2020: It Ain’t Over ‘till it’s Over

As most of our readers are aware, the Matisse Discounted Closed-End Fund Strategy is an income and growth strategy that focuses on purchasing Closed-End Funds at historically deep discounts to their NAVs and then selling these funds when their discounts narrow. Now past the halfway point of 2020, we remain very optimistic about the future results of our strategy, given both the depressed valuations we’re seeing (based on discounts) and our current indicated annualized cash distribution yield of 6.1% (as of 6/30/2020) in today’s “0” interest rate environment. In our professional opinion, we could not be positioned any better looking forward.

Reviewing what went wrong in the 1st Quarter of 2020

Right now, both our short-term and long-term performance track record is negatively skewed from the sharp and sudden decline we experienced in March. During the March volatility, our strategy declined more than our comparable benchmarks due to an overweighting to energy and MLP Closed-End Funds (and this all during a time when oil futures went negative). Fortunately, with significant cash flows into MDCEX during March (and near the market bottom), we had the ability to do several positive things for our fund:

1. We upgraded the “quality” of energy names in the portfolio – to what we believe would be the best survivors in a worst-case scenario.
2. We limited our future energy exposure to 10% – so we don’t experience a “sector” concentration problem again.
3. We did not panic out of energy at the market low – we continued to buy high quality, highly discounted names and have profited since then.

Fed Policy – Extremely Important with Closed-End Funds

The Fed has indicated that interest rates will likely be low for a long time (just as we’ve been on record talking about – see last year’s article in the Portland Business Journal). As Fed Chairman Jerome Powell stated, “we’re not even thinking about thinking about raising rates”. This is very important and potentially beneficial to Closed-End Funds in general. With today’s interest rates at about 0.5% on the 10-year US treasury bond, investors will likely slowly drive Closed-End Fund prices up and yields down to reflect this “new normal” for interest rates. As yields continue to fall to zero in money market funds, investors will look elsewhere for income, and we believe Closed-End Funds will be a good place for investors to look for income. If you look at our strategy today, our current indicated annualized cash distribution yield is 6.1%. In general, there is a healthy amount of income available in Closed-End Funds.
How We’ve Done Following Years of Negative Return

Since the inception of our discounted Closed-End Fund strategy in 2006 (which is audited and began with separately managed accounts), we’ve had 4 calendar years with a negative return (2008, 2011, 2015, and 2018). In every instance, during the next calendar year our strategy had a positive return:

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2011</th>
<th>2015</th>
<th>2018</th>
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<tbody>
<tr>
<td>Calendar Year Return</td>
<td>-31.5%</td>
<td>-2.8%</td>
<td>-6.6%</td>
<td>-9.1%</td>
</tr>
<tr>
<td>Next Calendar Year Return</td>
<td>+51.8%</td>
<td>+15.9%</td>
<td>+16.0%</td>
<td>+25.8%</td>
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</table>

2020 isn’t over, and we are not ruling out the possibility of a full recovery and positive calendar year return.

2008-2009 Comparison

As we mentioned in our March newsletter, our strategy returned over 100% in the 25-month period from 11/30/2008–12/31/2010. Could that happen again? Yes it could – see areas of opportunity below:

- Discount narrowing reflecting the “new normal” of interest rates could provide 5% to 10% of positive return going forward.
- Our current indicated annualized cash distribution yield is 6.1%.
- Any alpha we capture through trading will impact performance (historically this has contributed between 2% and 4% annually).
- Underlying NAV returns? This will be entirely market dependent and could be positive or negative. After such a major decline in March, we remain very optimistic for the rest of 2020.
- If all our holdings instantaneously began trading at NAV, that would create about 25 percentage points of positive performance.

Past performance is no guarantee of future results, but we remain optimistic that our strategy will generate solid returns over the next two years.
Historical CEF Discounts

Matisse Discounted CEF Strategy & Entire CEF Universe

(as of 6/30/2020)

Average Discount for Entire CEF Universe (since 2005)

Entire CEF Universe Current Discount

Average Discount for Our Portfolio (since 2005)

Our Portfolio Current Discount

US Equity CEFs

(as of 6/30/2020)

Average Discount for US Equity CEFs (since 2005)

US Equity CEFs Current Discount

Source: Matisse Capital
Historical CEF Discounts Continued

Discount to NAV

International Equity CEFs

Average Discount for International Equity CEFs (since 2005)

International Equity CEFs Current Discount

Source: Matisse Capital

Discount to NAV

Fixed Income CEFs

Average Discount for Fixed Income CEFs (since 2005)

Fixed Income CEFs Current Discount

Source: Matisse Capital
What’s Happening at Matisse:

MATISSE LAUNCHES 2ND MUTUAL FUND – MDFIX

The Matisse Discounted Bond CEF Strategy (MDFIX) was launched on April 30th, 2020 and is off to a great start. We plan on distributing a newsletter focused on this fixed income CEF strategy in the future. For more information, please send a request to info@matissecap.com.

MDCEX SURPASSES $230 MILLION IN ASSETS UNDER MANAGEMENT

The Matisse Discounted Closed-End Fund Strategy (MDCEX) now has over $230 million in assets under management (as of 6/30/2020).

Portfolio Composition:

TYPICAL ACCOUNT LOOKTHROUGH ALLOCATION 6.30.20

<table>
<thead>
<tr>
<th>Asset Allocation</th>
<th>Equity Cap Allocation</th>
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<tbody>
<tr>
<td>U.S. Equity 33%</td>
<td>Giant 27%</td>
</tr>
<tr>
<td>Fixed Income 18%</td>
<td>Medium 25%</td>
</tr>
<tr>
<td>Other 16%</td>
<td>Small 10%</td>
</tr>
<tr>
<td>Not Classified 3%</td>
<td>Micro 7%</td>
</tr>
<tr>
<td>Greater Europe Equity 5%</td>
<td>Non-U.S. Americas Equity 12%</td>
</tr>
<tr>
<td>Greater Asia Equity 13%</td>
<td>Other 16%</td>
</tr>
</tbody>
</table>

Source: Morningstar®

TOP 10 HOLDINGS 6.30.20

<table>
<thead>
<tr>
<th>Holding</th>
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<tbody>
<tr>
<td>Pershing Sq Hldgs</td>
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<tr>
<td>Third Point Offshore USD Ord</td>
</tr>
<tr>
<td>Adams Diversified Equity Fund</td>
</tr>
<tr>
<td>NexPoint Strategic Opportunities Fund</td>
</tr>
<tr>
<td>MS China A Share</td>
</tr>
<tr>
<td>Highland Income Fund</td>
</tr>
<tr>
<td>Central Securities Corporation</td>
</tr>
<tr>
<td>MS Emerging Markets Domestic</td>
</tr>
<tr>
<td>Aberdeen Asia-Pacific Income</td>
</tr>
<tr>
<td>ASA Gold and Precious Metals</td>
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Disclaimers:

1 Matisse Capital (Deschutes Portfolio Strategy, LLC) is the advisory firm to the Matisse Discounted Closed-End Fund Strategy and mutual fund. Performance cited currently represents a composite of all Matisse Capital-advised accounts employing our discounted closed-end fund strategy, including our publicly traded mutual fund, net of all commissions, and separate accounts with a presumed 1% management fee. For details of the performance calculation method, please see our separate audited report. All performance figures for the strategy (except cash distribution yield) are total returns net of actual commissions incurred, and net of a presumed 1% annual management fee. Benchmark returns, by contrast, do not reflect a deduction for fees. You cannot invest directly in an index. Performance comparisons are for illustrative purposes only and are not a forecast of future returns. Alpha, beta and R2 are annualized since inception. Please contact us if you would like to receive a copy of the performance audit from ACA Compliance Group (formerly Ashland Partners). Although the above data is derived from sources deemed to be accurate, Matisse Capital does not guarantee its accuracy.

2 The benchmarks referenced are included to reflect the general trend of the markets during the periods indicated and are not intended to imply that the underlying returns were comparable to the market indices either in composition or element of risk. There are significant differences between client accounts and the indices herein including, but not limited to, risk profile, liquidity, volatility, and asset composition. The S&P 500 Index is a capitalization-weighted index comprised of 500 stocks chosen for market size, liquidity and broad industry group representation within the U.S. economy. Index returns represent gross returns, and are provided to represent the investment environment during the time periods shown and are not covered by the report of the independent verifiers.

3 Matisse Capital is not affiliated or endorsed by Morningstar, Inc. Morningstar® has placed our publicly traded mutual fund into its Tactical Allocation category.

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