CLOSED-END FUND REVIEW

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THIRD QUARTER 2024 OVERVIEW

Following the positive second quarter of 2024 which saw the average closed-end fund (CEF) return +2.69%, CEFs continued their solid momentum during the third quarter. The average CEF returned an impressive +7.88% for the third quarter and is now up on average +17.28% year-to-date (YTD) through the end of the third quarter. Similar to the second quarter, it was a broad rally with equity CEFs up +8.40%, taxable fixed-income CEFs up +8.21% and municipal CEFs increasing +6.34%. Every category tracked by Morningstar delivered a positive total return for the third quarter. (Source: Morningstar. All data is share price total return.)

During the third quarter, equity CEFs benefited from the +5.89% gain in the S&P 500 Index and the +8.17% gain in the MSCI ACWI ex USA Index. Taxable fixed-income CEFs benefited from strong returns in several key fixed income indices including the +5.28% return in the ICE BofA US High Yield Constrained Index, the +2.04% return in the Morningstar® LSTA® Leveraged Loan Index, the +5.73% return in the ICE BofA Fixed Rate Preferred Securities Index and the +5.20% return in the Bloomberg US Aggregate Bond Index. Municipal CEFs benefited from the +2.81% return in the ICE BofA 7-12 Year US Municipal Securities Index. (Source: Bloomberg.)

Average Discounts to Net Asset Value Now Narrower Than the Long-Term Average

As I have written in prior CEF commentary pieces, it has been my contention that as the Federal Reserve (Fed) ends its tightening cycle and begins to lower short-term interest rates that we would see average discounts to net asset value (NAV) begin to narrow. This process now appears firmly underway, and I expect it to continue.

Average discounts to NAV narrowed during the third quarter to -4.44% from the -6.47% level they ended on 6/28/2024. They ended 2023 at -9.69%. Average discounts to NAV are now narrower than the 10-year average discount to NAV of -5.92%. Average discounts to NAV for equity CEFs narrowed during the 3Q24 to -7.14% from the -8.40% level they ended the 2Q24. Average discounts to NAV for equity CEFs are now slightly narrower than the 10-year average discount of -7.32%. Taxable bond CEFs ended the 3Q24 at an average premium to NAV of +0.10%. They ended the 2Q24 at an average discount to NAV of -2.33%. The 10-year average discount to NAV for taxable bond CEFs is -4.67%.

Among the broad categories, only municipal CEFs continue to trade at discounts to NAV which are wider than their long-term average. However, if the Fed continues to lower short-term interest rates, I expect average discounts for municipal CEFs to narrow and trade at discounts which are narrower than the long-term average. Discounts for municipal CEFs ended the 3Q24 at -5.56%, which is narrower than the -8.26% level they ended the 2Q24 but still slightly wider than the 10-year average discount of -5.23%. (Source: CEFData.com)

Outlook for remainder of 2024 and looking ahead to 2025

As the last quarter of the year begins, I believe the backdrop for the CEF structure remains solid. The Fed beginning the process of reducing short-term rates helps to create a solid backdrop for many CEFs as 62% of CEFs employ the use of leverage (Source: ICI). As the Fed reduces short-term interest rates, borrowing cost for levered CEFs trend lower which is expected to lead to improved earnings rates and could potentially lead to distribution increases or lead CEFs to payout less return of capital in their current distributions. In my view, both of these potential outcomes are positive. Another potential positive for the CEF structure for the remainder of 2024 and looking ahead to 2025 relates to the increase in demand and improved sentiment we could see if overall interest rates decline and yields on competing income-oriented investments including CDs, money market funds, U.S. Treasuries etc. decline. If competing and alternative rates are lower during the fourth quarter of 2024 and during 2025, investors may be more likely to consider the CEF structure given the very high and attractive distribution rates that exist in the secondary market for CEFs. As of 9/30/24, the average CEF had a distribution rate of 8.02%, according to Morningstar.

During this time of the year, I get inquiries related to my thoughts on whether 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 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 17.28% YTD and gains have been broad, I am not expecting a particularly bad season of tax-loss selling during this year's fourth quarter.

In summary, I believe the backdrop for many CEFs- particularly leveraged fixed income CEFs including municipal and preferred CEFs- is solid and will likely continue to improve throughout the remainder of 2024 and looking ahead to 2025 and discounts will likely continue to narrow. I advocate for CEF investors to remain disciplined and dollar cost average across many categories including but not limited to diversified equity CEFs, municipal CEFs, preferred CEFs, and high yield CEFs.