%. While average discounts to NAV narrowed to 6.45% from the 8.73% average discount in which they ended the third quarter, they still remained wider than the long-term 10-year average discount to NAV of 4.84% (Source: CEFdata.com). I continue to firmly believe the wider than average discounts to NAV presently available in the secondary market for CEFs provides investors with compelling entry points and opportunities to build diversified portfolios of CEFs. Moreover, given the positive backdrop I believe exists for the CEF structure (see below), I expect average discounts to NAV to narrow in 2021 to levels which are narrower than the 10-year average discount of 4.84%.

From my standpoint, the backdrop for the CEF structure remains positive for 4 primary reasons which I believe will lead to a further narrowing of discounts to NAV. The reasons are as follows:

1. Valuations: Average discounts to NAV at 6.45% remain wider than the long-term 10-year average of 4.84%. Inexpensive valuations relative to long-term averages should be attractive to buyers in the secondary market and lead to discounts narrowing.
2. Very Accommodative Federal Reserve (the Fed): The Fed has indicated that it does not intend to raise short-term rates until at least 2023. This benefits the CEF structure as it keeps leverage cost low for most of the roughly two-thirds of all CEFs which employ the use of leverage.
3. Low Yields on Traditional Income Investments: With yields on traditional income investments at very low rates, I believe more investors will be looking to the CEF structure to increase yield and cash flow from their portfolios. As of 12/31/20, the average CEF had a distribution yield of 7.22%, which is attractive to investors during this period of very low interest rates. (Morningstar).

4. Positive Macro Forecast: With our Economics team forecasting solid 3.0% real growth for the U.S. economy in 2021 (https://www.ftportfolios.com/Commentary/EconomicResearch/2020/12/7/2021-robust-growth,-higher-inflation), as well as a year-end 2021 target of 4,200 for the S&P 500 Index (https://www.ftportfolios.com/Commentary/EconomicResearch/2020/11/30/sp-4,200---dow-35,000), the environment for equity and credit sensitive CEFs should be a good one, I believe, as the global economy begins to open up and recover from the Coronavirus pandemic.

History also provides a guide for us as to why discounts to NAV will likely continue to narrow in 2021. Indeed, the last time the Fed cut short-term rates to near 0% was on 12/16/08 as the financial crisis was raging. At the time, the average discount to NAV for all CEFs was 17.5%. Two years later on 12/16/10, it had narrowed to only 2.04% as the CEF structure benefitted from near 0% short-term rates, low yields on traditional income investments and an improving global economy as the financial crisis ended by the summer of 2009. (CEFdata.com)

On 3/16/20, the Fed cut rates to near 0% as the global economy began to shut down. At the time, the average discount to NAV for all CEFs was 11.7%. It ended 2020 at 6.45% and I believe that just like the last time the Fed cut rates to near 0%, demand for the CEF structure will increase in the secondary market and average discounts to NAV will continue to narrow to levels below long-term historical averages.

From my standpoint, this remains a compelling time to take advantage of the positive backdrop that I believe exists for the CEF structure and dollar-cost average over the coming days and weeks across many different categories of the CEF marketplace. I believe attractive opportunities are currently present in many categories including equity CEFs, credit-sensitive taxable fixed-income CEFs (including senior loan CEFs, high-yield CEFs, limited duration CEFs and multi-sector CEFs) and investment-grade municipal CEFs. Average discounts to NAV remain wider than historical averages, the Fed is very accommodative and the global economy is poised to perform much better in 2021 relative to 2020 as the vaccine rollout helps to get the global economy open again.

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