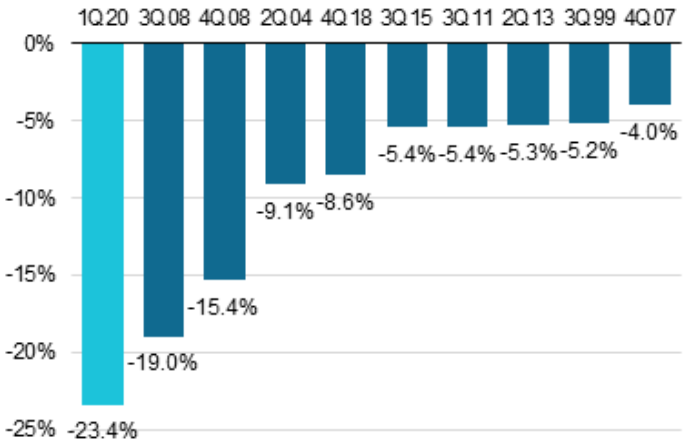
RiverNorth Closed-End Fund Market Review

RIVERNORTH®
Q1 2020

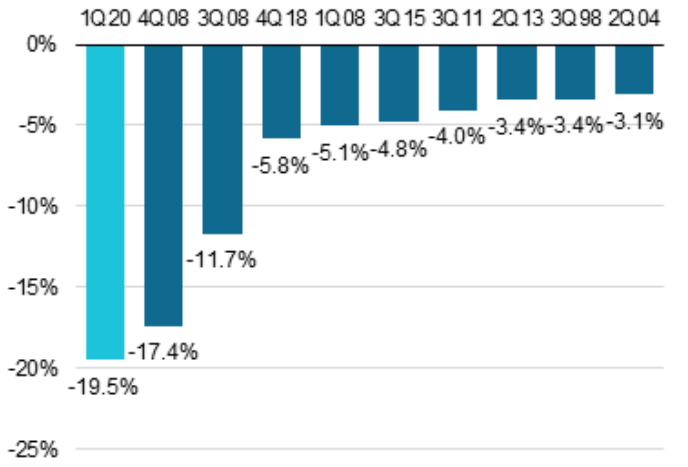
- Global fears surrounding the health and economic consequences of COVID-19 lead to extreme price declines in most major asset classes during the first quarter.
- Closed-end funds (CEFs) recorded their worst quarterly total return, measured on both market price and net asset value (NAV), in over twenty years.
- CEF discount averages hit a trough on March 18th at the following levels — All CEF (-21.27%), All Equity CEF (-20.02%), All Taxable Fixed Income (-23.21%) and all Municipal (-19.50%).
- Discounts of this magnitude have only been seen for a few days in the third quarter of 2008.
- Discounts narrowed over the last ten days of March but still finished the month near the 90th percentile of wideness.

Worst 10 Quarters by Price Total Return



Past performance does not guarantee future results. Data shown is for the Morningstar All CEF Peer Group. Source: RiverNorth Capital Management, LLC, Morningstar, Inc.

Worst 10 Quarters by NAV Total Return



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The most distinct feature of this bear market in CEFs is the velocity of the decline. Sure, the magnitude is noteworthy too, but the velocity makes this market unique. With the world economy shut-down due to self-quarantine, there was no debate that the world economy would enter into a recession and therefore capital markets repriced to this recessionary outlook with great speed and intensity. In the past, recessions have been forecast by some, but a bearish consensus has rarely been reached so quickly.

The velocity of this market decline wounded many (and nearly killed some) CEFs. We are referring to the permanent loss of capital due to deleveraging. More than three-quarters of CEFs use leverage. The type and amount of leverage vary by asset class and fund sponsor, but most taxable bond funds have (had) 30% leverage and muni bond funds have 40% leverage. There are also sector equity funds that use leverage. The sell-off in March caused many taxable bond funds (e.g. high yield bond and bank loan) to deleverage and sell some assets near the lows. To be clear, a permanent loss is never good, but the magnitude of the loss for most taxable bond funds was manageable at less than 5% of capital – we call that wounded. In contrast, some sector equity funds, infamously master limited partnership (MLP) CEFs, were nearly killed by the velocity of this market decline. At quarter-end, the average NAV for MLP CEFs was $3.17 – many had become penny stocks. The permanent losses for this group vary widely, but in each case, the losses are unprecedented.

In our view at the time, the playbook for trading CEFs was not December 2018, February 2016 or May 2013, it was September / October 2008. We could see that prices were down and discounts were extreme. However, we wanted to avoid as best we could, the permanent losses of capital. Therefore, instead of buying large baskets of closed-end funds – i.e. the “blood in the streets” trade – we were much more focused on select groups. We favored funds with lower NAV risk, more flexible capital structures (i.e. funds utilizing more non-40 Act leverage) and obviously funds with low to no leverage. We also prioritized liquidity, focusing on larger funds, to preserve our option to sell quickly. We believe this was the most prudent way to capitalize on the volatile opportunity. That said, this approach limited the amount of CEF exposure we could add.

The sell-off has also created opportunity in the business development company (BDC) market. Although we believe many BDCs will struggle to survive this recession, there are a handful of market leaders with investment grade balance sheets whose stocks have been trading at attractive valuations. We also like the debt issued by some of the larger BDCs.

In summary, the CEF market is much cheaper today than it was at year-end. Asset classes are certainly cheaper – lower multiples and wider spreads. And the CEF wrapper that owns those asset classes is trading at a discount in the 92nd percentile of attractiveness. We cannot forecast future NAV returns, but we do believe that wide discounts may narrow and generate alpha for CEF investors. We believe that CEF volatility should continue. For example, it’s easy to imagine 2020 as a banner year for tax-loss selling.

As always, we welcome any questions regarding the CEF market and our strategies.

Risk Information:

The price at which a closed-end fund trades often varies from its net asset value (NAV). Some funds have market prices below their NAVs - referred to as a discount. Conversely, some funds have market prices above their NAVs - referred to as a premium.

Investing involves risk. Principal loss is possible. Past performance is no guarantee of future results. Diversification does not ensure a profit or a guarantee against loss.

Definitions:

Alpha is a measure of performance on a risk-adjusted basis. The excess return of a fund relative to the return of the benchmark index is a fund's alpha.

Master limited partnerships (MLPs) are a business venture that exists in the form of a publicly traded limited partnership. They combine the tax benefits of a private partnership—profits are taxed only when investors receive distributions—with the liquidity of a publicly-traded company (PTP).

Business Development Company (BDC) is an organization that invests in small- and medium-sized companies as well as distressed companies. A BDC helps the small- and medium-sized firms grow in the initial stages of their development.

An investor should consider the investment objectives, risks, charges and expenses of the Fund (or of the Investment Company) carefully before investing. To obtain a prospectus containing this or other information about the Fund, please call 888.848.7569 or download a PDF version from rivernorth.com. Read the prospectus carefully before you invest.

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