



# HOW TO TACTICALLY SWAP CLOSED- END FUNDS TO POTENTIALLY REDUCE RISK AND ADD ALPHA

**Advanced CEF Skill Level**

January 24, 2012

John Cole Scott, CFS  
Portfolio Manager, Executive Vice President  
Closed-End Fund Advisors, Inc.

# Disclaimer

Important: The information in this presentation is not for general circulation and should not be considered an offer, or solicitation, to deal in any of the mentioned funds. The information is provided on a general basis for information purposes only, and is not to be relied on as advice, as it does not take into account the investment objectives, financial situation or particular needs of any specific investor.

Any research or analysis used to derive, or in relation to, the information herein has been procured by Closed-End Fund Advisors (“CEFA”) for its own use, and may have been acted on for its own purpose. The information herein, including any opinions or forecasts have been obtained from or is based on sources believed by CEFA to be reliable, but CEFA does not warrant the accuracy, adequacy or completeness of the same, and expressly disclaims liability for any errors or omissions. As such, any person acting upon or in reliance of these materials does so entirely at his or her own risk. Any projections or other forward-looking statements regarding future events or performance of countries, markets or companies are not necessarily indicative of, and may differ from, actual events or results. No warranty whatsoever is given and no liability whatsoever is accepted by CEFA or its affiliates, for any loss, arising directly or indirectly, as a result of any action or omission made in reliance of any information, opinion or projection made in this presentation.

The information herein shall not be disclosed, used or disseminated, in whole or part, and shall not be reproduced, copied or made available to others without CEFA expressed written permission. CEFA reserves the right to make changes and corrections to the information, including any opinions or forecasts expressed herein at any time, without notice.



# Today's Goal?

*What are the primary strategies and data points one might use to make swapping decisions in a managed portfolio of closed-end funds?*

- *When is it worth swapping CEFs?*
- *How should the tax implications be weighed by investors?*
- *What are the primary risks of swapping funds?*

***Reminder:*** *This presentation is for educational purposes only and does not constitute investment advice or any buy or sell recommendations. CEFA does not give tax-advice, please seek out a CPA or accountant for individual tax advice.*



# Reasons to Swap a Closed-End Fund

- Fund Selling at Premium to Net Asset Value (NAV)
- Fund Selling at a Relative Premium to NAV
- New Concern for Future Dividend Payments
- Poor NAV Performance
  - Vs. Peer Comparison
  - Vs. Other Investment Options
- Change in Portfolio Management
- Change in Investment Policy

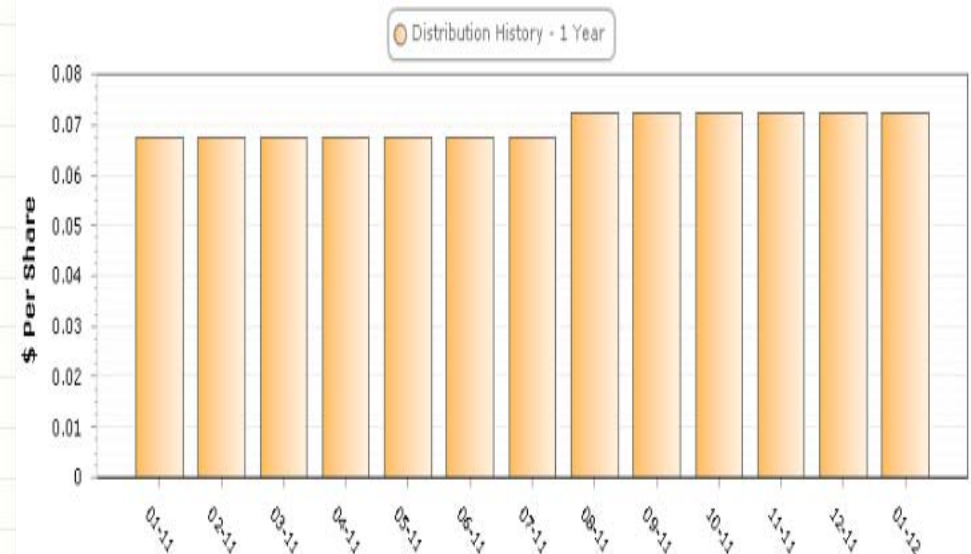
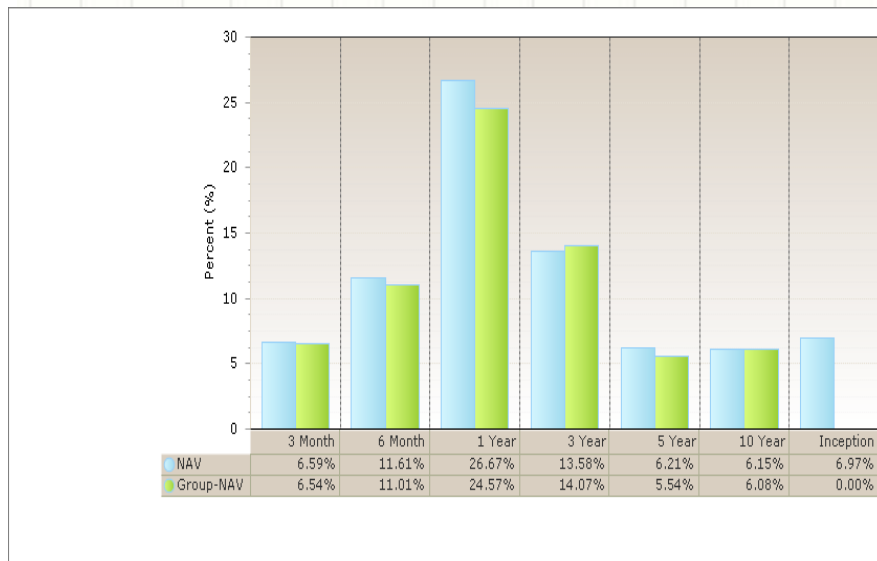
# Primary Data Points For Swap Consideration

- Premium to Net Asset Value
- Dividend Coverage
  - Earnings Ratio
  - Relative UNII
  - Return of Capital (ROC)
- Net Asset Value Performance
  - Fund
  - Peer Funds
- Sector or Market Outlook
  - Leverage
  - Credit Quality
  - Duration





# Swapping Out of a Premium Invesco Insured Muni Bond (IMC)



# Swapping Out of a Premium Invesco Insured Muni Bond (IMC)

## Top Holdings

As of 9/30/2011 reported by fund sponsor

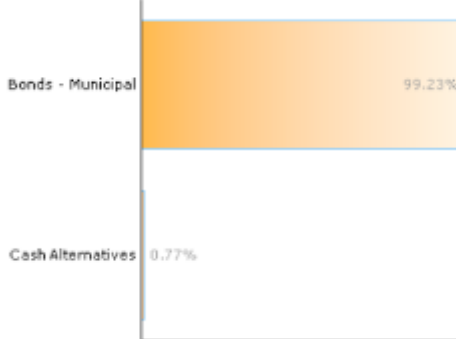
| Holding  | Value   | %Portfolio |
|--|---------|------------|
| New York St Dorm Auth 5% 5.00<br>01 Jul 2024                 | \$2.11M | 2.39%      |
| Metropolitan Transn Auth 5.5%<br>5.50 01 Jul 2020            | \$2.06M | 2.33%      |
| Broward Cnty Fla Sch Brd Ctfs Ctf<br>Of 5% 5.00 01 Jul 2026  | \$2.01M | 2.27%      |
| Norfolk Va Wtr Rev Wtr Rev B<br>5.875% 5.88 01 Nov 2020      | \$2.00M | 2.27%      |
| Chicago Ill O Hare Intl Arpt R<br>Second Li 5.38 01 Jan 2032 | \$2.00M | 2.26%      |
| Dallas Fort Worth Tex Intl Arp Jt R<br>5.5% 5.50 01 Nov 2031 | \$2.00M | 2.26%      |
| Jacksonville Fla Excise Taxes Rev<br>5.25% 5.25 01 Oct 2019  | \$1.56M | 1.77%      |
| Chicago Ill Pk Dist 5% 5.00 01<br>Jan 2024                   | \$1.56M | 1.76%      |
| Wayne Charter Cnty Mich Arpt R<br>Rev 5.5% 5.50 01 Dec 2017  | \$1.53M | 1.74%      |
| Anaheim Calif Pub Fing Auth 4.5%<br>4.50 01 Oct 2037         | \$1.49M | 1.69%      |
| Alaska Indl Dev & Expt Auth 5%<br>5.00 01 Jan 2027           | \$1.37M | 1.55%      |

## Top Sectors

As of 11/30/2011 reported by fund sponsor

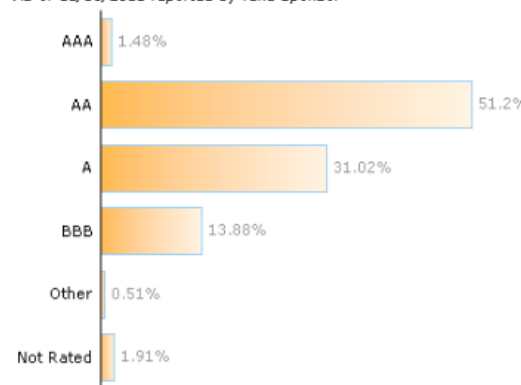
| Sector               | %Portfolio |
|----------------------|------------|
| Local GO             | 12.73%     |
| Water / Sewer        | 12.36%     |
| Public Power         | 11.90%     |
| Hospital             | 10.46%     |
| Higher Education     | 8.48%      |
| Dedicated Tax        | 7.25%      |
| Airport              | 6.58%      |
| Appropriation        | 6.44%      |
| Other Transportation | 5.56%      |
| Municipals           | 3.51%      |

As of 8/31/2011 reported by fund sponsor



## Credit Quality

As of 11/30/2011 reported by fund sponsor



## Portfolio Characteristics

|  |           |
|--|-----------|
| AMT (As of 10/31/2011):                      | 0.12%     |
| Average Coupon (As of 1/23/2012):            | 4.52%     |
| Average Maturity (As of 11/30/2011):         | 16.90 yrs |
| Number of Holdings (As of 9/30/2011):        | 135       |
| Annual Portfolio Turnover (As of 2/28/2012): | 4.00%     |
| Pre-Refunded (As of 10/31/2011):             | 0.08%     |
| Average Bond Price (As of 10/31/2011):       | \$100.56  |

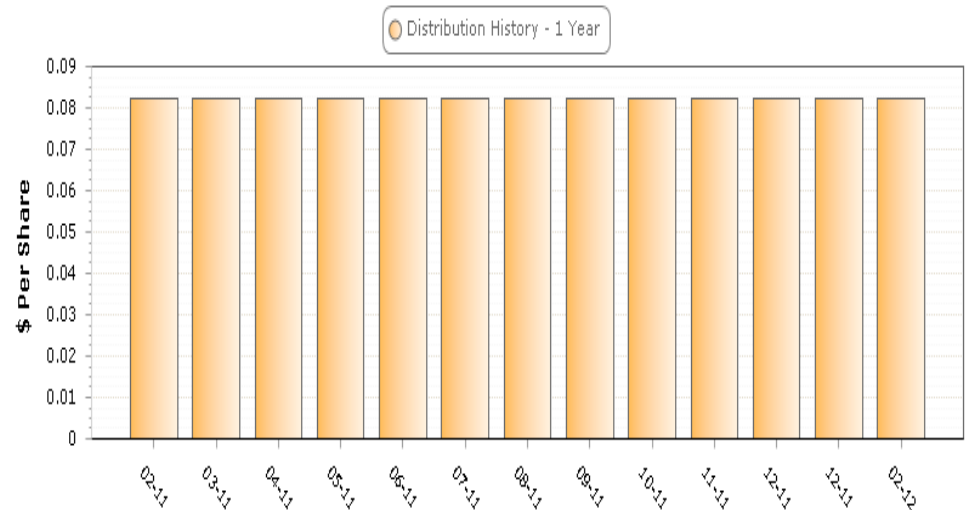
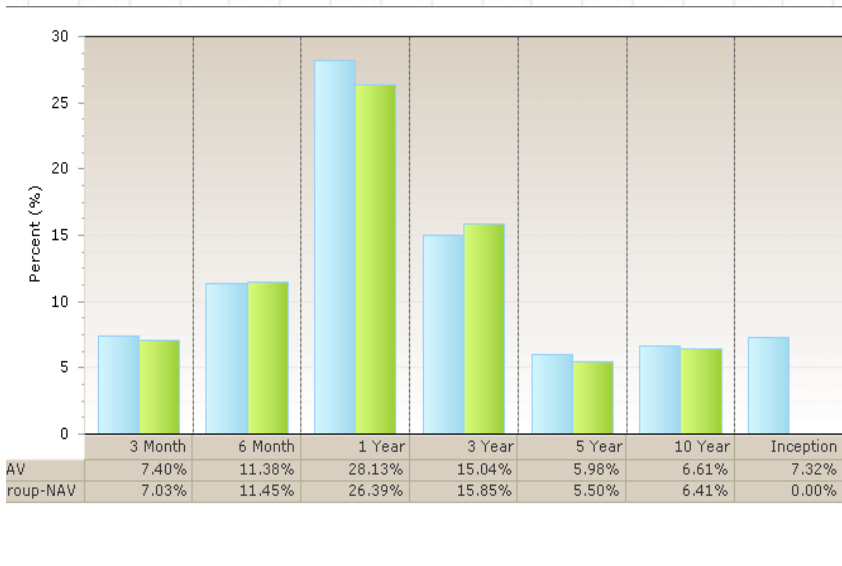
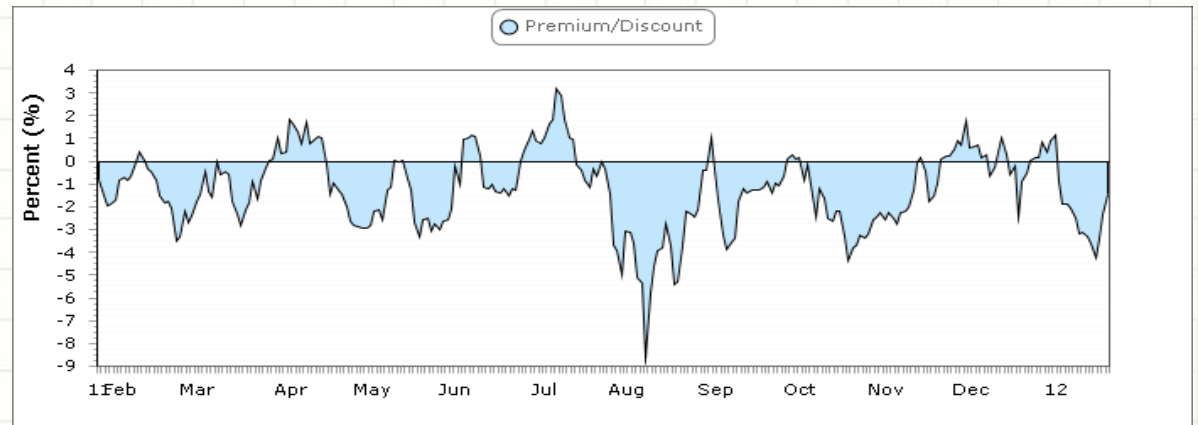
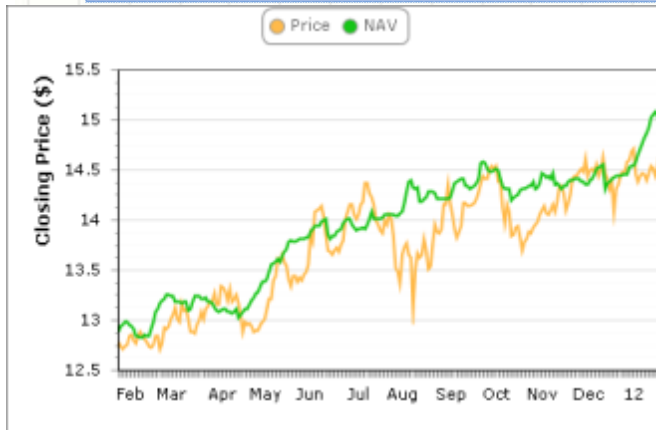
## Key Information Regarding Distributions

|  |          |
|--|----------|
| <b>Current Distribution (Monthly):</b><br>(As of 1/23/2012)      | \$0.0725 |
| <b>Avg. Earnings Per Share:</b><br>(As of 11/30/2011)            | \$0.0713 |
| <b>Annualized Distribution Rate on NAV:</b><br>(As of 1/23/2012) | 5.65%    |
| <b>Total Return on NAV (12 months):</b><br>(As of 1/23/2012)     | 26.67%   |
| <b>Avg. UNII Per Share:</b><br>(As of 11/30/2011)                | \$0.3076 |
| <b>Avg. Portfolio Coupon:</b><br>(As of 1/23/2012)               | 4.52%    |
| <b>Total % Portfolio Leveraged:</b><br>(As of 1/23/2012)         | 33.72%   |



# Swapping Into Discount

## Invesco Insured Muni Bond (NMA)





# Swapping Into Discount Invesco Insured Muni Bond (NMA)

## Top Holdings

As of 9/30/2011 reported by fund sponsor

| Holding   | Value    | %Portfolio |
|---|----------|------------|
| Matagorda Cnty Tex Nav Dist 5.95% 5.95 01 May 2030        | \$16.30M | 1.63%      |
| California St Go Bds 5% 5.00 01 Jun 2037                  | \$16.32M | 1.63%      |
| Clark Cnty Nev Arpt Rev Subordina 5.75% 5.75 01 Jul 2042  | \$16.28M | 1.63%      |
| Knox Cnty Tenn Health Edl & Hs Ref Rev & 01 Jan 2018      | \$14.84M | 1.49%      |
| Tobacco Settlement Fing Corp L To 5.875% 5.88 15 May 2039 | \$14.44M | 1.45%      |
| De Soto Parish La Pollutn Ctl Pol 5.875% 5.88 01 Sep 2029 | \$13.50M | 1.35%      |
| Will Cnty Ill Cmnty High Sch D Cabs 01 Jan 2024           | \$12.49M | 1.25%      |
| Oklahoma Dev Fin Auth 5% 5.00 15 Feb 2042                 | \$12.17M | 1.22%      |
| Perris Calif Single Family Mtg Sing 7.6% 7.60 01 Jan 2023 | \$12.09M | 1.21%      |
| Brazos River Auth 5.75%                                   | \$11.67M | 1.17%      |
| California St Various P 5.25% 5.25 01 Feb 2028            | \$11.53M | 1.15%      |

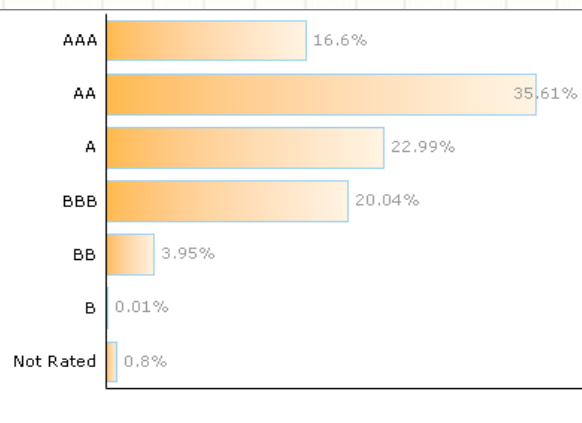
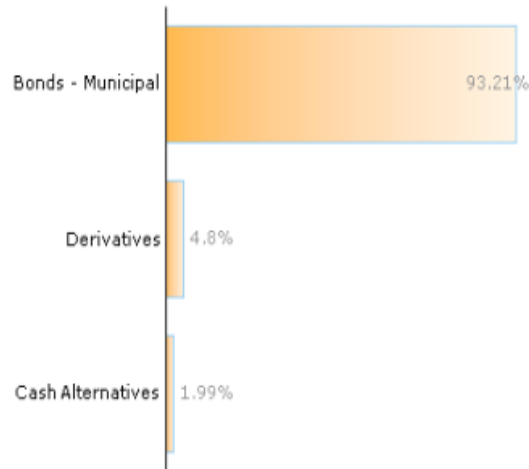
## Top Sectors

As of 12/30/2011 reported by fund sponsor

| Sector                    | %Portfolio |
|---------------------------|------------|
| Health Care               | 20.22%     |
| Tax Obligation/General    | 13.80%     |
| Tax Obligation/Limited    | 13.46%     |
| Transportation            | 12.70%     |
| US Guaranteed             | 11.68%     |
| Utilities                 | 11.53%     |
| Consumer Staples          | 6.83%      |
| Education and Civic Organ | 2.68%      |
| Water and Sewer           | 2.10%      |
| Net Other Assets          | 1.67%      |

## Asset Allocation

As of 12/30/2011 reported by fund sponsor



## Portfolio Characteristics

|   |           |
|---|-----------|
| AMT (As of 11/30/2011):                       | 13.77%    |
| Average Coupon (As of 1/23/2012):             | 4.10%     |
| Average Duration (As of 12/30/2011):          | 15.24 yrs |
| Average Maturity (As of 12/30/2011):          | 20.10 yrs |
| Number of Holdings (As of 11/30/2011):        | 231       |
| Annual Portfolio Turnover (As of 10/31/2012): | 14.00%    |
| Pre-Refunded (As of 12/30/2011):              | 7.49%     |
| Average Bond Price (As of 12/30/2011):        | \$84.72   |
| Average Priced To Date (As of 12/30/2011):    | 2019      |

## Key Information Regarding Distributions

|  |          |
|--|----------|
| <b>Current Distribution (Monthly):</b><br>(As of 1/23/2012)      | \$0.0825 |
| <b>Avg. Earnings Per Share:</b><br>(As of 12/31/2011)            | \$0.0740 |
| <b>Annualized Distribution Rate on NAV:</b><br>(As of 1/23/2012) | 6.62%    |
| <b>Total Return on NAV (12 months):</b><br>(As of 1/23/2012)     | 28.13%   |
| <b>Avg. UNII Per Share:</b><br>(As of 12/31/2011)                | \$0.1174 |
| <b>Avg. Portfolio Coupon:</b><br>(As of 1/23/2012)               | 4.10%    |
| <b>Total % Portfolio Leveraged:</b><br>(As of 1/23/2012)         | 39.62%   |



# Actual CEFA Swap Outcome

December 12, 2011 vs. Jan 23, 2012

- CEFA owned **Tortoise North American Energy (TYN)**
- **TYN** NAV: \$25.08 and Mkt Pr: \$24.01 = **4.9% discount**
- Purchased **Kayne Anderson Midstream (KMF)**
- **KMF** NAV: \$25.79 and Mkt Pr: \$22.54 = **12.6% discount**
- **KMF's** NAV perf: +6.6% and mkt perf: +12.6%
- **TYN's** NAV perf: +3.3% and mkt perf: +6.8%
- Allocation Alpha was **+5.8%**

Note: Example it not the typical outcome for a swap

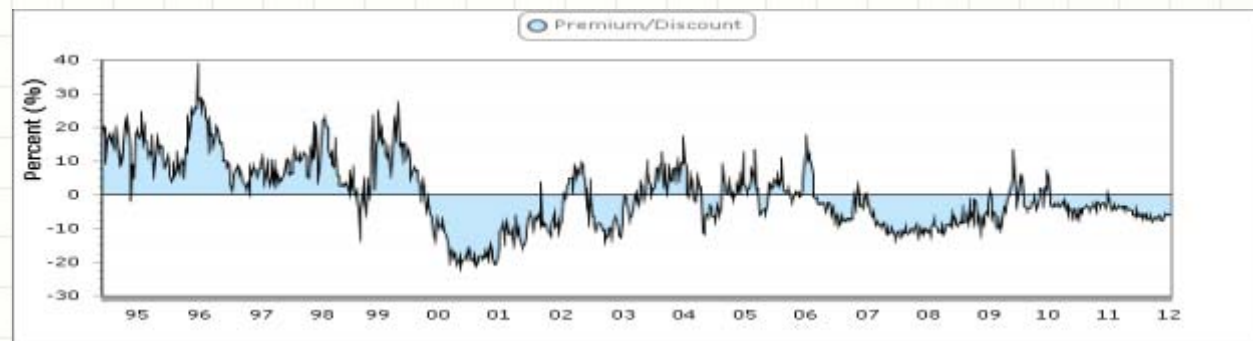


# Relative Premium: Definition

- Trading above its 90 day, 6 month or 1-year average relationship: Discount OR Premium
- 1-Year Z-Stat over 1, 1.5 or 2
- Historical Pattern of +/- 5%-10% of 'normal' Disc./Prem. (Not usually NAV)
- Trading above peer-group current Disc./Prem.

# How Can Swapping CEFs Reduce Risk?

- Fund have a normal historical Discount / Premium Range



- A Reversion to Mean is Common for CEFs
  - Based on Fund Policy's
  - Based on Market / Sector Conditions

# How Can Swapping CEFs Help Add Alpha?

- Expectation that NAV Performance in funds will be similar
- Investors look for value when selecting funds
- Discounts can help increase forward looking dividend yield vs. peer funds
- If the sector does experience negative news or dividend cuts a relative discount can protect your principal
- Holding cash doesn't make current sense for allocation.





# Tax Considerations

- CEFA Does not give tax advice
- Short-term gains vs. long-term gains
- Are you a high state and Federal tax bracket?
- Can you keep your tactical trading in an IRA / Tax-Free/Deferred account?
- Do you have loss carry-forwards?
- If the current premium went to a discount would the loss be significantly more than the current tax-burden?

# Risk of Swapping CEFs

- New fund underperforms on a NAV basis
- New fund cuts dividend more than original fund
- New fund doesn't raise the dividend as much as the original fund
- Disc / Relative Disc widens and never recovers
- Funds were not as similar as you originally believed
- Tax costs end up higher than benefit

# Summary

- Premiums & relative premiums are the primary factors for fund swapping
- Dividend risk with a premium can **double** your risk
- Why own a poor NAV performing fund?
- How significant are your tax considerations vs. the risk of principal?
- Commissions are often negligible: *\$7-\$11 per trade*
- The investment principal of swapping funds forces you to not get attached to 'owning a fund'.



# QUESTIONS?

**Closed-End Fund Advisors, Inc.**  
**7204 Glen Forest Drive, Suite #105**  
**Richmond, Virginia 23226 U.S.A.**  
**Toll Free: (800) 356-3508 – Local: (804) 288-2482**  
**[www.CEFAdvisors.com](http://www.CEFAdvisors.com) - [Info@cefadvisors.com](mailto:Info@cefadvisors.com)**

Sign up or view archive for *The Scott Letter: Closed-End Fund Report*: [www.ScottLetter.com](http://www.ScottLetter.com)  
Check out our NEW blog: [www.CEF-blog.com](http://www.CEF-blog.com)  
Register for more webinars / view on demand archive: [www.cefadvisors.com/webinars.html](http://www.cefadvisors.com/webinars.html)  
Learn more about our weekly CEF Data Service: [www.CEFUniverse.com](http://www.CEFUniverse.com)