CLOSED-END FUND REVIEW
THIRD QUARTER 2021

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THIRD QUARTER 2021 OVERVIEW

After two positive quarters to start the year, the total return for the average closed-end fund (CEF) was slightly lower during the third quarter but remains positive for 2021. Indeed, the average CEF returned -1.25% during the third quarter but is up 13.49% year-to-date (YTD) through 9/30/2021. Equity CEFs returned -2.22% during the quarter but remain up 21.36% YTD. The average fixed-income CEF declined -0.77% during the third quarter, with municipal CEFs returning -1.08% and taxable fixed-income CEFs declining -0.54%. Fixed-income CEFs are up 9.05% YTD, with municipal CEFs up an average of 7.06% YTD and taxable fixed-income CEFs up 10.64% YTD. (Source: Bloomberg)

Senior loan CEFs were a bright spot during the quarter in the fixed-income CEF universe as senior loan CEFs returned 1.03% and are now up on average 17.61% YTD. (Source: Morningstar. All performance is based on share price total return.) During the quarter, senior loan CEFs benefited from the 1.11% return of the S&P/LSTA Leveraged Loan Index. (Source: Bloomberg) Senior loans continue to benefit from a low default rate. Indeed, according to S&P Global Market Intelligence, the trailing 12-month volume of defaults in the S&P/LSTA Leveraged Loan Index fell to only $4.1 billion in September. This is the lowest level since April 2012 and represents a default rate by amount of only 0.35%. As of October 1, 2021 the default rate by issuer count is only 0.44%, which is the lowest since December 2007.

Discounts to Net Asset Value (NAV) Widen Slightly but Remain Narrower Than Long-Term Average

Average discounts to NAV widened slightly during the quarter but remain far narrower than the 10-year average. Indeed, average discounts to NAV ended the third quarter at -2.37%. They began the quarter at -1.61%. The 10-year average discount to NAV for all CEFs is -4.96%. Equity CEFs ended the third quarter with an average discount to NAV of -4.84%, which remains narrower than the 10-year average discount to NAV of -6.87%. Taxable fixed-income CEFs ended the third quarter with an average discount to NAV of -0.86%, which remains narrower than the 10-year average discount to NAV of -3.65%. Lastly, municipal CEFs ended the third quarter with an average discount to NAV of just -0.35%, which remains narrower than the 10-year average discount to NAV of -3.53%. (Source: CEFdata.com)

I continue to expect average discounts to NAV to remain in the low single digit range throughout the remainder of 2021 and at least through the first part of 2022, as I continue to believe the backdrop for the CEF structure remains very strong. A Federal Reserve (Fed) funds rate near 0% helps keep borrowing cost low for most of the roughly two-thirds of all CEFs which employ the use of leverage. Moreover, I continue to believe that with very low yields on traditional income investments, more investors will be looking to the CEF structure as a way to potentially increase yield and cash flow from their investments. Indeed, according to Morningstar as of 9/30/2021 the average CEF had an attractive distribution yield of 6.33%.

The demand for investments with high distribution yields should help keep average discounts to NAV for many CEFs narrower than their long-term averages for the remainder of 2021 and into 2022, in my view. I also think it is important to note that given the significant narrowing of discounts to NAV which has occurred in 2021, I would expect more of the potential total return a diversified portfolio of CEFs provides to come from the distributions as opposed to significant capital appreciation.

Outlook for Remainder of 2021 and Looking Ahead to 2022

From my standpoint, the outlook for investors who remain diversified across favored categories of the CEF marketplace (see below) remains a good one. With the backdrop of a Fed funds rate near 0%, coupled with our Economics team bullish forecast for U.S. equities https://www.ftportfolios.com/Commentary/EconomicResearch/2021/8/30/5,000 and no imminent recession, I am making no changes to my belief that the core of a diversified CEF portfolio should consist of U.S. equity CEFs, Senior Loan CEFs, Limited-duration Multi-sector Income CEFs and Municipal CEFs. In my view, this balanced, four-pronged blend continues to prove its worth as it continues to provide investors with a high-income stream while also helping to reduce volatility because of the different risk and reward characteristics of each category. For example, as long-term interest rates moved higher towards the end of the third quarter, it put pressure on long-duration municipal CEFs. As mentioned earlier, the average municipal CEF returned -1.08% for the quarter. However, shorter duration fixed-income CEFs were up for the quarter as they were much less impacted by the increase in long-term interest rates. Indeed, according to Morningstar, the average limited-duration fixed-income CEF was up 2.28% during the third quarter and senior loan CEFs were positive by 1.03%. I believe this illustrates the benefit of blending categories of CEFs that have different risk and reward characteristics as a way to create balance in a portfolio, potentially reduce volatility and still generate a high-income stream.

Lastly, during this time of the year, I get inquiries related to my thoughts on whether or not I think there will be a lot of tax-loss selling in the CEF structure. Tax-loss selling is when investors sell securities to realize losses for tax purposes in order to offset gains within their portfolios. Tax-loss selling tends to be most prevalent in late November and into December. It also tends to be most widespread in years when the average CEF is lower for the year. Given the fact the average CEF has returned 13.49% YTD and gains have been broad and included most categories of the CEF marketplace, I am not expecting a particularly bad season of tax-loss selling during this year's fourth quarter.

Past performance is not a guarantee of future results.

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