COVID-19 and CEFs – Shooting Fish in a Barrel?

COVID-19, on everyone’s mind, was the chief culprit of the stock market’s first quarter decline. We experienced the fastest bear market decline (-35%) ever in 36 days, destroying industrial and consumer demand in virtually everything, from the oil market to most cyclical companies. To no one’s surprise (except for the speed of the decline), most Closed-End Funds (CEFs) were trapped in this environment with the double whammy of sharply declining NAVs and discounts widening out as fear overwhelmed the markets (yes, retail holders panicked again). To make matters worse, our strategy’s exposure to good income and relatively safe “pipeline” energy MLPs was higher than normal, accounting for the difference between our performance and the relative index of CEFs. However, we are optimistic going forward as we’ve been here before, with the most recent comparison being 2008.

As a refresher, our strategy focuses on investing in CEFs that are trading at substantial discounts relative to their underlying net asset values. We believe individual CEF discounts fluctuate around a long-term mean, and we target CEFs whose current discounts are wider (more discounted) than their historical average discounts. It’s our view that investments in CEFs with these types of characteristics can allow our investors to profit from (1) the income generated from CEF distributions and (2) the capital appreciation achieved when such discounts narrow.

As of quarter-end 3/31/20 (Source: Matisse Capital):
- 88% of CEFs were trading at a wider discount than their 52-week average discount.
- 80% of CEFs were trading at a wider discount than their 10-year average discount.

At some point during March, 99% of all US-traded CEFs traded at a wider discount than their long-term average discount. At its most discounted, the median CEF traded 17 percentage points below its respective long-term average discount! This is an unprecedented discount environment, and we haven’t seen anything close to it since 2008-09. In our opinion, there is an unusually high amount of attractive investment opportunities today in the CEF space. While we can’t predict the future or guarantee future performance, we believe we are in a position to potentially deliver strong, positive returns going forward once the market begins to normalize.

To help demonstrate the significance of the CEF discounts we are seeing, we’ve included several of our Historical CEF Discounts charts on the following pages, and noted a few highlights below:
- As of 3/31/20, discounts on US Equity CEFs stood at 8.6% on average (about 4 percentage points wider than their since-2006 average).
- Our portfolio was 20.4% discounted on average (as compared to our 13.8% average portfolio discount since the inception of our strategy; 1/1/2006). This is the biggest month-end average discount in our portfolio since 2008.
- Broadly speaking, right now the most attractive CEF sector as a group is International Equity, but we are seeing an abundance of opportunities in taxable bond CEFs, municipal bond CEFs, and small-cap equity CEFs.
- Bill Ackman of Pershing Square managed his CEF (PSH) brilliantly with hedges, avoiding NAV depreciation during the quarter, but at the same time investors panicked, creating a great opportunity to own more of his fund at a significant discount to NAV.
Historical CEF Discounts

Matisse Discounted CEF Strategy & Entire CEF Universe (as of 3/31/2020)

- 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 3/31/2020)

- Average Discount for US Equity CEFs (since 2005)
- US Equity CEFs Current Discount

Source: Matisse Capital
Discount to NAV

International Equity CEFs
(as of 3/31/2020)

Average Discount for International Equity CEFs (since 2005)

International Equity CEFs
Current Discount

- 7.4%

- 13.7%

Discount to NAV

Fixed Income CEFs
(as of 3/31/2020)

Average Discount for Fixed Income CEFs (since 2005)

Fixed Income CEFs
Current Discount

- 7.2%

- 4.0%
What’s Happening at Matisse:

MATISSE DISCOUNTED BOND CEF STRATEGY

The Matisse Discounted Bond CEF Strategy is now available to qualified outside investors and clients, through separately managed accounts and a newly launched publicly traded mutual fund. For more information, please send a request to info@matissecap.com.

OREGON BUSINESS MAGAZINE BRAND STORY

Our firm was featured in the April 2020 issue of Oregon Business Magazine. Click here to read the article.

BARRON’S ARTICLE

Bryn Torkelson was recently featured in Barron’s in “Muni Bonds Have Started to Rally. Why You Should Get on Board — and Where to Find Bargains”. Click here to read the article.

MONEY LIFE WITH CHUCK JAFFE PODCAST

Eric Boughton, CFA was recently featured on the Money Life with Chuck Jaffe podcast. Click here to listen to the podcast.

Portfolio Composition:

TYPICAL ACCOUNT LOOKTHROUGH ALLOCATION 3.31.20

<table>
<thead>
<tr>
<th>Asset Allocation</th>
<th>Equity Cap Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Equity 28%</td>
<td>Giant 20%</td>
</tr>
<tr>
<td>Greater Europe Equity 5%</td>
<td>Medium 32%</td>
</tr>
<tr>
<td>Greater Asia Equity 8%</td>
<td>Small 17%</td>
</tr>
<tr>
<td>Non-U.S. Americas Equity 12%</td>
<td>Micro 10%</td>
</tr>
<tr>
<td>Fixed Income 27%</td>
<td>Other 16%</td>
</tr>
<tr>
<td>Not Classified 4%</td>
<td>Not Classified 4%</td>
</tr>
</tbody>
</table>

Source: Morningstar®

TOP 10 HOLDINGS 3.31.20

<table>
<thead>
<tr>
<th>Pershing Sq Hldgs</th>
<th>Highland Income Fund</th>
<th>NexPoint Strategic Opportunities Fund</th>
<th>Aberdeen Asia-Pacific Income</th>
<th>Invesco CEF Income Composite ETF</th>
</tr>
</thead>
<tbody>
<tr>
<td>VanEck Vectors High-Yield Municipal ETF</td>
<td>PIMCO Energy &amp; Tactical Credit Opps</td>
<td>Calamos L/S Equity &amp; Dynamic Inc Trust</td>
<td>Tortoise Essential Assets Income Term</td>
<td>Central Securities Corporation</td>
</tr>
</tbody>
</table>

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2The 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.

3Matisse 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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