



Discounts, Double-Digit Yields, and AI Risk: Takeaways from the CFA Society Cleveland Session



A May 13, 2026, summary of John Cole Scott’s CFA Society Cleveland presentation on using closed-end funds and BDCs tactically inside diversified portfolios.

John Cole Scott, President at CEF Advisors, gave the presentation to CFA charter holders and investment professionals in Cleveland on May 13, 2026. The goal of the talk was practical: help analysts, advisors, portfolio managers, and allocators understand how to properly use closed-end funds and business

development companies tactically inside largely diversified portfolios of other investments.

The central case was not that every CEF or BDC deserves a place in every portfolio. It was that these structures, when understood correctly, can offer something rare in public markets: active management, durable income, selective access to less-liquid assets, and a market price that can move independently from net asset value in ways that create repeatable alpha opportunities.

That tactical edge is not only about buying discounts. It also comes from knowing how to trade around rights offerings, tender offers, dividend changes, liquidation events, mergers, and tax-loss-selling dislocations. Based on CEFData research, those recurring opportunities, when handled properly, can add up to roughly 1% per quarter of alpha over a passively held diversified basket of 30 to 40 closed-end funds and BDCs.

Structure still matters

“The volatility is your friend.”

Closed-end funds remain publicly traded common-stock vehicles with professionally managed portfolios and a published net asset value, but without daily fund-level redemptions. That matters because managers are not forced to sell at the wrong time just because investors want liquidity on a bad day.

The same structural feature is also why discounts and premiums exist. A closed-end

fund can trade above or below the value of its underlying portfolio because shares trade in the secondary market, not directly with the sponsor.

For experienced investors, that is where the opportunity begins. Market-price volatility is usually greater than NAV volatility, and the gap between the two can create a second layer of return beyond the portfolio itself.

The income case in 2026

“The better question is not what it pays today, but what the manager has to earn to keep paying it.”

The room in Cleveland already had a working familiarity with listed CEFs and BDCs, so the discussion quickly moved from definitions to portfolio use. The key message was that income remains attractive across the space, but that headline yield is only useful when the underlying portfolio economics can support it.

In taxable closed-end funds, yields remain compelling across many sectors. Municipal CEFs continue to offer meaningful tax-exempt income, while listed BDCs still provide low-double-digit market yields in many cases, supported by both portfolio earnings and, in some cases, wider-than-normal discounts.

Return of capital came up, as it always does. The point was simple: return of capital is not automatically bad, but investors need to know whether it is coming from accounting treatment, tax management, or actual overdistribution.

Why discounts remain useful

“They trade at a discount because they can.”

Discounts are not random noise. They are often the market’s imperfect way of pricing liquidity, sponsor reputation, investor sentiment, distribution policy, activism risk, and plain old retail behavior.

Across the broader listed CEF universe, discounts remain meaningful by long-term standards. In listed BDCs, discounts have widened enough that the sector is back in valuation territory that has historically attracted more serious bottom-up scrutiny.

That does not mean every wide discount is a bargain. Sometimes the market is correctly anticipating a dividend cut, weaker NAV marks, or deteriorating manager credibility. But broad discount levels still suggest that selective investors have room to earn more than simple buy-and-hold market beta.

Tax-loss-selling season remains one of the most durable examples. When discounts widen into year-end and partially recover early in the following year, diversified investors who actively reposition around those moves can improve returns with relatively plain-vanilla trading discipline.

Corporate actions can create alpha

“A lot of alpha in this space comes from the wrapper, not just the guts.”

One of the more important themes in the talk was that closed-end fund alpha is not only about sector selection. It also comes from understanding and reacting properly to corporate actions and policy changes that move discounts and reset shareholder expectations.

Rights offerings, tender offers, dividend increases, dividend cuts, mergers, open-end conversions, and liquidations all matter because they can change both supply-demand dynamics and expected total return. In some cases, these events create short-term dislocations. In others, they unlock value that had been trapped in a persistently discounted vehicle.

CEFData research suggests that properly trading these recurring events, when combined with tax-loss-selling opportunities, can add up to around 1% per quarter of alpha over a passively held diversified basket of 30 to 40 CEFs and BDCs. That does not happen automatically, and it requires rules, discipline, and a willingness to distinguish between events that help current shareholders and events that mainly help sponsors or future buyers.

A tender offer can narrow a discount quickly. A merger can improve scale, lower costs, or eliminate a weak sponsor dynamic. A liquidation can crystallize value. A dividend cut can be painful in the short term but healthy if it restores credibility and stabilizes NAV. A rights offering can be harmful to existing holders if priced poorly, but useful later for those entering after the pressure clears. In this

market, wrapper analysis is often just as important as portfolio analysis.

BDCs, private credit, and the AI question

“What matters most is still whether managers can write deals and get paid back.”

The BDC portion of the discussion generated the most audience engagement. That makes sense in 2026, when private credit has become a mainstream topic and investors are trying to separate real credit issues from generalized market anxiety.

A new slide in the Cleveland presentation grouped BDCs by return on equity and overlaid AI-related exposure across thousands of underlying portfolio companies. The early takeaway was that software and AI exposure are worth monitoring, but they do not appear to explain most of the difference between stronger and weaker managers.

The bigger issue remains underwriting quality, manager discipline, and how firms behave when a credit starts to wobble. That is where fair-value marks, non-accrual trends, and payment-in-kind income become more informative than a broad narrative about AI disruption.

Audience questions sharpened the discussion

“Is the manager bruised, or is the manager broken?”

The audience questions made the Cleveland session especially useful because they pushed the discussion into the practical details that matter in real portfolios. One attendee asked what was actually driving weaker BDC managers if software exposure was not dramatically different across cohorts.

The answer was that manager quality, vintage, underwriting discipline, and responsiveness matter more than a single sector label. A good manager can have a rough patch. A weak manager can hide problems for longer than investors expect.

Another attendee asked whether it is possible to separate deal PIK from workout PIK. That distinction matters because planned payment-in-kind can be a legitimate feature of a financing structure, while distressed PIK can be a sign that a borrower is running out of room. The answer was that it is a worthwhile distinction, but a difficult one to extract cleanly from large volumes of filings and disclosures.

The room also asked about BDC buybacks. In theory, repurchasing shares below NAV can be highly accretive. In practice, many management teams are balancing buybacks against earnings optics, leverage targets, and the opportunity to put money to work in a better-spread lending environment.

Marks, non-accruals, and the gap between headlines and reality

“The market can be early, but it can also overshoot.”

A natural question followed: if BDC discounts have widened, has loan performance actually deteriorated enough to justify the move? The answer was nuanced.

Some return-on-equity pressure is real, and certain managers are clearly under more strain than others. But current marks still look more like markdowns than broad-based defaults, and sector-level stress remains well short of true crisis conditions.

That gap matters because listed BDCs report in a quarterly earnings-season rhythm. Between reporting dates, the market often trades on fear, expectation, and headlines. Sometimes that creates a warning. Other times it creates a tactical entry point for investors who know which managers they trust.

CLO equity and where caution still wins

“You do not have to reach for the most aggressive version of the trade to get paid.”

The discussion also touched on CLO equity. The message was not that CLO equity has no place, but that investors should be honest about the amount of structural leverage and downside sensitivity embedded in that exposure.

For many diversified portfolios, there are easier and cleaner ways to earn attractive income through selected listed BDCs, senior-loan CEFs, municipal funds, and taxable credit funds. Those sectors can still be volatile, but

they often offer a better balance between income, transparency, and recovery potential.

In that context, the Cleveland message was consistent: investors do not need to chase every double-digit yield. They need to understand what is driving the yield, what could interrupt it, and whether the wrapper gives them additional ways to win.

Distribution policy, activism, and sponsor behavior

“The wrapper is not passive.”

Distribution policy still matters more than many allocators expect. A monthly payer can trade better than a quarterly payer with a similar portfolio simply because retail investors often value frequency and predictability.

That behavioral preference ties directly into activism. Boards, sponsors, and activists all influence discount behavior, and funds with poor communication, weak policies, or little urgency around persistent discounts can become more vulnerable to pressure.

This is another reason why CEF and BDC investing rewards active monitoring. It is not enough to know what is in the portfolio. Investors also need to understand what boards and sponsors are likely to do when discounts widen, yields look too high, or scale becomes an issue.

Practical ways to improve outcomes

“Better buy-and-hold results usually come from better entry points and better event discipline.”

For investors looking to use CEFs and BDCs more effectively in diversified portfolios, a few practical disciplines can improve the odds of success:

- Focus on manager quality first, especially in BDCs and more complex credit sectors.
- Compare market yield to what the manager must earn on a leverage-adjusted NAV basis.
- Treat wide discounts as invitations to investigate, not automatic buy signals.
- Pay close attention to rights offerings, tenders, mergers, dividend changes, and liquidation opportunities.
- Use tax-loss-selling season as a tactical tool, not just a year-end housekeeping exercise.
- Diversify across roughly 30 to 40 holdings if building a dedicated allocation, so no single event or manager drives the whole outcome.
- Reassess positions when the discount narrows materially, not just when the NAV outlook changes.

- Prefer funds and managers with clear communication, stable policies, and a record of acting in shareholders' interests.

Closed-end funds and BDCs still offer one of the public market's more unusual combinations of yield, active management, and tactical opportunity. But the Cleveland session made clear that the better outcomes usually go to investors who treat the structures as active tools inside diversified portfolios, not as set-it-and-forget-it yield products.

Event slides can be accessed by emailing Sales@CEFadvisors.com with “**CFA Cleveland Slide Request**” in the email subject.

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2711 Buford Road, Suite #382
Richmond, Virginia 23225 U.S.A

www.CEFData.com