Don't Overlook the Benefits of Closed-End Funds

Closed-end funds (CEFs) tend to be a misunderstood investment. Unfortunately, when something is misunderstood, it can often be pushed to the side with something else taking its place. For long-term investors though, we believe CEFs are investments worth taking the time to understand.

We've found that CEFs can provide a wide array of benefits to investors' portfolios and they can help provide unique insights into retail investors' perceptions of the market. For the purposes of simplicity, in this article we will briefly explore four critical elements that warrant a further look at CEFs: diversification, their ability to stay invested, their strategic use of leverage, and discounts.

First, in terms of diversification, CEFs offer investors a variety of securities within a single portfolio, which is oftentimes extremely difficult to accomplish on an individual level. This is true for both equity and fixed income CEFs.

For example, from the equity side, investors may find it difficult to adequately diversify across managers, sectors, market capitalizations, or geographical regions. Additionally, investors may not be able to use options or use other hedging strategies in a cost-effective manner to further diversify their portfolio. This is something that equity CEF investors can accomplish relatively easily.

Alternatively, from the fixed income side, unless a portfolio is of a larger size, it is quite difficult to purchase a variety of individual bonds that spreads risks across various issuers, sectors, maturities, or portions of the yield curve. With fixed income investments, it is also much more cost effective to get this diversification through a relatively liquid investment vehicle, such as a CEF.

While it is true that investors can sufficiently diversify their portfolios using open-ended mutual funds, this leads to our second key advantage: managers of CEFs don't have to liquidate portfolio securities in the event many investors seek to sell at an inopportune time.

Next, the strategic use of leverage is also advantageous to CEF investors. Through leverage, portfolio managers are able to borrow (through loans, issuance of various preferred securities, etc.) and purchase more securities in line with their stated objectives. While leverage can enhance gains, it can also magnify losses. The operative term to stress though, is the *strategic* use of leverage – where managers can choose the most appropriate form of leverage they see available.

The last critical advantage of CEFs is the ability to often buy them for less than the full value of their underlying assets – which is referred to as a discount. We believe that the ability to buy an undervalued investment at a discount and then sell that investment when the discount has narrowed, coupled with the income received while the discount narrows, provides an attractive total return profile for investors' portfolios.

We've found that CEFs discounts are also a key analytical tool because they provide insight into retail investors' perceptions. Because CEFs tend to be heavily utilized by retail investors and retail investors that invest across all asset classes represent a diverse cross section of the investing public, we've found that

	Open-End Mutual Funds	ETFs	Closed-End Funds
Pooled Investment Vehicle?	Yes	Yes	Yes
SEC Registered	Yes	Yes	Yes
Liquidity	Redeemable at end of day; shares continuously offered	Intraday; traded on exchange	Intraday; traded on exchange; fixed number of shares outstanding
Price	Purchased and redeemed at NAV of fund	Based on supply/demand but usually trades very close to NAV	Bought or sold on exchange, often at a discount or premium to NAV
Impact of fund flows	Can severely impact ability to stay fully invested	Minimal	None
Leverage	Allowed (typically not employed)	Sometimes	Prevalent
Continuously offered	Yes	Yes	No

Rochester, NY
183 Sully's Trail
Pittsford, New York 14534
Phone: 585 586 4680
Fax: 585 586 4315

www.karpus.com

Naples, FL
1415 Panther Lane
Naples, Florida 34109
Phone: 239 591 6615

their tendencies are indicative of the market as a whole. What their tendencies then translate into are buy and sell signals through the discounts and premiums of CEFs.

By forcing investors to be contrarians, investing in CEFs at attractive discounts and utilizing indexing when discounts aren't very attractive helps investors avoid the herd mentality that can plague investors who solely index their portfolios and hope they are right.

On top of this, if the Board of a CEF isn't managing the fund's discount or a manager isn't performing sufficiently, investors in CEFs have the ability to annually vote on directors and propose actions to reduce the discount or improve a fund's corporate governance procedures.

Simply put, we've found value for clients' portfolios by actively investing in CEFs at wide discounts, while holding certain passive investments for tactical exposure when values aren't quite as attractive as we believe they can be.

For other Karpus insights, please see our website.

COM-034-R1 (11.2023)

KARPUS
INVESTMENT
MANAGEMENT

Contacts

Information/Queries

Rochester, NY
183 Sully's Trail
Pittsford, New York 14534
Phone: 585 586 4680
Fax: 585 586 4315

Naples, FL
1415 Panther Lane
Naples, Florida 34109
Phone: 239 591 6615

Website

www.karpus.com

Important Notice