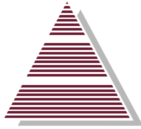

KARPUS
INVESTMENT
MANAGEMENT

INVESTMENT THEMES

October 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 assist 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

1. We believe that the U.S. economy is nearing the end of its current cycle.

To understand what this means, let's start at the beginning. At the start of an economic cycle, businesses invest in themselves. This creates jobs and boosts the economy. With more jobs, people have more discretionary income, which they spend on goods and services, further fueling economic growth. To promote economic growth and expansion, interest rates are typically low in the early phases of an economic cycle.

MRB Partners Inc., Analysis: Karpus Investment Management.

Interest rates have risen rapidly since their first increase in March 2022, from 0.25% to 5.5%. The Federal Reserve (Fed) is raising interest rates in an effort to combat inflation, which reached a 40-year high in June 2022 in the U.S. By raising interest rates, the Fed makes it more expensive for businesses and consumers to borrow money. This can lead to a slowdown in economic activity, which can help to bring inflation under control.

To counterbalance the slowing economy, the government has increased fiscal spending. This includes spending on infrastructure, semiconductors, and other programs that are designed to create jobs and boost economic growth. The Inflation Reduction, Infrastructure, and Chips Acts are all examples of fiscal stimuli. These programs are expected to inject billions of dollars into the economy over the next several years.

The late stage of the economic cycle is often characterized by economic shocks or declines. These events can be difficult to predict, but some recent examples include the COVID-19 pandemic, the Great Financial Crisis, and the dot-com bubble. During this stage, the economy is more vulnerable because companies and consumers have less financial flexibility to weather downturns.

2. We think that quality investing is a prudent strategy in the current market environment.

Quality investing means focusing on companies with strong financial fundamentals, such as high profitability. One key measure of profitability is return on equity (ROE). ROE is calculated by dividing net income by shareholders' equity. Companies with high ROE are more likely to be profitable in the long-term. They are also better positioned to weather economic downturns.

We also look for companies with stable year-over-year earnings and low financial leverage. This means that we want companies with a long track record of profitability and earnings growth, and that don't have to borrow a lot of money to grow. We prefer companies that are profitable and reinvest their earnings back into the business.

Lastly, we think that focusing on companies with strong cash flows is also prudent in today's environment. Cash flow is the money a company has left after paying all of its expenses, including interest, taxes, and investments. It is a measure of a company's financial health and its ability to generate cash. Companies with strong cash flows have more options. They can pay dividends to shareholders, repurchase their own shares, or invest in new growth opportunities. They are also less likely to need to borrow money, which is especially important when interest rates are high. Cash flow is also a better measure of profitability than earnings because earnings are subject to accounting assumptions. Cash flow is a more direct measure of how much money a company is actually generating.

3. The domestic equity CEF discount cycle.

Closed-end funds (CEFs) are our primary focus. We look for CEFs with a proven track record and strong net asset value (NAV) performance over a long period of time. However,

just last year in August 2022, average domestic equity CEF discounts (as measured by funds within "Lipper Closed-End Diversified Equity Funds") narrowed to their 15-year low. As discounts narrowed, we became net sellers of CEFs. As of 9/29/2023, the average domestic equity CEF discounts are widening and we are cautiously adding to our CEF positions. We have ample capital ready to deploy as domestic equity CEF discounts continue to widen. We are excited about the buying opportunities that lie ahead.

International Equities

1. *A New view of China?: How will Xi Jinping operate the economy in his historic 3rd term as Premier?*

This time last year we wrote: "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." Year-to-date through September 29, 2023, the MSCI EAFE Index produced 7.50% in total return while the iShares MSCI China ETF lost -7.99%.

On October 1, 2023, the International Monetary Fund cut 2024 growth targets amid balance sheet deterioration of systemically important property developers, among other issues. Further, much like the Chinese government's response to COVID-19, the recent fiscal and monetary efforts have been perceived as slow and underwhelming from the point of view of Western investors. The fear of uncontrollable overstimulation has kept authorities from acting quickly. It is difficult to say if this will change. Discounts in China-focused CEFs reflect the uncertainty with readings much wider than the average of international equity CEFs.

2. *Not all Inflation is created equal.*

In 2022, international equity prices were propped up by fiscal stimulus, a promising Chinese reopening, and supply-side issues stemming from the Russian invasion of Ukraine. Now, in 2023, an Iranian-backed Hamas attack threatens to push oil back above $100 and broad inflation metrics with it. Energy can be self-produced at home though the U.S. Strategic Petroleum Reserve has been dwindling and in need of replenishment, which can push oil prices further upward. In contrast, Europe's inflation threats are what we deem as more visceral, closer to home, and simply more complicated. With rates not far below those in the U.S., this winter could prove fragile for Europe where valuations reflect these risks.

Unlike the U.S. and Europe, Japan is fighting to keep short-term rates near zero. While Japanese price increases have not reached levels in the U.S. or Europe, they have risen and began turning down, albeit at a delayed pace. The difference in policy rates has negatively impacted the Yen. As Japan starts to let longer rates float more freely, a strengthening Yen could help boost the already positive year-to-date performance of Japanese equities. Despite the strong performance, we have been able to purchase Japanese CEFs at wide discounts. Further, due to all of the uncertainty surrounding rates and prices, we have maintained a position in a low-volatility fund, and have an underweight to European stocks heading into the cold season.

3. *The international equity CEF discount cycle.*

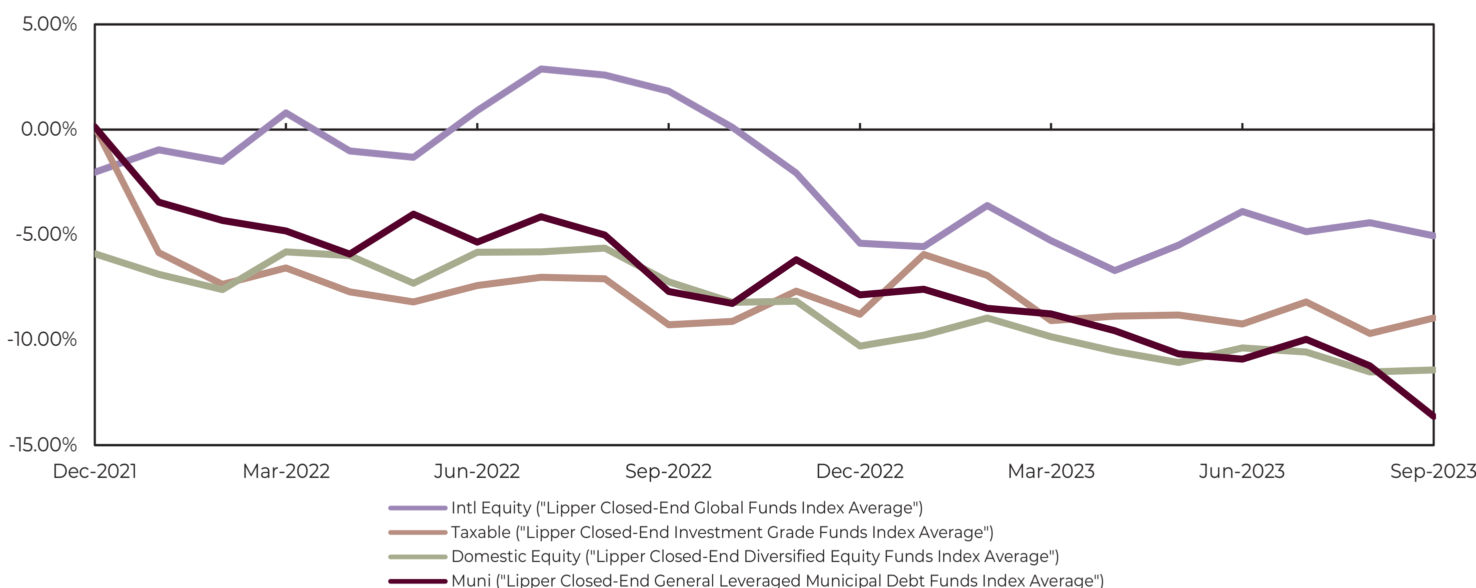
Based on our analysis, international equity CEF discounts are at rarely seen levels. Due to this, the international equity portion of applicable portfolios increased CEF exposure from 10% at the end of 2021 to nearly 60% at the end of September 2023. Notably, our percentage holding at the end of 2021 was historically low for our strategy, but by increasing our CEF exposure we were able to avoid discount widening risk in applicable portfolios in the first wave. We expect further volatility, and therefore opportunity, as this lengthy cycle continues to unfold.

Fixed Income Themes

1. *Interest rates have continued to rise in 2023 making for a challenging environment for bond investors.*

The rise in bond yields since the end of 2021 has been painful for bond investors. From 12/31/2021, through 9/29/2023 the yield on a 10-year Treasury Bond has risen from 1.51% to 4.57%, respectively. In other words, the yield has more than tripled during this time period, making for a very unique and

Average Closed-End Fund Discounts
(12/31/2021 – 9/29/2023)



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 12/31/2022. 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.

challenging time. As mentioned above, the Fed has aggressively increased the Fed Funds Target Rate from .25% to its current 5.5% during this time. As a result, all fixed rate bonds have faced challenges as the bond market re-prices bonds at these new higher rates.

Given these conditions, we have been extending our clients' portfolios' durations by gradually adding longer maturity investments where applicable. We believe that interest rates have reached or nearly reached a peak in this cycle, and our portfolio durations are now longer than our applicable benchmarks (where prior to this run-up in interest rates we maintained portfolio durations lower than that of our benchmarks). We anticipate that our client portfolios will benefit from flat or perhaps declining interest rates in the future.

2. We continue to maintain high quality and liquid fixed income portfolios.

As bond investors know, there are two primary risks in fixed income portfolios - credit risk and interest rate (duration) risk. We continue to favor high quality investments that we believe can provide safety and attractive risk-adjusted returns over time. While the rise in interest rates has been dramatic and has caused a decline in portfolio values, we do not foresee any credit related risks with our holdings. Additionally, we continue to maintain a substantial allocation to SPACs (pre-acquisition only), which we believe have no foreseeable credit risk and can be sold as needed.

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

Investors continue to realize valuable losses to offset current or future gains elsewhere in their portfolios. The 3rd quarter of 2023 was particularly challenging for municipal bond CEFs, as we believe significant tax-loss harvesting was a driver that caused widening discounts on many of these funds. We expect this selling pressure to diminish in Q4 2023 as many losses may have already been realized.

4. The fixed income CEF discount cycle.

We have been intimately following CEFs and their discounts to net asset values (NAVs) for decades as our core strategy. Our strategy is to patiently wait and buy CEFs when they are most deeply discounted.

Discounts on municipal CEFs have widened from -7.85% on 12/31/2022 to -13.63% on 9/30/2023 (as measured by the funds within "Lipper Closed-End General Leveraged Municipal Debt Funds"). Net asset values have also declined so far this year due to increased yields and the inverse relationship between a bond's price and its yield.

In fact, the discount for municipal bond CEFs as of the end of September is the largest disconnect between prices and NAVs in the last 15 years with the average discount now 10.2% wider than the average for the period. While we can never be certain of the direction of interest rates, our bottom-up approach to portfolio construction has led us to allocate more to municipal bond CEFs than we ever have before.

Alternatively, at this time, we don't find taxable fixed income discounts nearly as attractive as their municipal counterparts. Although we've been able to add positions in a handful of small taxable fixed income CEFs, most taxable CEFs are in what we deem a hold or even pushing sale territory. For value reasons, we also continue to add municipal bond CEF holdings within our taxable fixed income portfolios.

For other Karpus insights, please see our website.

Sources: Alpine Macro, Bloomberg Finance, L.P., iShares, Lipper, Lowy Institute, MRB Partners, Reuters, The Federal Reserve Bank of St. Louis, The U.S. Department of Energy, The White House, Yahoo Finance.

Index Definition: The MSCI EAFE Index is an equity index which captures large and mid-cap representation across 21 Developed Markets countries* around the world, excluding the US and Canada. Developed market countries include Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland and the UK. With 795 constituents, the index covers approximately 85% of the free float adjusted market capitalization in each country as of 9/29/2023. Data provided by Bloomberg Finance, L.P.

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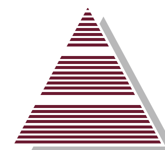

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