Fourth Quarter 2020 Strategy Commentary

Matisse Discounted Closed-End Fund Strategy Composite

December 31st, 2020

Investment Objective: Income with Modest Growth. The Strategy's investment objective is to produce superior risk-adjusted returns by purchasing income-producing closed-end funds at significant discounts to NAV\(^1\). We scrutinize the entire universe of US closed-end funds daily, using our proprietary statistical model to select closed-end funds best positioned for both capital gains and income. We build a diversified, globally balanced portfolio using closed-end funds.

### Fourth Quarter 2020 Strategy Highlights

During the fourth quarter, the Matisse Discounted Closed-End Fund Strategy Composite gained 19.6%, beating both the S-Network Composite Closed-End Fund Total Return Index\(^5\) (12.7%) and the S&P 500® Index\(^6\) (12.1%). Our fourth quarter outperformance was driven by several factors:

- The average discount for the entire closed-end fund universe narrowed by 231 bps to 6.4%, which was a tailwind
- Driven by several notable successes, our positions in highly discounted closed-end funds narrowed more than the broad closed-end fund market, and discount movement/capture for our strategy contributed 585 bps to performance
- Equities did well, helping our more equity tilted asset allocation
- Cash distributions from our holdings totaled 2.76% in the fourth quarter, providing a tailwind of cash returned at NAV\(^1\)
  - This included year-end cap gains distributions from many of our holdings (as is typical to expect)
  - As of year-end, our weighted average holding’s indicated cash distribution yield was 5.1% (not counting potential year-end cap gains distributions)
- Unlike third quarter, our energy exposure (larger than benchmarks at an average of 10% during the quarter) was a positive
  - Providing a further benefit, MLP CEF discounts narrowed from 26.0% to 20.8% during the quarter
  - Energy/commodity names in the aggregate contributed 264 bps to our fourth quarter return
- Foreign stocks finally turned the tables, beating US stocks, helping our more foreign tilted asset allocation
  - This outperformance was driven primarily by US dollar weakness
- Similarly, value finally turned the tables on growth, helping our value-tilted portfolio

As we look ahead, we view MLP CEFs as the most attractive closed-end fund sector right now. On average, MLP CEFs trade at a 20.8% discount to NAV\(^1\) as of year-end, compared to their trailing 10-year average discount of 4.2%. In our opinion, MLP CEFs are well-positioned to experience future discount narrowing (which all else equal is a tailwind for investors).
Strategy Outlook
We continue to maintain a highly diversified portfolio with 80 holdings as of year-end, given (what we would describe as) a plenitude of highly discounted investment opportunities in closed-end funds. We’ve increased our energy exposure, which now stands at 14% of the overall portfolio. Healthcare, financial services, and consumer cyclical are our next largest equity sectors, each at 10% to 11% of our portfolio. Overall, our equity exposure is just over 80%, with about one-third of that foreign.

As we look at our renewed energy exposure in 2021, we are happy to have found perhaps the only sector of the market with a single-digit PE ratio (9), trading at 7x EBITDA, with close to a 10% indicated yield. Once-bitten investors appear to still be staying away, and their potential return to MLPs could occur on a “rolling” basis over the next several years. Ironically, the new administration’s aversion to fossil fuels may drive oil/gas prices (and pipeline rents) up as the extraction of energy could become more difficult and costly. Situations like this (20% or greater discounts in a broad asset class that is also very cheap and very under-owned) rarely occur more than once or twice a decade, and we believe our willingness to swing at this fat pitch might reward our investors handsomely.

We have previously noted and continue to believe that one important advantage for closed-end funds, in general (as we consider the overall outlook for the strategy) is today’s low interest rates. Back in 2008, the 10-year US treasury yield never fell below 2.00%. As of quarter-end, the 10-year US treasury yield was 0.92%. More importantly, the Fed has committed itself to zero rates for the foreseeable future, even stating explicitly that they will allow inflation to run above two percent “for a time” (should that ever come to pass). In our view, the structural advantages of closed-end funds (easy and cheap borrowing paired with high and largely sustainable cash distributions) will eventually be found by an increasing number of investors who ignore closed-end funds now. Investors desire yield, and closed-end funds may eventually become a mainstream and common option to satisfy investor’s income needs. If this trend is realized, then discounts could ultimately narrow for secular reasons for years to come. In our opinion, it makes today’s discount levels that much more exciting.

Despite COVID-19, the US stock market had a great year in 2020. The forward PE of the S&P 500® Index now stands at 23, well above its average of 18 over the past 30 years. The open question is whether the strong economic growth that could occur in the second half of 2021 (due to the anticipated re-opening of the economy, along with record-low interest rates that could persist for many years) is sufficient to support stock prices at current levels or potentially drive them higher.

Offsetting the positives of any potential “coiled spring” economic growth and still-low interest rates, the new reality of Democratic control of both the legislative and executive branches could lead to higher taxes for the wealthy, resumed regulation, tighter quarantines, anti-monopoly actions against Big Tech, and possibly rising interest rates. This tug-of-war could continue to play out throughout 2021.

Foreign stocks, meanwhile, remain significantly cheaper than US stocks, and the gap between value and growth remains significant. Hence, we are not surprised that we are finding some of the most attractively discounted closed-end funds in foreign and value.
Current Market Environment

As of December 31st, 2020, discounts on all closed-end funds stood at 6.4% on average (which is still 1.0% wider than their trailing 10-year average discount). During the quarter, the average discount in the entire universe of closed-end funds narrowed by approximately 231 basis points.

As a group, highly discounted closed-end funds (those in the bottom quintile of discounts) saw their discounts narrow by more than the broad closed-end fund market. The discounts on highly discounted closed-end funds narrowed by an average of 346 basis points during the quarter, while all other closed-end fund discounts narrowed by approximately 198 basis points on average. Discount narrowing, all else equal, serves as a tailwind for closed-end fund investors.

Discounts on MLP closed-end funds narrowed by 5 percentage points during the quarter. As of quarter-end, the average discount on all MLP closed-end funds stood at approximately 20.8%, which is significantly wider than the trailing 10-year average discount on MLP closed-end funds. In our opinion, MLP closed-end funds are currently the most attractive closed-end fund sector as a group, statistically speaking based on current average discounts compared to long-term average discounts.

Other notable highlights in the closed-end fund market are International Equity closed-end funds and US Equity closed-end funds. International Equity closed-end funds current average discount is 12.4% (compared to a trailing 10-year average discount of 8.9%). US Equity closed-end funds current average discount is 10.2% (compared to a trailing 10-year average discount of 6.5%).

In our professional opinion, the current market environment in closed-end funds is favorable for closed-end fund investors, and we could see significant discount narrowing over the next 12 to 24 months. We noted a similar conclusion in last quarter’s commentary, and it remains unchanged.
Historical Discounts to NAV\(^1\) (Trailing 10-Years)

**Entire Closed-End Fund Universe**

- **Average Discount for Entire CEF Universe (Trailing 10-Years)**
- **Entire CEF Universe Current Discount**

**US Equity Closed-End Funds**

- **Average Discount for US Equity CEFs (Trailing 10-Years)**
- **US Equity CEFs Current Discount**

**MLP Closed-End Funds**

- **Average Discount for MLP CEFs (Trailing 10-Years)**
- **MLP CEFs Current Discount**

Source: Matisse Capital
4th Quarter 2020 Strategy Commentary

Matisse Discounted Closed-End Fund Strategy Composite

Performance Contributors and Detractors

**Top Contributor #1**
Pershing Square Holdings (PSH NA) contributed 244 basis points to our fourth quarter return. It began the quarter at a 30.3% discount and ended the quarter at a 23.0% discount. The underlying NAV\(^1\) of this position appreciated 16% during the quarter. Discount narrowing combined with the underlying NAV\(^1\) movement resulted in a gain of 28% during the quarter. PSH NA was about a 9% position in our strategy to start the quarter, and market appreciation increased it to 9.5% of our strategy as of quarter-end (our largest holding). Pershing Square is buying back shares and pays a dividend, and we believe the discount may narrow substantially. PSH NA has traded at a 19% discount since its launch in 2014.

In addition, there is potential underappreciated NAV\(^1\) upside in the form of Pershing Square's recently issued SPAC, Pershing Square Tontine Holdings (PSTH). PSTH was the largest SPAC issued in 2020 (at $5 billion), and it effectively expands Bill Ackman's reach into the not-yet-public market. PSH has a large position in PSTH, with the right to increase the position if a deal is consummated, along with standard warrants. This optionality is currently reflected in PSH's NAV\(^1\) at a nominal value, giving PSH investors potential upside if Ackman can find an attractive target (and the IPO market stays robust), along with minimal downside if not.

**Top Contributor #2**
Third Point Investors (TPOU LN) contributed 124 basis points to our fourth quarter return. It began the quarter at a 23.3% discount and ended the quarter at a 19.0% discount. The underlying NAV\(^1\) of this position appreciated 17% during the quarter. Discount narrowing combined with the underlying NAV\(^1\) movement resulted in a gain of 24% during the quarter. TPOU LN was about a 5% position in our strategy to start the quarter, and it remains about a 5% position in our strategy as of quarter-end. Third Point is buying back shares, we've noticed more institutional and discount-focused investors have been purchasing shares recently, and we believe the discount may narrow substantially. TPOU LN has traded at a 16% discount since its launch in 2007. Also notable, chairman Steve Bates (who began in 2019) instituted the share buyback and promised to come back to shareholders with revised proposals to address TPOU LN's large discount to NAV\(^1\) within 3 years.

**Top Detractor #1**
No position detracted more than 5 basis points from our strategy’s fourth quarter return. However, the leading detractor was Tortoise Energy Infrastructure (TYG) which detracted 4 basis points.

**Top Detractor #2**
No position detracted more than 5 basis points from our strategy’s fourth quarter return. However, the second leading detractor was Salient Midstream & MLP (SMM) which detracted 2 basis points.
Notable Portfolio Changes

Our largest new position in the quarter was Tortoise Energy Infrastructure (TYG), which we purchased in November and December at a weighted average 22.8% discount to NAV\(^1\). We view this as an exceptional bargain for a fund that has traded at an average 1% discount to NAV\(^1\) since its 2004 launch. TYG primarily owns pipeline MLPs and (like most MLP CEFs) applies leverage. In 2020, MLP market values in general were (to put it lightly) destroyed. At the low on March 18th, TYG was down 87% YTD at NAV\(^1\) and 92% YTD at market. From March 18\(^{th}\) until year-end, MLPs as a group doubled, while TYG gained 165% at NAV\(^1\), and 288% at market.

As we looked around in the fourth quarter for great investment opportunities in the closed-end fund space, we decided that MLP CEFs as a group were compelling. In general, we concluded that MLPs CEFs were:

- Still highly discounted (20% to 30%)
- An unpopular asset class
  - For example, from 12/31/15 to 12/31/20, AMLP was down 57% (on price only)
  - Even though oil prices advanced 31% over that same time period
- Getting hit with potential fourth quarter tax loss selling, as we saw evidence of eager tax loss sellers in these funds
  - For example, even after TYG’s bounce, it still finished the year 70% below its price on 12/31/19
- Still offering good yields (6.0% at year-end in TYG’s case)
- Vehicles that have tax characteristics that could become more attractive as tax rates for the wealthy could increase
  - One could even make the case that the new administration’s tighter regulations and discouragement of new drilling could lead to much higher oil prices worldwide, especially if vaccine success leads the world economy to recover sharply

In our opinion, MLP CEFs (including TYG) were well positioned for investment in the fourth quarter and have the potential to deliver high risk-adjusted returns going forward.

Our largest sale in the quarter was Invesco Dynamic Credit Opps (VTA), which we sold in November at a 13.4% discount to NAV\(^1\) in favor of more attractive opportunities. We had purchased VTA in March and April at a 27.0% discount to NAV\(^1\).

For More Information

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Objective
The Matisse Discounted Closed-End Fund Strategy Composite seeks to provide investors with total return consisting of income with modest long-term capital appreciation.

Outlook
Matisse Capital views closed-end funds as a unique opportunity where an investor can purchase a diversified fund and potentially generate additional returns through a change in the relationship between a closed-end funds’ market price and its Net Asset Value (NAV)\(^1\).

Strategy
1. Invests in closed-end funds that invest in both equity and fixed income securities.
2. Opportunistic trading strategy that attempts to take advantage of both short-term and long-term changes in a fund’s discount or premium to its NAV\(^1\).
3. Uses both a proprietary quantitative screening process and qualitative analysis.

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<thead>
<tr>
<th>Asset Allocation</th>
<th>Equity Cap Allocation</th>
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<tbody>
<tr>
<td>Non-U.S. Americas Equity 14%</td>
<td>Giant 21%</td>
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<tr>
<td>U.S. Equity 42%</td>
<td>Medium 30%</td>
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<tr>
<td>Greater Asia Equity 10%</td>
<td>Large 26%</td>
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<tr>
<td>Other 8%</td>
<td>Not Classified 4%</td>
</tr>
<tr>
<td>Cash 4%</td>
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Top Ten Holdings
1. Pershing Sq Hldgs 8.75%
2. Third Point Investors USD Ord 5.17%
3. NexPoint Strategic Opportunities Fund 4.56%
4. Highland Income Fund 4.48%
5. MS China A Share 3.86%
6. Adams Diversified Equity Fund 3.58%
7. Tetragon Financial Ord 3.09%
8. Central Securities Corporation 3.02%
9. MS Emerging Markets Domestic 2.97%
10. Calamos L/S Equity & Dynamic Inc Trust 2.46%

Current and future holdings are subject to change. Asset Allocation, Equity Cap Allocation, and Top Ten Holdings numbers were obtained and are available through Morningstar. Asset Allocation and Equity Allocation pie chart data may not sum to 100% due to rounding.
The price at which a closed-end fund trades often varies from its NAV. A fund is said to be trading at a discount when its market price is below its NAV. Alternatively, a fund is said to be trading at a premium when its market price is above its NAV.

Matisse Capital (Deschutes Portfolio Strategy, LLC) is the advisory firm to the Matisse Discounted Closed-End Fund Strategy Composite. 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.

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.

Inception date for the Matisse Discounted Closed-End Fund Strategy Composite was 12/30/2005.

S-Network Composite Closed-End Fund Total Return Index: This fund index is designed to serve as a benchmark for closed-end funds listed in the US that principally engage in asset management processes seeking to produce taxable annual yield. The index employs a modified net assets weighting methodology designed to assure accurate investment exposure across the various style segments that together comprise the taxable yield sector of the closed-end fund market.

S&P 500® Index: (registered trademark of The McGraw-Hill Companies, Inc.) is an unmanaged index of 500 common stocks primarily traded on the New York Stock Exchange, weighted by market capitalization. Index performance includes the reinvestment of dividends and capital gains.

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