



# Can CEFs Help Build a 6%+ Tax-Free Yielding Portfolio?\*

Active Management with Repeatable Inefficiencies

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Last Updated: 9/9/14

# What Is CEF Advisors?

- Investment Management, Research & Data
- Independent, Fee Only & Family Owned
- “*Scott Letter: Closed-End Fund Report*”
- Discretionary Portfolio Management
- Daily CEF News Alert System
- Weekly “CEFA’s Closed-End Fund Universe” Report
- Monthly “Best Ideas” CEF List, Hourly & Project-Based CEF Consulting Work
- Founder: “CEF Network” on LinkedIn



[www.CEFadvisors.com](http://www.CEFadvisors.com)

Founded in 1989



# What Are Closed-End Funds?

Closed-end funds (CEFs) are in their basic sense:

- 1) Fixed Amounts of Capital without Redemption Pressures for Portfolio Manager(s)
- 2) Actively Managed 40 Act Investments
- 3) Publically Listed with Daily Investor Liquidity
- 4) Inefficient and Volatile by Nature with Exploitable Alpha due to Liquidity Issues
- 5) Often Out-of-Sync with Peer Funds and May Exhibit Price Swings Over Time
- 6) Primarily Yield Oriented, Total Return Vehicles

# Closed-End vs. Open-End Mutual, Exchange Traded Funds, Unit Investment Trusts and Individual Bonds

	Discount	Trading	Capitalization	Redemption Pressure	Leverage	Active Management	Expense Ratios
<b>CEFs</b>	Yes	Intraday	Fixed at IPO* (except DRIPs, Rights, tender)	None, can make pure investment decisions	Yes, if the fund wishes	Yes	Often lower than MF peers. Includes leverage cost
<b>ETFs</b>	No*	Intraday	Creation Unit Redemption	Yes	Only w/ derivatives	Some	Tends to be lowest
<b>Open-End Funds</b>	No	After 4pm post trading	Constant in and out flow	Yes, can force manager to make buy/sell decisions	No*	Yes	Can be higher, many have load fees and 12b1 fees.
<b>UITs</b>	No	No	Fixed	Terms 1+ to 5 years	No	No	Load Upfront 1% to 4%
<b>Indv Bond</b>	Vs. Par	Intraday	Indv Security	N/A	No	No	Wide B/A Spreads 0.5% to 1% per trade

# Who Invests in CEFs?

Investment Company	Number of US Households	Percentage of US Households
Open-End Funds	46.2 Million	39.4%
Exchange Traded Funds	3.3 Million	2.8%
Closed-End Funds	2.1 Million	1.8%
All Mutual Funds	51.6 Million	44%
Total US Households	117.3M	100%

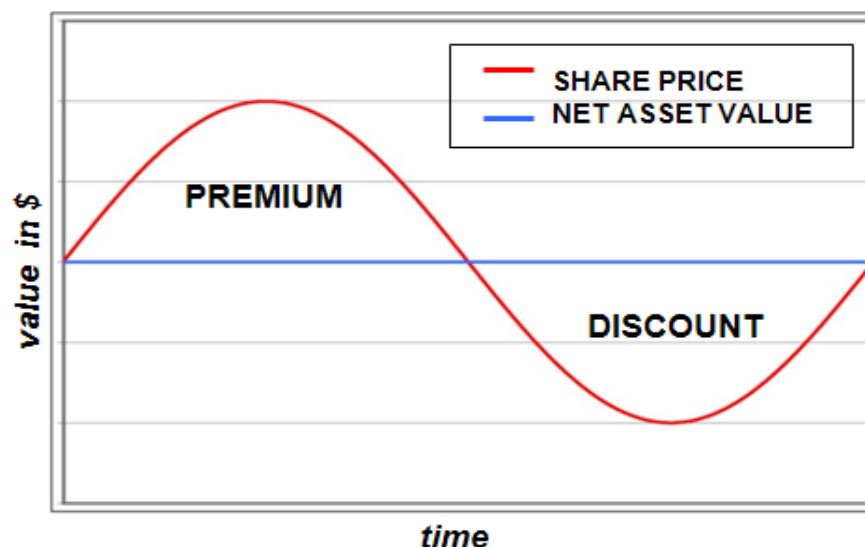
	All US Households	Closed-End Fund	Mutual Fund
Ave Age of Head	49	54	50
Income	\$49,800	\$118,000	\$80,000
Assets	\$75,000	\$500,000	\$200,000
Four Year Degree	31%	63%	46%
Retired	29%	55%	25%

*Source ICI, 2012 Investment Company Fact Book*



# Closed-End Fund Discounts / Premiums

- ▶ CEFs are often known for their *'infamous' discounts*. The discount is the feature built into CEFs that makes them unique & potentially quite lucrative.
- ▶ We believe that CEFs historically trade at discounts because they can, and you have to price this into the value of the fund.



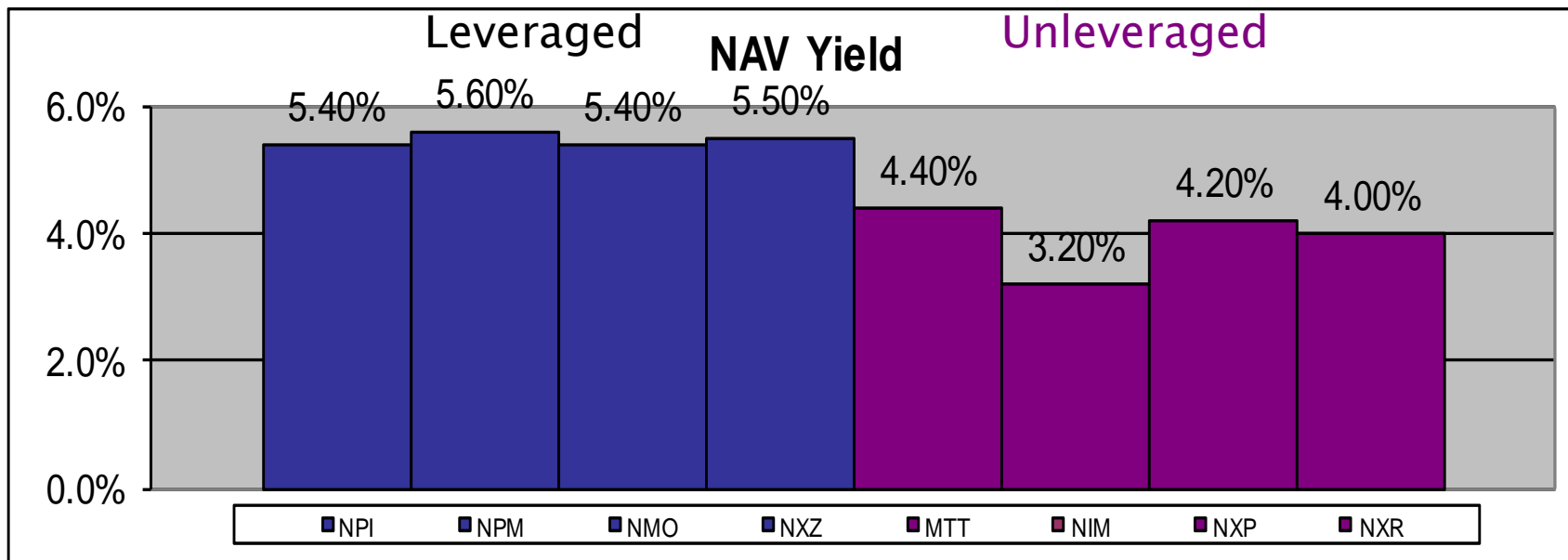


# Impact of Fund Leverage

## Municipal (Tax-Free) Bond Funds

Average: 5.5%

Average: 4.0 %



Credit Quality ranges from A to AAA.

\*Currently leverage is giving these example muni CEFs an average of 1.5% higher distribution yield.

Source: CEFA's Closed-End Fund Universe, September 5, 2014

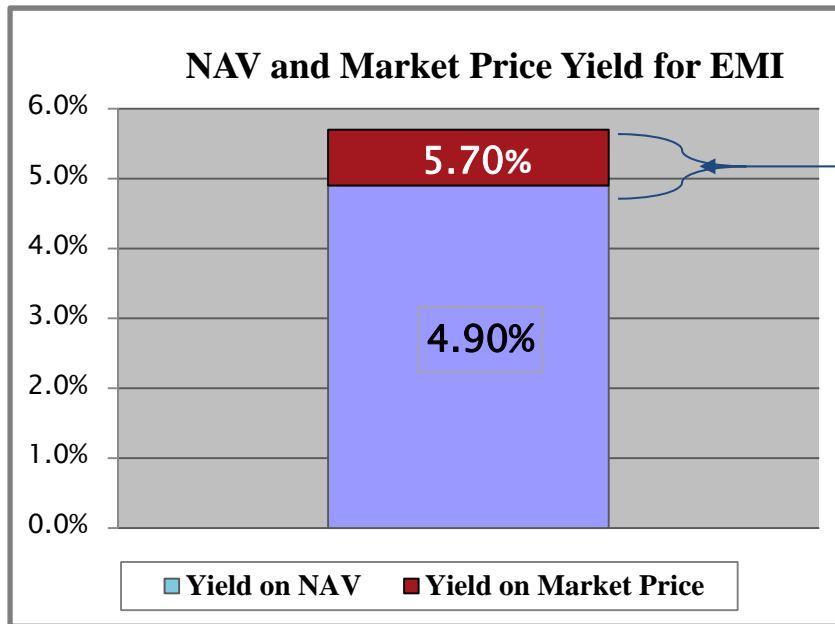
Past performance is not indicative of future results. This presentation is not intended as an offer to sell any of the funds shown. Rather, funds shown are for illustrative purposes only.



# Discount Yield Benefit

## Advantage of Paying “90 cents for \$1.00 of Assets”

Example: EV MI Muni Incm Tr (NYSE: EMI)



Discount Yield Benefit = 0.8%

Market Price: \$12.48

NAV: \$14.43

Discount: -13.51%

As of September 5, 2014

Source: CEFA's Closed-End Fund Universe

Past performance is not indicative of future results. This presentation is not intended as an offer to sell any of the funds shown. Rather, funds shown are for illustrative purposes only.





# Suggested CEF Investment Philosophy

*CEF Investing is a Blend of Income & Contrarian Investment Opportunities*

## Questions to Ask:

1. What has Been Normal for the Fund; Historically or vs. its Peers?
  2. Is the CEF Over, Under or Fairly Valued?
  3. Is the Dividend Level Sustainable and Reasonable for the Sector?
  4. Has the Manager Achieved Good Net Asset Value (NAV) Performance?
  5. Is the Fund Earning its Dividend Rate? Is the Data Stale?
- Is it Reducing its UNII Balance or Adding to It?
  - What is its Leverage Adjusted Duration and Maturity?
  - Which States is the Fund Exposed To, & Credit Quality?
  - Cost & Amount of Leverage, Liquidity and AMT% Exposure?

	NAV St Dev	Mkt Pr St Dev	Mkt Pr St Dev Increase %	Discount St Dev
<b>Equity CEFs</b>	11.7	13.9	18.8	2.0
<b>Bond CEFs</b>	3.9	9.6	146.2	1.7

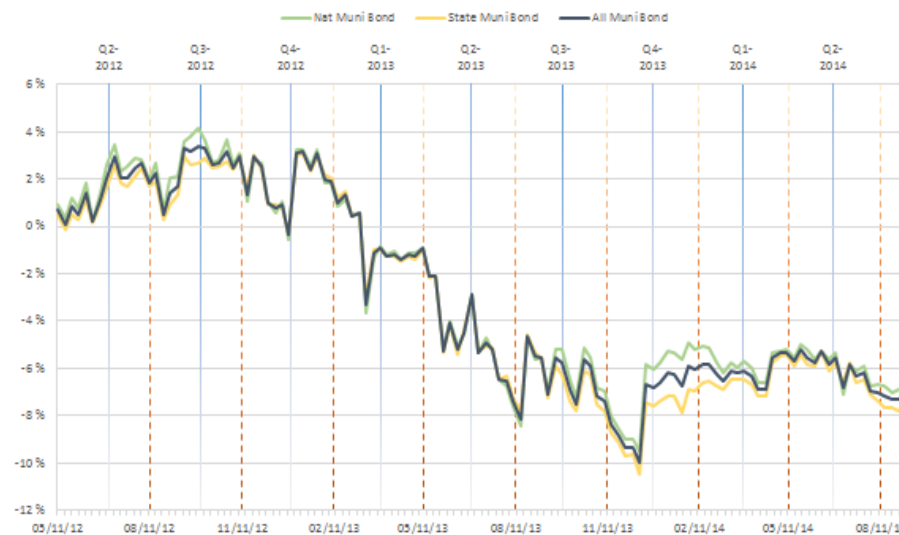
Data as of September 5, 2014 from CEF Universe Data



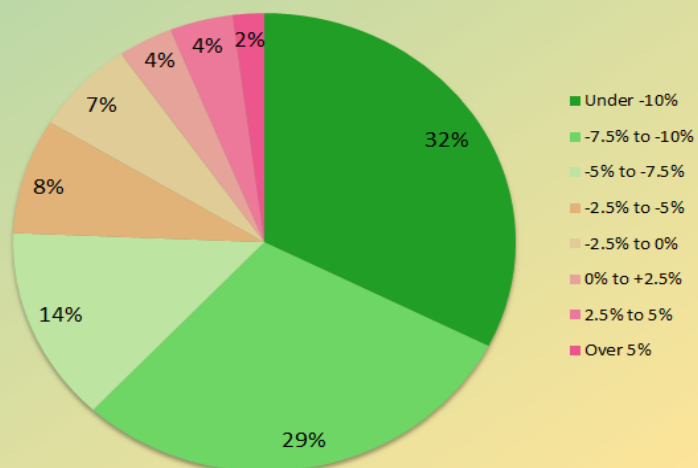
# Municipal Bond Closed-End Fund Universe

	National Muni Funds	Single State Muni Funds	Total
Number of Funds	104	93	197
Net Assets (Total)	\$47,574	\$18,746	\$66,320
Net Assets	\$457	\$202	\$337
Earnings Coverage Ratio %	98.2	98.0	98.1
Premium / Discount %	-6.94	-7.42	-7.16
Total Mkt Yield %	6.05	5.55	5.81
Leverage Adj NAV Yield %	4.28	3.83	4.07
NAV Volatility	3.71	3.55	3.63
Leverage %	31.7	33.6	32.6
Leverage Cost %	0.43	0.56	0.49
Duration	9.78	9.60	9.70
Insured %	22.2	27.1	24.5
Investment Grade %	87	92	89
Credit Quality	A	A	A

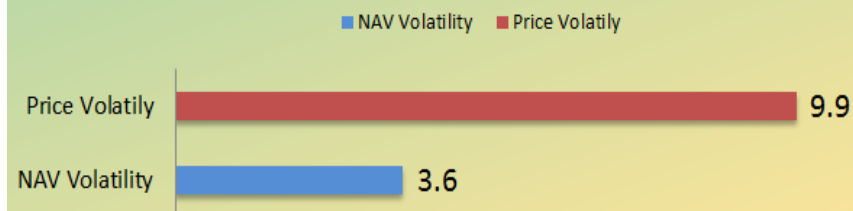
All Muni Bond Groups - Average CEF Discount  
May 11, 2012 - September 05, 2014



Municipal Bonds - Discount / Premium



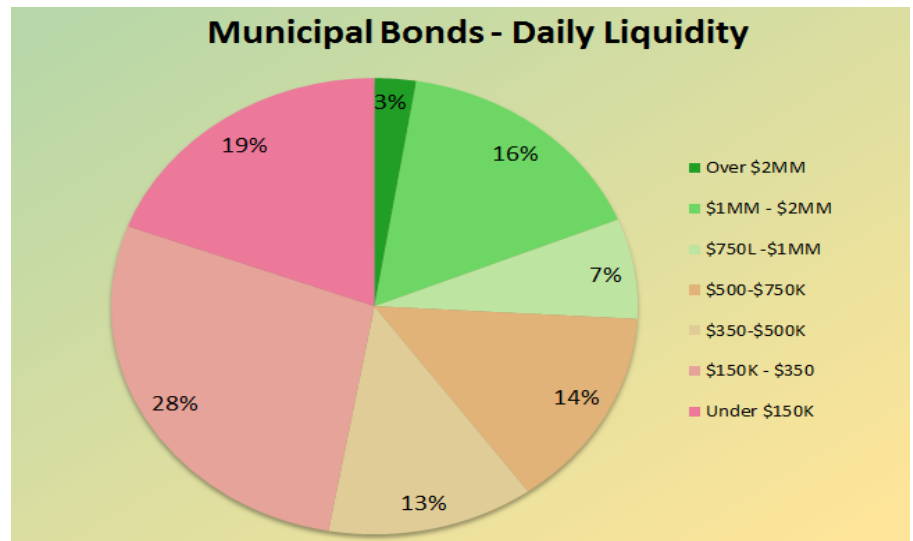
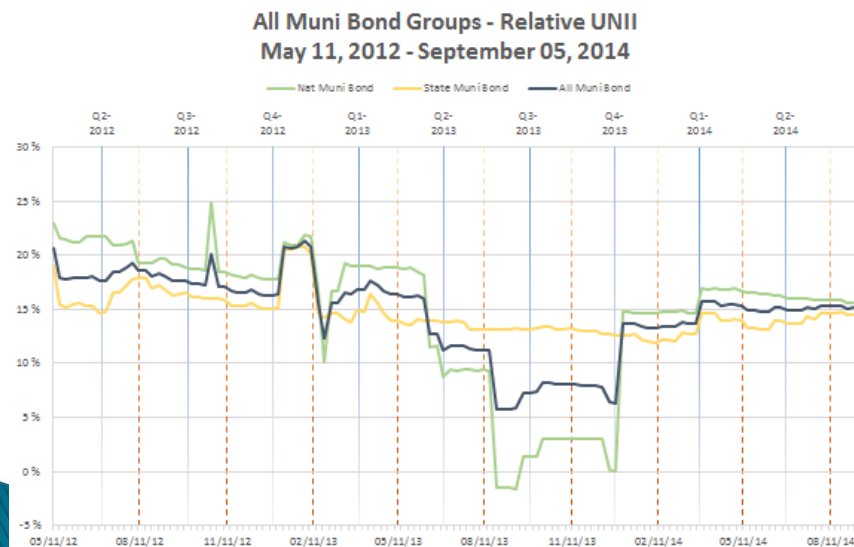
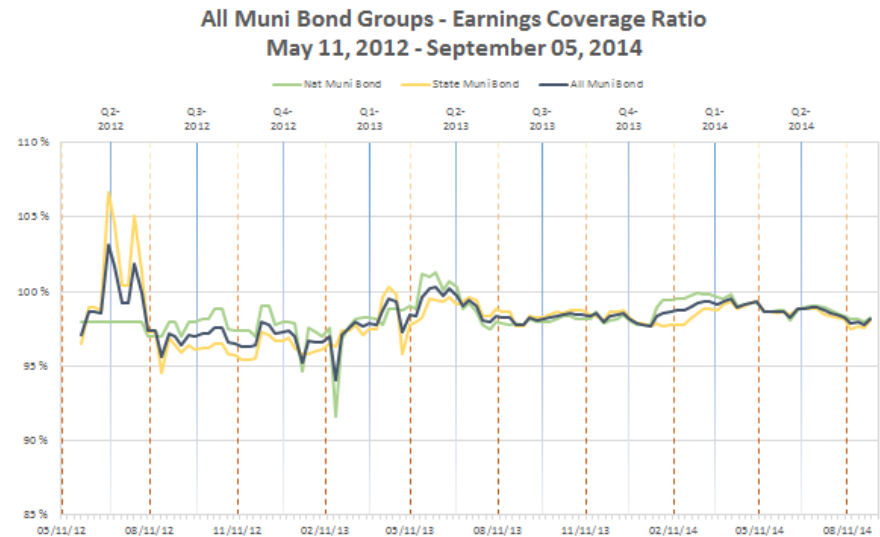
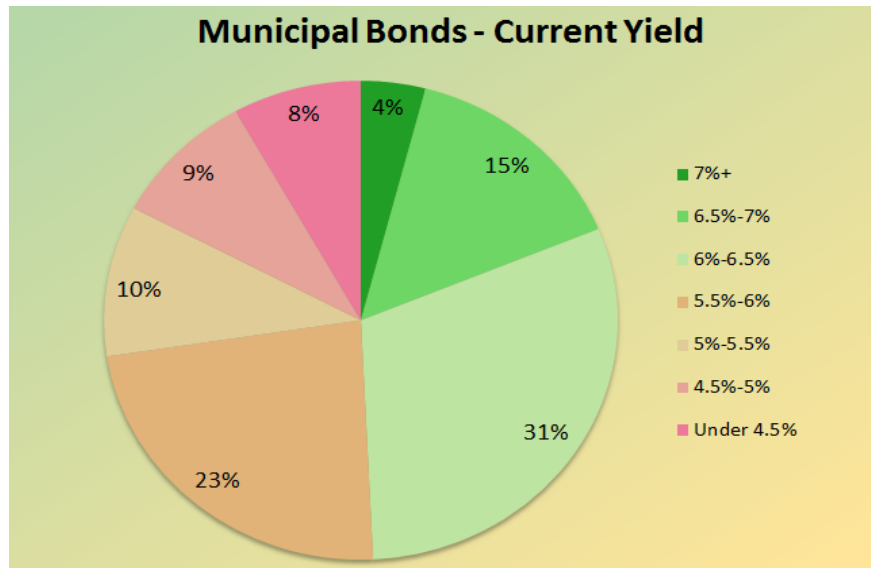
Municipal Bonds Volatility: Price vs NAV



Data as of September 5, 2014 from CEFA's Universe Data



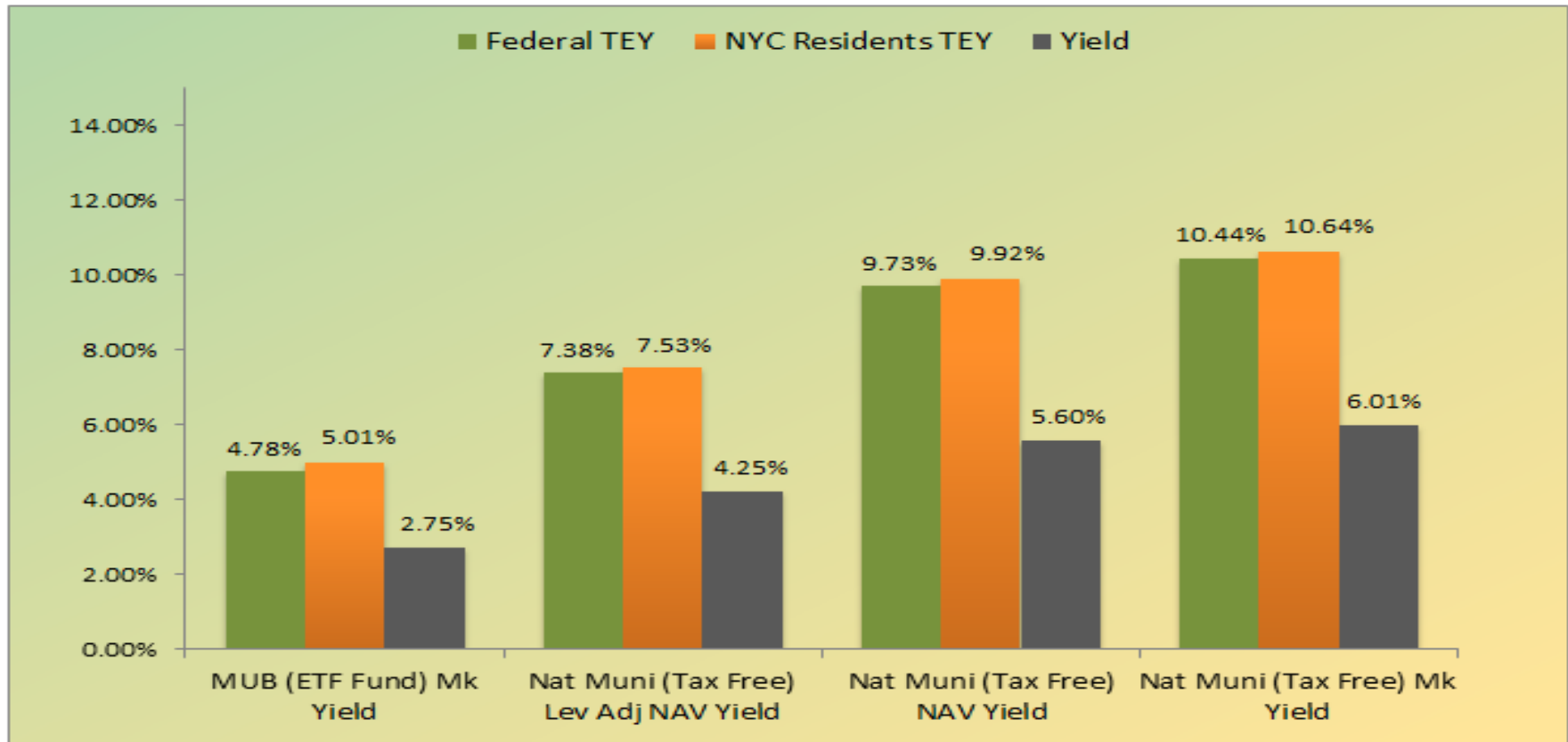
# Municipal Bond Closed-End Fund Universe



Data as of September 5, 2014 from CEFA's Universe Data



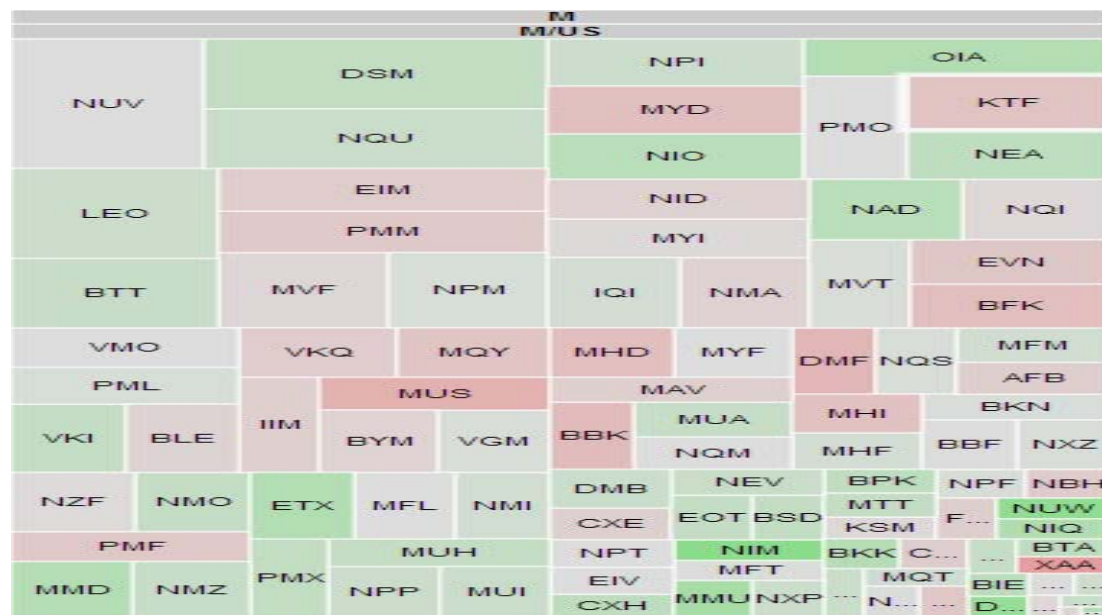
# Tax Equivalent Yield Comparison Married Couple with W-2 Income of \$1MM+



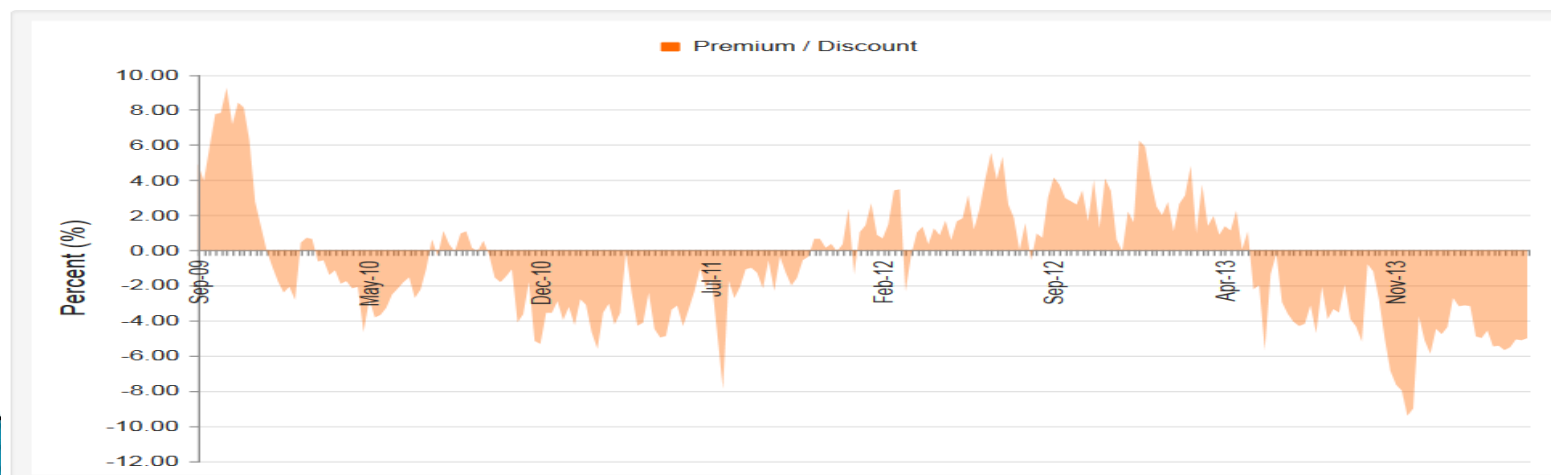
National Municipal Data from CEFU Report Dated September 5, 2014  
MUB Market Yield as of September 4, 2014, closing price.



# Municipal Bond CEF Inefficiency



Premium/Discount Information



Source: <https://cefalyzer.com/treemap>, CEF Connect



# Data Highlights for Muni CEFs

## CEF Based Data

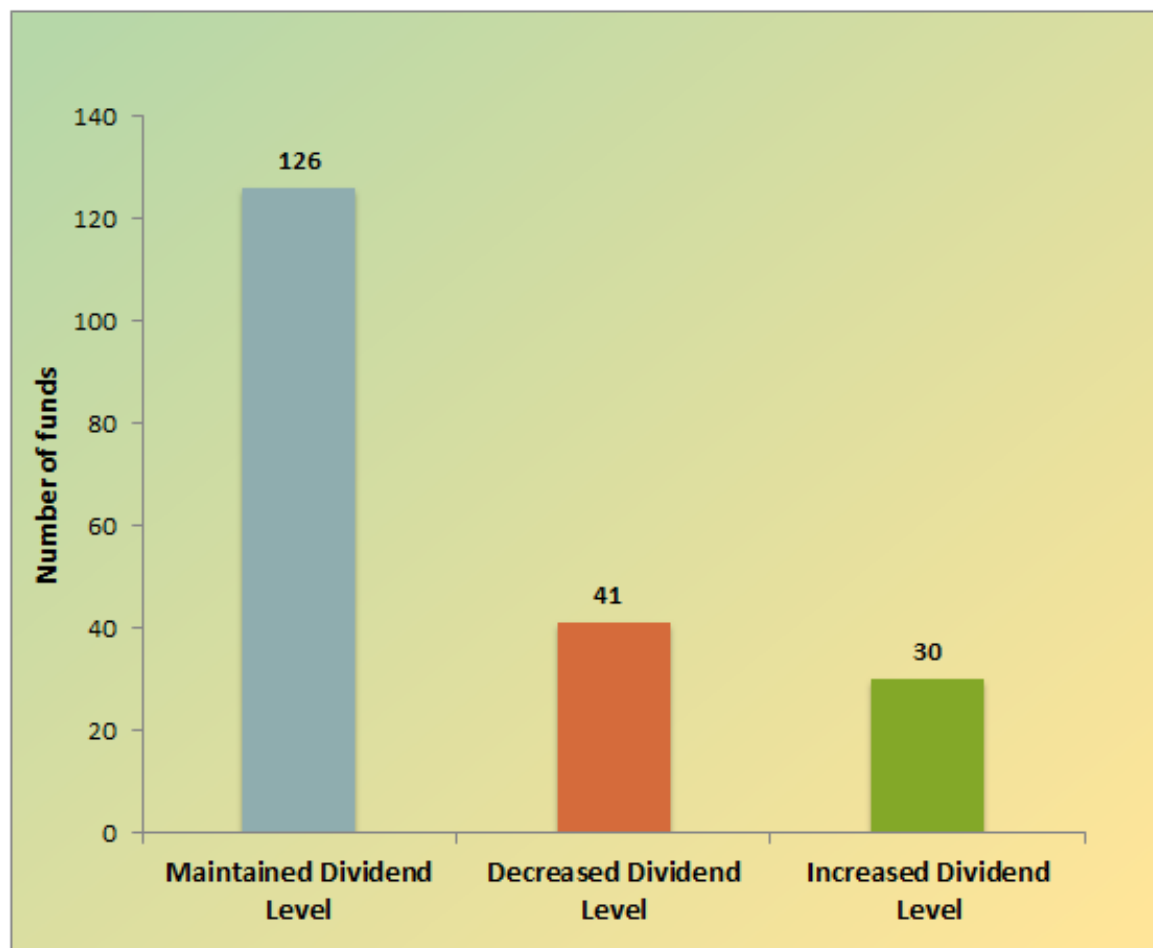
- Current Discount
- Historical Discounts for Fund
- Peer Discounts
- UNII & Trend & Date
- Earnings Coverage
- Lev Adj NAV Yield
- Earnings & AMT Eq Yield
- Leverage Type and Cost
- Liquidity and Correlation
- Short Interest
- Activist Holders & Trends
- NAV and Mkt Pr Correlation

## Fundamental “Bond Data”

- NAV Total Return
- Duration & Maturity
- Credit Quality and State Exposures
- Percent Insured Bonds
- Call Risk
- Avg Pr per Bond and Coupon
- Percent Zeros



## Dividend Levels of Municipal Funds from September 1, 2013 through August 31, 2014



Average Dividend Increase	3.72%
Average Dividend Decrease	-7.21%

*Source: Fund Press Releases*



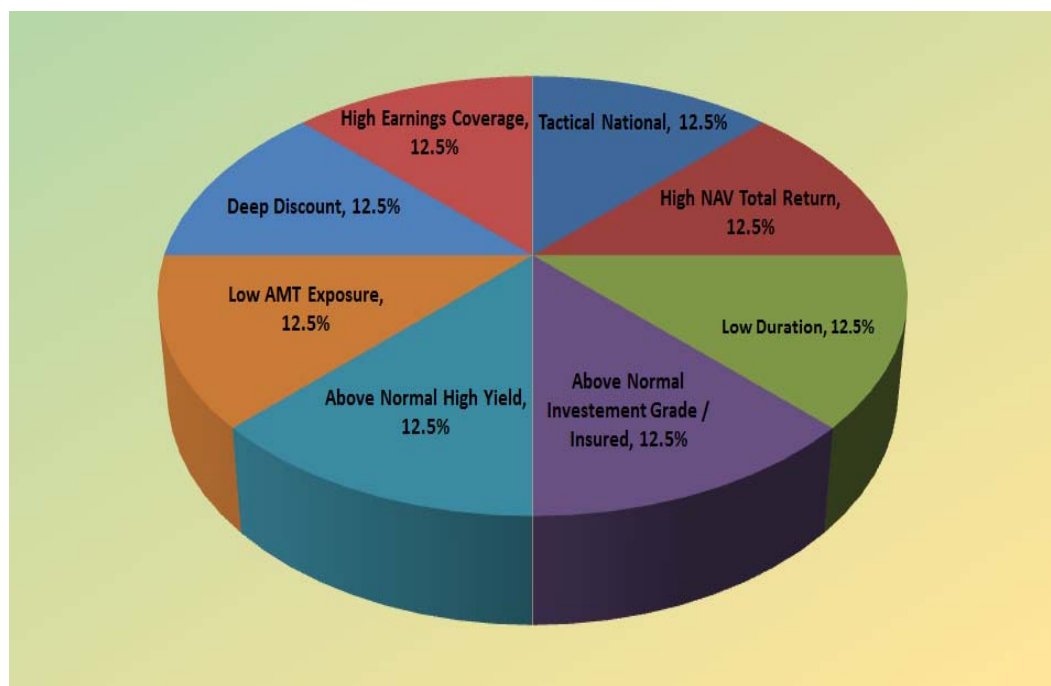
# CEFA's Managed Municipal Bond Portfolio (National)

**Investment Mandate:** To manage a diversified portfolio comprised of eight to twelve municipal closed-end bond funds gaining exposure to top managers and seeking high tax-equivalent yield for high income couples. CEFA's research and management expertise seeks to help reduce the risk of dividend cuts, manage duration and credit risk and attempt to maximize the underlying performance of the municipal bond exposure.

Avg Fund's Data	Percentage %
Disc/Prem	-6.6%
Market Price Yield	6.5%
Earnings Coverage	100.3%
Lev Adjusted NAV Yield	4.4%
NAV Volatility	3.9
Leverage	37.2%
Leverage Cost	0.49%
Duration (Lev Adj)	10.5
Insured Bond	20.1%
Credit Quality	A
Investment Grade	83.7%

Top Five State Exposure	
California	13.78%
Illinois	9.21%
Texas	8.91%
New York	7.07%
Florida	5.74%

## Portfolio Allocation by Fund Classification



Information shown above is from CEFA's current hypothetical portfolio model and does not yet have assets managed in the strategy. Data is from CEFA's Closed-End Fund Universe dated September 5, 2014.



# Sponsor/Manager Diversification, Fee Schedule and Tax Equivalent Yield Comparison (National)

Current Portfolio Fund Sponsors	
BlackRock	
Invesco	
Nuveen	
Allianz	
New York Life	

Fee Schedule (Annual)	
Accounts Size \$1,500,000 to \$3,000,000	0.50%
Accounts over \$3,000,000	0.39%
Min Quarterly Fee	\$1875

Married Couple W-2 Income	Federal Marginal Tax Bracket	Federal TEY	Federal & NY/NYC Marginal Tax Bracket	NYC Residents TEY
\$250K+	33%	9.64%	43.65%	9.77%
\$500K+	41.50%	11.04%	52.60%	11.23%
\$1MM+	42.45%	11.23%	53.55%	11.42%
\$2.5MM+	43.02%	11.34%	54.12%	11.53%
\$5MM+	43.21%	11.38%	54.31%	11.57%

*All data is based on the portfolio's current market price yield of 6.46%, 7.1% NY state exposure and 92.9% non-NY. Federal Marginal Tax Bracket includes the federal marginal bracket and appropriated pro-rated 3.8% tax on income or NII over \$250K.*

For portfolio model allocations, we will generally have one CEF per allocation. Tax Equivalent Yield (TEY) assumptions: married couple with W-2 earned income. For the Federal Only TEY calculations, we used the highest Federal Income Brackets 33% and 39.6%, and the proportional 3.8% surtax on modified adjusted gross income or net investment income in excess of \$250K. Non-tax related data is from CEFA's Universe Reports dated 09/05/2014. Tax related data is from IRS.gov and the New York State and New York City Revenue Department websites. It should be noted that we have reduced our normal fee schedule for this model and increased our minimum account size. The reason is due to total return expectations for a municipal bond only portfolio being lower than CEFA's generally more equity based strategies. An investment in the portfolio model may result in a loss.

# CEFs in a Rising Rate Environment

From March 1, 2004 to September 28, 2007 30-day Libor rose from 1.0973% to 5.4927% (a 4.40% increase) over a period of 43 months. Below shows how the major CEF groups did on average by both market price total return and the percentage change in yield (cents per share).

Group/Sector	# CEFs	Avg Total Return on Mkt Pr.	% Funds w/ Neg TR Perf	Avg Yield Change %	% CEFs with Dividend Changes
US Equity Funds	30	+37.7%	3.3%	+100.2%*	63.3%
Non US Equity Funds	39	+133.0%	2.6%	+681.2%*	46.2%
Specialty Equity Funds	34	+30.6%	11.8%	+5.65%	79.4%
Taxable Bond Funds	95	+19.3%	4.2%	-2.06%	81.1%
National Municipal Bond Funds	89	+17.1%	2.3%	-18.91%	96.7%
State Focused Muni Bond Funds	93	+12.92%	12.4%	-15.70%	100%
Debt-Focused BDC Funds	5	+31.94%	0.0%	+4.42%	100%
Average Traditional CEF	361	+28.48%	6.4%	-2.50%	97.2%
S&P 500 TR	+42.33% TR				
Barclays Global Agg. Bond Index	+16.96% TR				
Barclays Municipal Bond Index	+13.26% TR				

*Disclosures: Avg. Yield change is expressed in percentage terms. If the yield went from 8% to 7% the calculation would be -12.5%, not -1%. Also the column that shows the percentages of funds with dividend changes includes funds with increases, and is meant to help show which areas of the CEF universe are likely to have a higher number of funds that change their distribution policies.*

*Index Data from Thompson Reuters. CEF data from CEF Universe Data and Yahoo Finance. Over the 43 month period, US CEFs went from yields of 6.1% yields to 8.1% and Non-US CEFs went from yields of 4.9% to 6.1%. Many of the dividends came as semi-annual or annual dividends and were driven by pass through capital gains vs. income to maintain the tax-beneficial status for the fund itself.*

*Past performance is not indicative of future results.*



# Common CEF Mistakes

1. Buying a CEF on the IPO
2. Only buying a CEF at a discount
3. Only buying a CEF because of yield
4. Buying a selection of CEFs and holding them “forever” *(not swapping funds over time)*
5. “I have lost so much, I just want to get back to even”
6. “I have made so much, I am happy with whatever happens” *... (I don't care if I lose 10-15% b/c I am up 70%)*
7. Unknowingly buying a CEF at a high premium or high relative premium





# In Summary:

## Why We Like Closed-End Funds For Munis

- ▶ Total Return (Yield Driven)
- ▶ Diversification
- ▶ Professional Management (5+ managers)
- ▶ Leverage Used by Fund
- ▶ Leverage of The Discount
- ▶ Control: *Limit & Stop Orders*
- ▶ Fixed Capitalization: *No Redemption Pressures*
- ▶ Capitalize on Market Inefficiencies
- ▶ Little Institutional Ownership / Mostly Retail (8% for Muni's)
- ▶ Investors can't use margin on Muni income and keep tax benefits. Avg CEF leverage cost inferred at 1.43%.



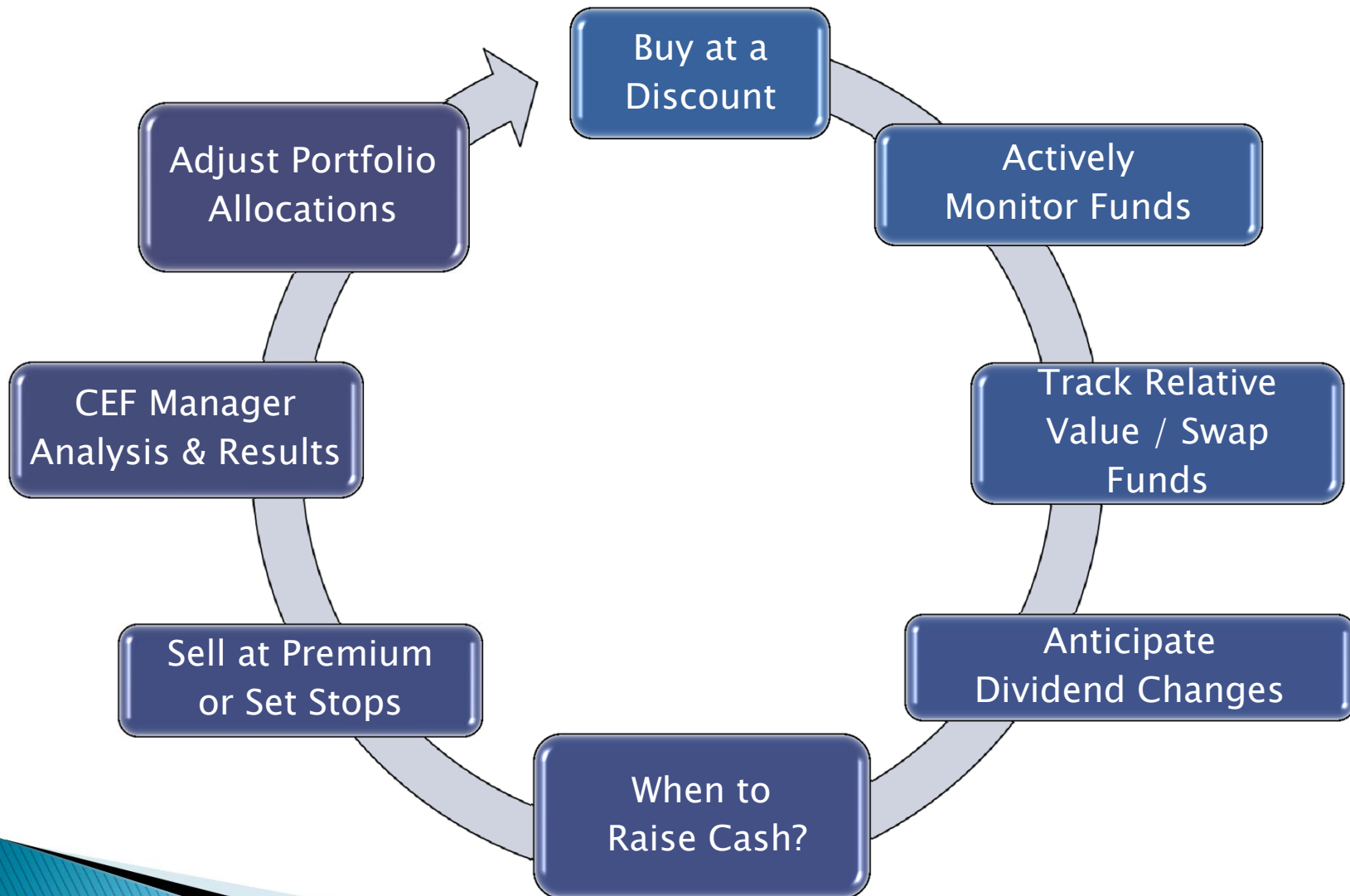
(According to our CEF Universe data from Sept 5, 2014)



# Review

- ▶ CEFs allow you to enhanced the yield on underlying municipal securities.
- ▶ Due to discounts and leverage you can potentially get above 9% tax equivalent yields for high income couples.
- ▶ You can hire CEFA as a manager, buy access to our data, news or Best Ideas List, or do it yourself.
- ▶ Why not build a portfolio with better than peer-average: *discounts, yield, duration, earnings coverage, investment grade percentages?*

# CEFA's Investment Philosophy



# Closed-End Fund Advisors (CEFA):

- 1) Has the Experience and Resources to be Successful in CEF Research and Trading for 25+ years.
- 2) Nimble Enough to be Tactical with AUM of \$105+MM
- 3) Portfolio Manager with 13+ years experience at the firm and under 40 years old.
- 4) One of the Few CEF Specialty Firms; the Only One, to our knowledge, with Self Sourced Comprehensive Data & Research Services.
- 5) Blends Fundamental Market & Economic Research with Data Driven Analysis.
- 6) Adjusts Model Allocations and Fund Exposure Based on Active On-Going Research.

# For Your Information

## Free CEF Resources



The Closed-End Fund Association: [www.Closed-EndFunds.com](http://www.Closed-EndFunds.com)

CEF Connect (Nuveen Sponsored): [www.CEFconnect.com](http://www.CEFconnect.com)

Morningstar's CEF Site:

<http://www.morningstar.com/Cover/CEF-Closed-End-Funds.aspx>

CEF Analyzer: <http://CEFanalyzer.com>

Investment Company Institute: [http://www.ici.org/research#fact\\_books](http://www.ici.org/research#fact_books)

CEFNetwork (Pristine Advisers): [www.CEFnetwork.com](http://www.CEFnetwork.com)

CEF Insight (Activist Info from AST Fund Solutions): [www.cefinsight.com](http://www.cefinsight.com)

Capital Link's CEF Portal: <http://cef.capitallink.com/>

Morningstar Discussion Board (78K+ posts since 1998):

<http://socialize.morningstar.com/NewSocialize/forums/100000006.aspx>

The CEF Network on LinkedIn (1225+ Members): [www.CEF-Network.com](http://www.CEF-Network.com)

Seeking Alpha: <http://seekingalpha.com/articles?filters=closed-end-funds>

More Useful Links at: [www.cefadvisors.com/investRes.html](http://www.cefadvisors.com/investRes.html)

# Appendix 1: Portfolio Manager Bios

## **George Cole Scott**

*Sr. Portfolio Manager, President of Closed-End Fund Advisors*

George's investment career started in 1969 when he joined a regional brokerage firm after a career as a journalist. In 1976 he helped a client buy control of a deeply discounted CEF which became Bergstrom Capital (AMEX: BEM). He served on the board of the fund for 27 years. In 1987 he founded *The Scott Letter: Closed-End Fund Report* which was a well regarded print newsletter ending the publication when he became a shareholder of CEF Advisors in 1996. In 1991 he co-authored the only hardback book on CEFs with a finance professor. He is a graduate of The University of Washington, holds the FINRA 66 License and is a long time member of The CFA Society and CFA Virginia. He has been widely published and interviewed. He has also worked with various closed-end funds on a consulting basis. George is one of a few CEF specialists with more than four decades of CEF experience .

## **John Cole Scott, CFS**

*Portfolio Manager, Executive VP of Closed-End Fund Advisors*

John has worked at the firm since 2001. He sits on the firm's investment committee and holds the FINRA 66 License and the Certified Fund Specialist designation (CFS). He is a graduate of The College of William and Mary and has been quoted widely in the financial press and presented at conferences and for investment groups on more than 30 occasions. In 2008 John founded *CEFA's Closed-End Fund Universe*, a comprehensive weekly data service now covering 165+ data points for the almost 600 traditional US listed closed-end funds and 65+ data point on the 50+ business development company (BDC) CEFs. He also founded and manages The CEF Network group on LinkedIn and is editor of the firm's blog. John is a board member of The Richmond Association for Business Economics (RABE), a member CFA Virginia and serves on the Investment Committee for The New York State Society of The Cincinnati.

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