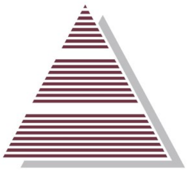


KARPUS
INVESTMENT
MANAGEMENT

INVESTMENT THEMES

January 2022

What do we mean by "themes"?

At Karpus, our top priority is preserving clients' capital to build wealth over time.

We seek to buy closed-end funds (CEFs) for our clients when discounts are wider than their long-term averages, and then sell when the discounts are narrower. While we have a focus on CEFs, we diversify portfolios among CEFs, open-end mutual funds, exchange traded funds, and other securities that we feel assists clients in achieving their financial goals in the most attractive, risk-adjusted manner possible (e.g., special purpose acquisition companies (pre-acquisition) (SPACs) and senior notes issued by 1940 Act investment companies).

There are many steps in our investment process but one of them is to identify overarching themes that we believe are driving other investors' decisions. We look at each of these themes to help guide our investment decisions with bottom-up investment analysis ultimately driving our choices.

With this said, below are some of the key themes we're seeing within the equity and fixed income markets. We hope they help you understand some of the more nuanced concepts that we're currently seeing. A more detailed discussion is in each respective section that follows.

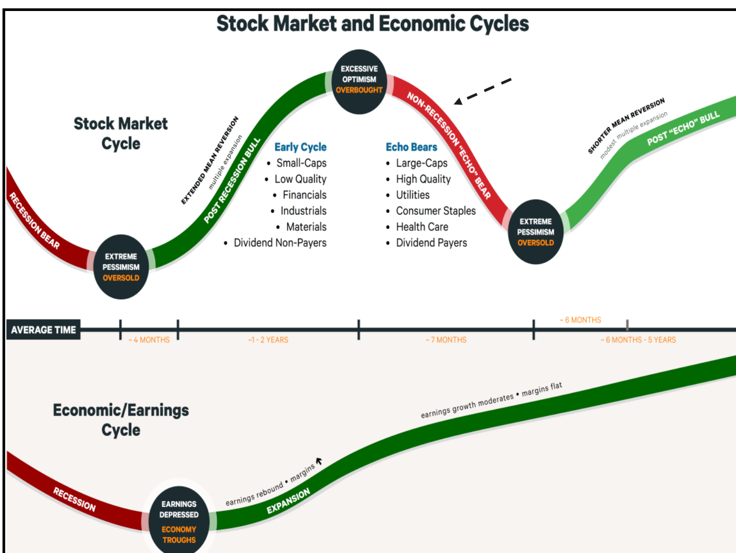
Equities' Themes

Domestic Equities

As we enter the mid-cycle of the expansion (and gross domestic product (GDP) growth, earnings, liquidity, and fiscal support all peak), we believe that GDP and earnings growth will begin to decelerate toward pre-pandemic trend levels.

With this, we think that equity returns will remain positive but will be more moderate over the long-term and will also be accompanied by periods of increased volatility.

As the economic landscape gradually changes from the end of the first leg of the economic recovery, so will our positioning in companies or sectors that we feel will benefit most as we enter mid-cycle economic growth.



Ned Davis Research, 2021 Mid-Year Outlook

1. *A balance between growth & value styles with a focus on the technology sector.*

Emerging from a recession, sectors most negatively impacted have regained leadership roles, particularly the energy, materials, financials, and industrial sectors—which tend to be value-oriented.

As we move forward, we believe earnings surprises from value sectors will begin to diminish, and investment appetite for companies that can offer strong earnings growth will lead markets. In recent months we've noticed a back-and-forth leadership between value and growth styles.

Accordingly, we are currently positioned with a barbell approach through a combination of closed-end funds and exchange-traded funds with both value and growth style characteristics. We anticipate using periods of strength to reduce cyclical value-oriented investments.

We believe secular trends in the technology, consumer discretionary, and consumer communication sectors will likely lead markets during the next phase of the expansion. Due to the chip shortage, the technology sector provides unique opportunities in the semiconductor arena while also gaining exposure to high-quality secular growth companies.

2. *Reducing small-cap exposure from maximum allocation.*

Following positive vaccine developments last November, optimism about a return to normalcy and the reopening of the economy ignited the performance of beaten down small-cap stocks. As the economy enters the mid-cycle of expansion and growth starts to decelerate, we believe reducing exposure to economic sensitive areas of the market in small-caps toward investments in large-caps will prove beneficial. Large-cap stocks tend to be less volatile, have easier access to capital and generally have more stable and predictable free cash flows.

3. Factor investing in quality.

Corporations have used the current low interest rate environment to increase debt levels. In fact, according to data from the Federal Reserve Bank of St. Louis, over the past five years ending 7/1/2021 corporate debt has risen by 33.8%. Additionally, there was a general lack of volatility in 2021 (with the most significant drawdown being just 5.2%). We believe the next leg of the bull market will bring the rise of volatility and more frequent and healthy pullbacks. With this in mind, companies that exhibit a quality factor have gained popularity in a debt-ridden economy due to their strong balance sheets with low debt-to-equity ratios, high return on equity, and stable earnings growth. Quality has a defensive factor that can reduce risk during periods of volatility while offering reasonable earnings growth in a decelerating economy.

4. The CEF discount cycle.

Our primary focus is to buy quality CEFs with strong performance and investments teams when discounts are wide and uncertainty is elevated. Alternatively, part of our investment process is to reduce CEF exposure when discounts begin to narrow. It is a balancing act of experience, knowledge, and instinct to navigate through these discount cycles. We've found CEF discount opportunities to be most prevalent when there are periods of heightened volatility and uncertainty. With that said, since CEF discounts have narrowed for this cycle and so far this year, we have been actively reducing our CEF exposure in preparation for the next buying opportunity.

International Equities

With international equities, it's important to remember that the U.S. accounts for only 4% of the world's population and 25% of economic output, yet it constitutes 59% of the MSCI All-Country World Index. With a substantial portion of companies being domiciled outside of the U.S., we believe it is critically important to have a portion of one's portfolio invested abroad.

More than the benefits of diversification, it is important to remember that the U.S. was once an emerging market and any nation can climb its way to the top. Based on these factors (and more) there are substantial benefits to global equity exposure. Internationally, three key themes we're following include:

1. Developed and emerging market policy divergence and outcomes.

Through the pandemic there has been a notable divergence of monetary, fiscal, and public health policy among various nations. Quantitative easing, pandemic relief, and lockdown procedures returned mixed consequences, especially impacting less capable nations.

Governments who could provide support to businesses, markets, and struggling citizens were able to stabilize and even thrive. High-vaccination quality countries are poised to pull ahead and as it looks now, low-efficacy administrators can have years of catching up to do.

In-house indicators put developed markets as more attractive from both a valuation and trend breadth standpoint. These vitals will be monitored as global central banks consider a change of direction in policy. For this reason, our portfolios have been tilted towards developed markets. However, if pessimism reaches an extreme, returning allocations toward high-potential nations can be warranted.

2. China and how it fits in the global economy.

China is a powerful and complicated force in the global economy. We believe capitalism will be allowed to coexist, though more at the control of the Chinese Communist Party (the Party) than before as Premier Xi Jinping is interested in stability and shared prosperity above all else. In terms of regulatory crackdowns, we believe this is only the beginning as equality is necessary to the Party's stability. Beyond technology firms, the private education realm was targeted as the high cost of raising children has been a point of friction against worsening demographic trends. How the Party deals with their next target, deleveraging the real estate sector, will give much more insight into overall growth as property development is a driver of China's GDP.

We are of the view that China's rise was meteoric, though the country's identity is still forming. Over the long-term we believe there is great promise as their population is the world's largest and their resolve is seemingly relentless. Over the short-term we believe it will be a wild ride littered with ambiguity. For these reasons we are cautious while looking for opportunities surrounding oversold sectors.

3. The CEF discount cycle.

International CEF discounts are at levels not seen in nearly a decade. As a result, we have significantly trimmed portfolios' CEF investments and await discount widening and opportunities presented by that widening.

Fixed Income Themes

Within the taxable and tax-sensitive fixed income markets, we are currently following somewhat similar themes, as concerns about inflation, interest rates, and continued stimulus continue to push investors to seek yield wherever they can find it.

1. Credit quality has improved and continues to improve for municipal bonds.

Credit quality in municipal bonds has improved since the pandemic began, and we believe this trend should persist. The economic recovery has benefitted most state and local governments, as tax revenue to support coverage of municipal bonds has increased since the start of the pandemic, and has reached new record highs. Further, the Federal government has pledged its support to muni issuers as a safety net through the American Rescue Plan.

Improving credit conditions have helped to lift the price of municipal bonds relative to taxable Treasury bonds. The 10-year AAA Muni/Treasury ratio has decreased from its average of 121% in 2020 to a level of 69% on 12/31/2021. In other words, muni bonds have performed well and have become more expensive relative to other comparable high-quality bonds.

We have reduced our holdings of municipal bonds in our taxable fixed income accounts (e.g., IRAs), as the muni treasury yield ratio has become less favorable. We have also reduced our municipal bond holdings in our tax-sensitive fixed income accounts by way of selling some of our municipal bond CEFs.

2. Interest rates have risen significantly since the beginning of 2021.

The rate on a 10-year U.S. Treasury note has risen from 0.91% on 12/31/2020 to 1.51% on 12/31/2021. We believe this is a dramatic move in a short period of time.

Our client portfolios had been positioned defensively prior to this rise in rates and we have maintained a lower duration relative to our stated benchmarks. More specifically, fixed income portions of portfolios have been substantially invested in special purpose acquisition companies (pre-acquisition) (SPACs) and shorter duration investments that we believe will hold up well in a rising rate environment.

As fixed income investors, we welcome higher bond yields, as this indicates higher levels of income going forward. With our duration well below our stated benchmarks throughout 2021, we have positioned portfolios from loss of principal.

Now that rates have made what we believe is a substantial rise, in tax-sensitive fixed income portions of applicable portfolios we will strategically add a small exposure to longer duration investments as we see fit. In taxable portfolios, we also have exposure to some longer duration investments, but currently also maintain a below benchmark duration.

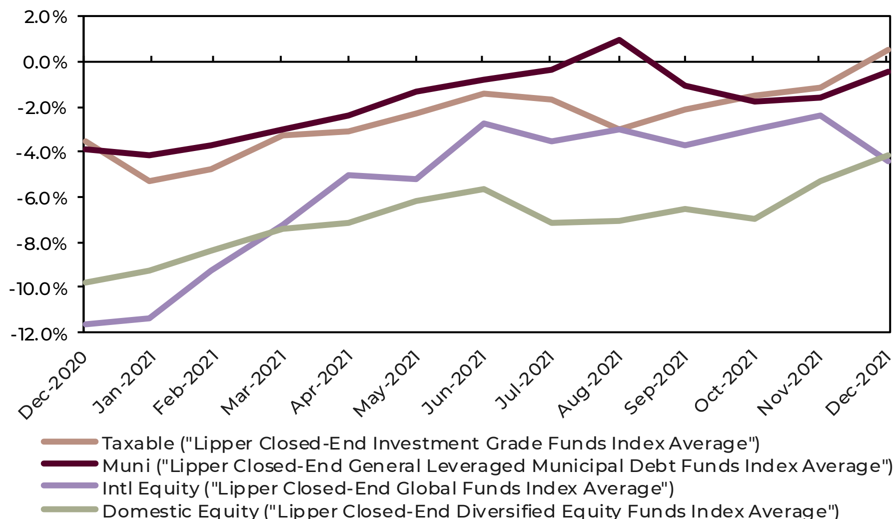
Our research indicates that rates tend to rise quickly, then plateau — and perhaps even drift lower after their initial move. We continue to remain below benchmark duration, but felt it was prudent to add to our fixed income portfolios' duration after this recent rise.

3. The CEF discount cycle.

Discounts on municipal and taxable bond CEFs are both narrow relative to their long-term averages. We closely monitor the discounts on these funds, and our experience leads us to believe that now is the time to continue to reduce our portfolios' exposure to these investments.

Strong retail demand for taxable and tax-free income has pushed prices higher on both muni and taxable CEFs relative to their net-asset values.

Our research tells us that the discounts on CEFs are cyclical, and that they do not remain excessively wide or narrow in perpetuity. We remain patient and cautious for this to occur. In the meantime, we have largely replaced these holdings with SPACs.



The Taxable Fixed Income average discount is from the Lipper Closed-End Investment Grade Funds Index Average, the Tax-Sensitive Fixed Income average discount is from the Lipper Closed-End General Leveraged Municipal Debt Funds Index Average, the Domestic Equities average discount is from the Lipper Closed-End Diversified Equity Funds Index Average, and the Int'l Equities average discount is from the Lipper Closed-End Global Funds Index Average, as categorized by "All Refinitiv Lipper Index Components" as of 12/31/2021. The data represents the simple average of the discounts of the funds within each index and is as of month end for all funds in an index for either all or part of the defined period.

Sources: Bloomberg Finance, L.P., Federal Reserve Bank of St. Louis (FRED data), National Association of State Budget Officers, U.S. Census Bureau, The World Bank

Index definition: The MSCI All-Country World Index captures large and mid cap representation across 23 Developed Markets and 25 Emerging Markets countries. With 2,966 constituents, the index covers approximately 85% of the global investable equity opportunity set as of 12/31/2021. Data provided by Bloomberg Finance, L.P.

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