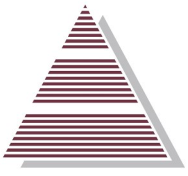


KARPUS
INVESTMENT
MANAGEMENT

INVESTMENT THEMES

January 2023

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).

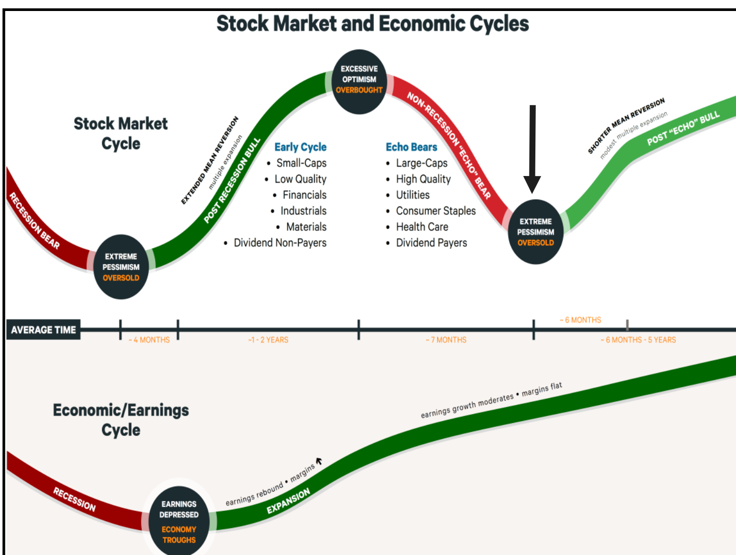
There are many steps in our investment process but one of them is to identify overarching themes that we believe are driving other investors' decisions. We look at each of these themes to help guide our investment decisions with bottom-up investment analysis ultimately driving our choices.

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

The fight against inflation continues to be a major topic, with the Federal Reserve (Fed) implementing multiple rates increase in 2022, putting the Fed Funds target rate at its highest level since 2007. On top of this, there have been significant decreases to the Fed's balance sheet. Traditional fixed-income returns have been historically negative as the yield on the 10 and 30-year U.S. Treasury bonds increased over 2% in 2022. This change in yield has hurt fixed-income returns and caused equity valuations to contract from highly overvalued to more reasonable levels.



Ned Davis Research

1. We believe inflation has peaked and is moderating.

Fueled by years of loose financial conditions, labor shortages, and rising commodity prices, a tailwind of ripple effects drove producer and consumer prices to levels not felt in years. In June, inflation (measured by the consumer price index) achieved a multi-decade high of 9.1%. However, inflation to us appears to have peaked in June 2022 as restrictive monetary conditions are beginning to impact the financial system and the economy. We believe that the bulk of interest rate increases are behind us and soon the Fed will be able to slow or even pause its rate hike campaign.

Because of this belief, we think that disinflation pressures will be a themed topic over the next year. Commodity prices which thrived from strong global growth and concerns related to the Russia/Ukraine conflict have shown signs of receding. The Bloomberg Commodity Index reached an over 8-year high in June and has declined over 17% since peaking in June 2022. Oil is 6.7% above where it started 2022, minimizing much of the gains attained in the year's first half. Housing-related inflation has remained firm but has shifted lower as of late. Restrictive monetary policy and higher mortgage rates are starting to impact housing prices as housing data has declined since July. We believe that the future effect of housing-related inflation should be muted.

Wage growth remains a sticky segment of inflation. Job openings are about 1.75 times the average of the 10 years prior to the pandemic and job creation has surprised to the upside. As such, we see that low-skilled workers have benefited from the pandemic-related labor shortage but will be the segment most vulnerable to rising

unemployment as restrictive financial conditions filter through the economy. Therefore, we think that wage inflation will eventually succumb to slowing demand.

2. Opportunities in small-capitalization stocks.

Small-capitalization stocks have underperformed their large-capitalization counterparts for the past decade ending 12/30/2022. Mega-capitalization stocks (more specifically mega-capitalization technology stocks) have recently dominated the marketplace and seen valuations heighten. However, we believe several factors can pave the path for small-capitalization stocks to outperform.

Inflation, volatility, higher borrowing costs, and economic uncertainty have caused small-capitalization stocks (measured by the Russell 2000 Index) to underperform, driving stock prices lower. With recent market performance, valuations are at attractive levels, trading at a steep discount to large-capitalization stocks from a forward price-to-earnings perspective. Furthermore, small-capitalization companies tend to lead economic recoveries as they can be agile in inventory and supply chain adjustments.

With evidence of peak inflation, small capitalization stocks tend to outperform when inflation is falling. In general, smaller firms tend to fare better when the Fed pivot is drawing nearer. This applies to both growth and value styles. Additionally, seasonality has been in small-capitalization stocks' favor. In fact, Ned Davis Research has shown that the three months from December 2021 to February 2022 have demonstrated relative strength for small-capitalization stocks, noting two explanations for their findings: (1) December to February is the best time of the year for the broad market, with higher beta small-caps outperforming; and (2) tax-loss selling pressure in less liquid, small-capitalization securities are sold and repurchased 30 days later, creating what is known as the "January Effect. "

3. Finding security in dividend growers.

Dividend growers are companies with a long track record of paying and increasing dividends over time. Over the past 20 years ending 12/30/2022, dividend growers (measured by the S&P 500 Dividend Aristocrats Index) have offered above -market returns while exhibiting quality and defensive characteristics. With 2022's challenging market environment, dividend growers have again delivered attractive risk-adjusted returns due to their strong balance sheets, high dividend coverage ratios, and reliable cash flow potential. Due to these attributes, dividend growers have historically offered compelling performance during up markets while providing support during market drawdowns and in volatile environments.

4. The CEF discount cycle.

Our primary focus is and always will be to buy quality CEFs with managers who have illustrated strong net asset value performance and investment teams when discounts are wide and uncertainty is elevated. The 2nd half of 2022 brought bouts of uncertainty and volatility, creating opportunities within the CEF space. Fortunately, we entered this part of the cycle well-positioned with minimal exposure to CEFs. Out-of-favor stock prices and tax-loss selling pressure have produced what we believe are attractive discount opportunities across the CEF space. Recently, we have become net buyers of a collection of CEFs at attractive discount levels compared to their long-term averages while offering what we believe are generous distribution payouts. We have stayed patient and disciplined in our strategy and discount targets, and we believe now is a favorable time to deploy investment capital as opportunities present themselves in domestic equity CEFs.

International Equities

1. A new view of China? How will Xi Jinping operate the economy, now in his historic 3rd term as Premier?

Initial reaction to Xi winning a 3rd term and stocking positions of power with allies was seen as troubling. A meeting with President Biden tempered fears as minor travel-related COVID policies seemed to ease. Then came China's first deaths since May. This caused a series of risk-off and risk -on moves as China's dynamic zero-COVID policy grew more and more into question amid strong protests.

The key question is: how can this impact portfolios? Over the short-term, we believe we will continue to see volatility in Chinese equity markets largely attributable to unclear communication, policy ambiguity, and colored data. On the bright side, the response to the protests was to open the country more quickly. We view his shift to have caused many to view the Chinese Communist Party's (CCP) aim as neo-authoritarian, as opposed to old-school authoritarian. In a December 5, 2022 article by Alpine Macro, they stated "Neo-authoritarianism is a form of benevolent dictatorship that not only stresses the monopolistic power of the CCP but also emphasizes the government's role in delivering social and economic goods in response to public demands."

2. Not all inflation is created equal.

While prices in the U.S. were propped up by war-related supply side issues, they were also amplified by copious fiscal policies. In contrast, Europe's inflation threats are what we deem as more visceral, closer to home, and simply more complicated. In the U.S, energy can be self-produced, while Germany chided less efficient European Union countries for years as they quietly reaped advantages of cheap Russian Oil. Despite efforts to diversify, this particular problem is bandaged but not healed as price levels have printed over 10% year-over-year increases two months in a row as of November 30, 2022.

Further illustrating divergences in global inflation, the U.S., Europe, and many other economies have had differing policy responses. For instance, the Fed is extremely focused on reducing inflation, the European Central Bank (ECB) is reluctantly raising rates, Japan is holding steady at zero, and China is easing.

How does this all impact investors' portfolios? Rising prices in Europe have pushed the ECB to raise rates in the face of long-term energy uncertainty. For these reasons we have implemented positions in global energy, low-volatility, and

have an underweight to European stocks heading into the cold season.

3. The CEF discount cycle.

International equity CEFs discounts are at wide levels. Due to this, international portfolios increased exposure from 10% at the end of 2021 to 45% at the end of 2022. Notably, our percentage holding at the end of 2021 was historically low for our strategy, which means the most aggressive discount widening risk thus far in the cycle has been avoided. We expect further volatility, and therefore opportunity, as the current cycle unfolds.

Fixed Income Themes

Within the taxable and tax-sensitive fixed income markets we are following similar themes as concerns about inflation and interest rates continue to take center stage.

1. Interest rates rose sharply in 2022 and we believe they peaked in Q4 for this tightening cycle.

2022 was one of the most challenging years in the bond market. In fact, municipal bonds (as measured by the Bloomberg Municipal Bond Index) experienced their biggest annual price decline since 1981 and taxable bonds (as measured by the Bloomberg Government/Credit U.S. Bond Index) experienced their biggest annual price decline since 1994.

Our client portfolios were positioned defensively prior to this sharp rise in rates that we experienced in 2022, with holdings substantially positioned in SPACs and other short duration investments.

Our research indicates that rates tend to rise quickly, then plateau (and perhaps drift lower) as the market digests new levels of interest rates. We have been extending our duration by gradually adding longer maturity investments to our clients' fixed income portfolios, where applicable.

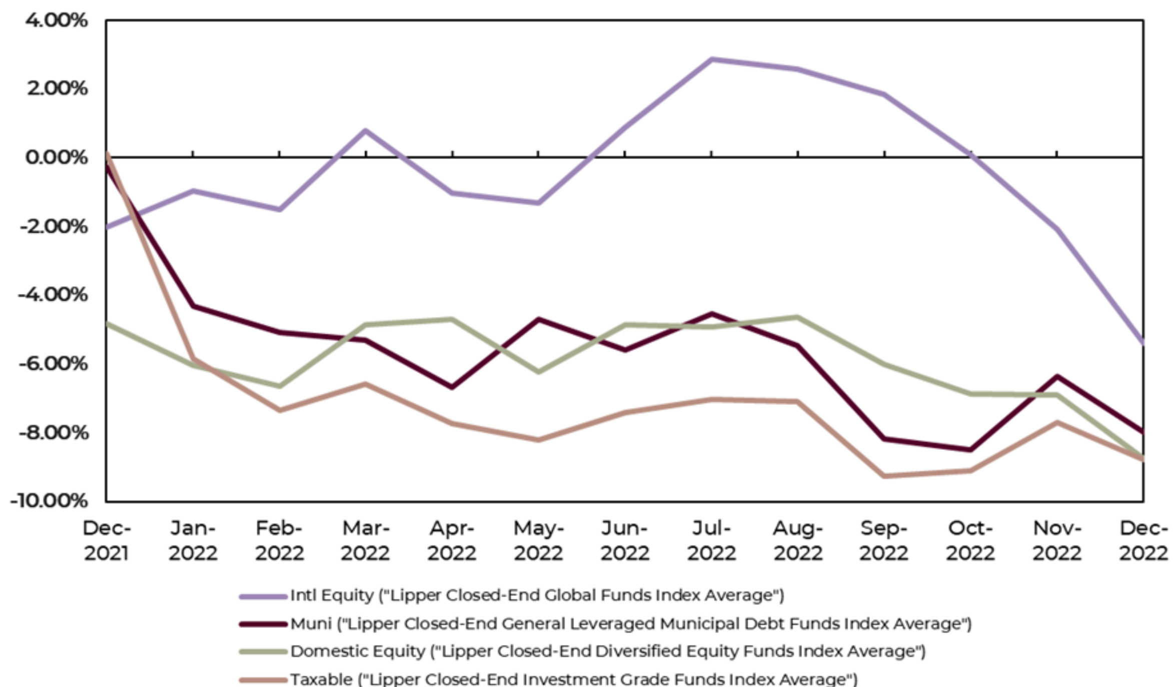
2. Tax-loss harvesting has placed additional ongoing selling pressure in the CEF bond market.

Investors continue to realize these valuable losses to offset current or future gains elsewhere in their portfolios. Although past performance is not a guarantee of future returns, similar to 2018 we saw this selling pressure into the end of 2022 (particularly with municipal bonds and municipal bond funds) and then anticipate the pressure will subside in the beginning of 2023.

3. We continue to maintain high-quality fixed income portfolios with an emphasis on preservation of capital.

We continue to maintain a substantial allocation to SPACs in clients' portfolios (where applicable) as we currently believe they provide extraordinary risk-adjusted returns compared to any other investment we know. 2022 has been a very difficult year for fixed-income investors to find safety anywhere in the marketplace. Our approach to SPACs (pre-acquisition only) has functioned as a ballast to preserve capital. More recently, we've begun to reduce our allocation to SPACs as higher yields have presented new compelling opportunities in other fixed-income investments (i.e., CEFs).

Average Closed-End Fund Discounts
(12/2021 - 12/2022)



The Int'l Equities average discount is from the Lipper Closed-End Global Funds Index Average, the Tax-Sensitive Fixed Income (Muni) 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 Taxable Fixed Income average discount is from the Lipper Closed-End Investment Grade Funds Index Average each 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.

4. The CEF discount cycle.

We have been intimately following CEFs and their discounts to net asset values for decades as our core strategy. Our strategy is to buy CEFs when they are most deeply discounted and to patiently wait for what we believe are attractively valued investments.

We believe that a compelling opportunity is presenting itself now. Discounts on municipal CEFs have widened significantly since the beginning of 2022, along with declining net asset values. We have been aggressively adding these investments to our fixed income portfolios. In our analysis, municipal bond CEF discounts are wider than their long-term averages and we believe much of the go-forward risk has been stripped out of them by way of lower net asset values and wider discounts. We believe tax-loss selling is a primary driver causing these CEFs to trade at wide discounts. For this reason, we have purchased many of these CEFs in anticipation of discounts narrowing early in 2023. To learn more about this opportunity, please take a look at an article we wrote, entitled "A Compelling Opportunity in Municipal Bond Closed-End Funds."

For other Karpus insights, please see our website.

Sources: Alpine Macro, Bloomberg Finance, L.P., CNBC, Council on Foreign Relations, Indexologyblog.com, International Energy Agency – IEA Atlas of Energy, Janus Henderson, Lowy Institute, Ned Davis Research, Reuters, The Wall Street Journal.

Index Definitions: The Bloomberg Commodity Index is calculated on an excess return basis and reflects commodity futures price movements. The index rebalances annually weighted 2/3 by trading volume and 1/3 by world production and weight-caps are applied at the commodity, sector and group level for diversification. Roll period typically occurs from the 6th-10th business day based on the roll schedule. The Bloomberg Municipal Bond Index covers the U.S. dollar denominated long-term tax-exempt bond market. As of 12/31/2021, the index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and prerefunded bonds. The Bloomberg U.S. Government/Credit Bond Index (BGC) is a broad-based flagship benchmark that measures the non-securitized component of the U.S. Aggregate Index. It includes investment grade, U.S. dollar-denominated, fixed-rate Treasuries, government-related and corporate securities as of 12/31/2021. The BGC is unmanaged, includes the reinvestment of income and cannot by purchased directly by investors. The S&P 500 Dividend Aristocrats Index is designed to measure the performance of S&P 500 index constituents that have followed a policy of consistently increasing dividends every year for at least 25 consecutive years. The S&P 500 Index is widely regarded as the best single gauge of large-cap U.S. equities and serves as the foundation for a wide range of investment products. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalizations as of 12/31/2021. The Russell 2000 Index is comprised of the smallest 2000 companies in the Russell 3000 Index, representing approximately 8% of the Russell 3000 total market capitalization.

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