CLOSED-END FUND REVIEW

FIRST QUARTER 2021

JEFF MARGOLIN
Senior Vice President
Closed-End Fund Analyst

FIRST QUARTER 2021 OVERVIEW

Following a very strong fourth quarter of 2020 when the average closed-end fund (CEF) increased by 12.75% (https://www.ftportfolios.com/Commentary/Insights/2021/1/22/fourth-quarter-2020), CEFs continued their positive momentum and gained 6.42% for the first quarter of 2021. It was a broad rally with equity CEFs rising 11.94%, fixed-income CEFs gaining 3.36%, municipal CEFs increasing 1.72% and taxable fixed-income CEFs growing 4.71%. Equity CEFs benefitted from the 6.17% increase in the S&P 500 Index as well as the 3.49% increase in the MSCI All-Country World Ex US Index. Fixed-income CEFs (particularly credit sensitive fixed-income CEFs) benefitted from strength in the underlying high-yield bond and leveraged loan markets. The ICE BofA High-Yield Bond Index was up 0.91% for the first quarter, while the S&P/LSTA Leveraged Loan Index gained 1.78%. Despite a decrease of 0.64% for the ICE BofA 7-12 Yr. Municipal Index during the quarter, municipal CEFs increased 1.72%—which, in my view, reflects the demand for the attractive 4.26% distribution yield the average municipal CEF provides. (Source: Morningstar. All performance is based on share price total return).

Discounts to Net Asset Value (NAV) Continue to Narrow

Average discounts to NAV narrowed during the quarter, from the -6.48% level they ended 2020, to -3.89% on 3/31/21. Average discounts to NAV are now narrower than the long-term 10-year average discount to NAV of -4.92%. (Source: CEFdata.com). As I have written previously, I expect average discounts to NAV to continue to narrow throughout 2021 given my view that the backdrop for the CEF structure remains a good one for 3 primary reasons including:

1. **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 costs low for most of the roughly two-thirds of all CEFs which employ the use of leverage.
2. **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 3/31/21, the average CEF had a distribution yield of 6.42%, which is attractive to investors during this period of very low interest rates. (Morningstar).
3. **Positive Macro Forecast:** With our Economic Team forecasting job gains in the seven million range for all of 2021 and very strong real GDP growth of 6% (https://www.ftportfolios.com/Commentary/EconomicResearch/2021/4/5/jobs-are-booming), I believe the environment for equity and credit-sensitive CEFs should continue to be a good one as the global economy continues to open up and recover from the Coronavirus pandemic.

Building a Diversified CEF Portfolio with 4 Favored Categories

Given the fact that yields on traditional income-oriented investments remain at very low levels, it can seem like a daunting task for a portfolio to generate the potential for high income. However, I believe CEFs can play an important role in a portfolio for investors who are seeking high income but also broad diversification across different asset classes. To that end, I favor blending CEF portfolios across 4 primary areas:

1. U.S. Equity CEFs
2. Senior Loan CEFs
3. Limited-Duration Multi-Sector Income CEFs
4. Municipal CEFs

The benefit of this balanced, four-pronged approach is that it helps investors seeking a high income stream while also helping to reduce volatility because of the different risk and reward characteristics of each category.

For example, while many municipal CEFs have overall investment-grade average credit quality ratings and attractive tax-free distribution yields averaging 4.26% (Morningstar), they tend to take on a meaningful amount of duration risk. Senior loan and limited-duration multi-sector income CEFs also generate high distribution yields of 7.26% and 8.47%, respectively (Morningstar); however they tend to have far less duration risk than municipal CEFs but with more credit risk than investment-grade municipal CEFs. I believe when these three fixed-income categories are blended, it can help reduce some of the inherent risk that each category has on its own by creating appropriate balance and diversification-- all while generating high income.

Lastly, with average discounts to NAV of 5.72% and average distribution yields of 6.79% (Morningstar), U.S. equity CEFs can also contribute high income to a portfolio but also provide a potential growth engine as I believe U.S. equity CEFs should continue to benefit from the growth and re-opening of the U.S. economy in 2021.

First Trust

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