Chris Lakumb

So today we'll be talking about the five RiverNorth MacKay Shields municipal closed-end funds. And just as a refresher, those ticker symbols are RMI, RMM, RFM, RFMZ, and RMMZ. Given the similarities across the funds, the strategies, portfolios, etc., we tend to discuss these as a group. But if you'd like any information specific to one of the funds, we have a dedicated website with all the details, fact sheets, literature, regulatory filings, etc., for each fund individually. So with that being said, I'm going to kick it over to Chris Roberti. And Chris, why don't you give us an update on what's going on in the municipal market overall?

Chris Roberti

Sure. Thanks so much, Chris. Pleasure to be here. So let me just first briefly touch on 2023 on the heels of a tough 2022. 2023 ended up being a little bit of a mix of a number of things. The first six months, definitely lackluster if you look at last year, somewhat flattish to down. Then a very weak third quarter, actually, in October, as a lot of those 2022 dynamics sort of returned in terms of rate volatility, etc. And then November and December were incredibly strong. Some of the hugest rallies we've seen in our marketplace, really, since the beginning. And so, it was good to see the fourth quarter have a nice turnaround. Focused a little bit more on the fourth quarter, the investment grade index was up around 7.89%, big number for just a quarter, where major market indices actually ended up in positive territory for the year because of that two-month cycle.

If you look at some of the key variables for the fourth quarter, economic indicators really pointed to higher growth, leading to October rate volatility. This really reversed itself a bit as some of those indicators began to weaken, really leading to a fixed-income rally for the rest of the year, more specific to munis in terms of additional contributors to the marketplace. Adding to a strong quarter, you had seasonal supply which tends to dampen down a bit towards the end of the year during the holiday season. Couple that with a strong technical through reinvestment of municipal bond principal and income at a very high volume. End-of-the-year cycle, lots of bonds coming due in terms of principal and income looking to reinvest in the market. So that was very, very supportive in the marketplace.

More specifically, looking at just overall portfolio positioning, some themes in the portfolios, things that worked out really nicely. Having a longer yield curve positioning worked out very nicely. You had a 90-basis-point rally on the long end of the curve, so that worked out very nicely. Security selection in areas like transportation, Illinois played out well as bonds rallied. Coupled that with some better than maybe anticipated credit upgrades in the Illinois space over the year. Some of the things that may have detracted a bit or did detract a bit, the Treasury hedge, because rates rallied and having that hedge ended up being a bit of a detractor. And also being underweight, healthcare. Not so much a credit story, but more that these tend to be longer-duration bonds, which duration was your friend in the fourth quarter.

Chris Lakumb

Great. Thanks, Chris. That's a good recap of the overall market environment. Steve, why don't we kick it over to you to talk about the muni closed-end fund space and that component of the portfolios?

Steve O'Neill

Sure. Yeah. So it's been a pretty terrible two years for closed-end fund investors. And allow me to go back those two years just because the magnitude of the decline is just so interesting. If you look back two years, even with the rally that we had in the fourth quarter, which for munis was 13%, so muni closed-end funds were up 13%. They outperformed the overall market that Chris referred to. And so even though the muni closed-end funds were up 13% in the fourth quarter, they're still down 20% in the past two years. And included in that 20%, you've got 13 points of discount widening. And so it's really, okay, I mean, I would say almost impossible for retail investors to truly appreciate. They look at an index, the Bloomberg Muni Bond Index. It's down, call it, 300 basis points in the past two years. But muni closed-end funds again are down about 20 points. And again, that loss comes from levered net asset values and also 13 points of discount widening. And that combination, in our view, has really killed confidence in the closed-end fund market.

So, you asked a simple question, "How's it going in closed-end fund land?" And despite a recent rally, I would say sentiment has really never been worse. We started trading closed-end funds in 2007, or at least I did. And we've got data going back 25 years. But we're in the 99.5 percentile of cheapness. You look across the board, discounts are at 13 to 15 percent. And that is quite wide for what I like to call a Single-A bag of bonds. These are closed-end funds that are highly diversified with reasonable management fees. And certainly, there is leverage in the capital

structure. But these are not esoteric securities. These are out of favor, mainstream. It's a mainstream asset class in an out-of-favor wrapper. And so, it really is quite historic. And so, with that loss, I mean, obviously, we've got a partner here. The team at Mackay had really a great year. I mean, the market was pretty good for muni bonds. MacKay's running a levered muni bond portfolio, so they did really well. And that helped performance overall for the fund.

Truth be told, the closed-end fund sleeve was positive too. But last year, closed-end funds were up about 3.5% whereas their NAVs were up about 8, 8.5. And so you had 500 basis points of discount widening. And I apologize for all the discount versus price talk. But the bottom line was the MacKay sleeve really did well last year, but closed-end funds didn't do that well. They were up, call it, 3.5%. And so when you roll it together, sleeve-- I'm sorry, fund performance, when you combine our two asset classes, yeah, we beat the benchmark, but on a risk-adjusted basis, it wasn't very good because we are running a levered fund. And the NAVs for our strategies were up about 6 to 8 percent, which is just slightly better than the index. And so, again, maybe the bottom line would be we like how we've structured these funds to have closed-end funds and cash bonds. And in this year, specifically, it really helped to have the cash bond part of the portfolio because it helped deliver good returns, helped generate income. Obviously, our sleeve did well, generated income as well. But the closed-end fund part of the portfolio really underperformed here in 2023. And it very much underperformed in 2022 as well.

Chris Lakumb — Thanks, Steve. Chris, why don't we go back to you? In terms of outlook, again, I'll give a plug here. MacKay Muni Managers has just recently released its top five insights here for 2024. So maybe you can weave that into the conversation about what 2024 looks like at this point.

Chris Roberti — Yeah. Thanks a lot, Chris. And anyone that wants to see that in greater detail can go to muni360.com or look for our Muni360 podcast on all the providers. But I think the common question that many are asking is, after such a strong rally in the fourth quarter to the tune of around 7%-plus, is there still opportunity? And the answer is we do think there is. We're still very constructive on the marketplace. There's plenty of runway to do well in terms of capturing a strong income stream in total return. But style of management matters, the vehicle matters, and also part of the yield curve. So, we actually favor the long end of the yield curve. It's steeper. You're capturing more value versus that belly of the curve where there's a lot of passive SMAs (separately managed accounts) and ladders, etc., that are corely there. And it's a richer part of the market, just as an example. Another example would be the Bloomberg Municipal Bond Index is still elevated in terms of yield to worst, right? At the rich levels of 2021, you were lucky to see that at 2%. It's still elevated at 3.4%, so think about the tax equivalent yield on that.

It puts you in the camp, roughly, depending upon your tax bracket, of 5 to 6 percent for an investment-grade mix, not to mention total return potential through active management, which is what we do here. And then also on the credit fundamental side, we talk about credit fundamentals, the health of municipalities. We still believe and have a lot of conviction that credit fundamentals are strong. You had stronger-than-expected collections. Upgrades have outpaced downgrades. I think our market is one where when the casual observer expresses concerns in headline news, it tends to have a knee-jerk reaction. You have less occurrences of positive credit news in the market from a headline point of view. But that, to us, creates opportunity to find value. And the reality is, credit fundamentals, we do think are strong. And issuers have a great deal of flexibility. They're resilient. They can raise revenues and cut expenses.

And then finally, the last piece is tax policy. Now that we have a bit of a calmer tone in the market a bit, there's less turbulence, we think investors will start to refocus on the tax-exempt nature of munis, tax-free income, right? With the notion of money-market investments, so much money sitting there, there's a huge tax bill to be paid that I think will create some sticker shock and lead to a refocus on tax-free income for many clients. The Tax Cuts and Jobs Act expires in 2017-- I'm sorry, the Tax Cuts and Jobs Act of 2017 expires next year, not this year. But even though it's next year, we think a lot of clients will get ahead of that-- will get ahead of that and start to refocus, again, on taxes. So that's really what we think will help to be yet another tailwind for munis. Volatility is probably not over, but we do think the message really is there's still opportunity using active managers if you're in the right part of the curve and sort of managing credit appropriately.

Chris Lakumb

Thanks, Chris. Maybe to go back to Steve, you made a comment about investors asking. And Chris, this is the comment you made, investors asking, like, "Hey, given the strong performance of Q4, how has that impacted the opportunities going forward?" I think the same could be said of the closed-end fund space. It was a pretty solid Q4, mainly driven by November, December. Steve, what does that mean for the closed-end fund outlook going forward as it relates to specifically discounts?

Steve O'Neill

Yeah. I mean, look, the muni market bounced back in the fourth quarter. Closed-end funds bounced back. But I mean, closed-end funds have just an enormous runway from here. When you asked me about the closed-end fund market, I was pretty negative. And it really was bad in the last two years. But that's in the past. And I think the portfolios now are really positioned to outperform. And so, the question is, how do we come back? How do we outperform from here? I think a lot of that's going to come in the RiverNorth sleeves, so what do we do about that? We've got to increase our closed-end fund exposure. And that's what we did, in part, in September and October. We worked with the MacKay team to pull more money into our sleeve, buy more closed-end funds, so that when discounts do bounce back, we can make more money on the way out than we lost going in. I think that's an important part of kind of our forecast for outperformance.

Now, when will discounts narrow? That is really hard to say. Frankly, when I think about what drives discounts, let me kind of list a couple of things and kind of just point out that it hasn't had an impact yet. I mean, we've seen a market rally, which discounts typically follow performance, but they haven't. We've got rate cut expectations priced in the market, which would usually help a levered closed-end fund, but they haven't. We've seen a number of large closed-end fund sponsors raise their distribution, essentially returning more capital at a discount. That's certainly a positive, but it hasn't had an impact. Some investors worry about leverage in the closed-end fund market, which can be troublesome at times, but now is not one of those times. The market rally really helped most closed-end funds delever. And you've also got heavy institutional accumulation. You've got hedge funds activists pushing closed-end funds to narrow the discounts.

So, you kind of have gotten everything you could hope for as a closed-end fund investor, but discounts haven't moved. In fact, discounts are the same as they were before the bond market rally and all those other factors that I listed off. And so, when we talk about outperformance and what we expect, we've got to be honest to say that we don't know when discounts will narrow. There is certainly a bit of waiting that we need to do. But I kind of go back to my earlier comment. This is a mainstream asset class in an out-of-favor wrapper, but that wrapper won't always be out of favor. There's going to be a-- there's going to be a period of time where kind of the overall-- within the broader capital markets, the yield curve normalizes. I think the CEF yields in the marketplace now will begin to shine, and investors will come back to the space.

And so, when we talk about our opportunity set, we've already kind of set the table. We've done a lot of work in the past year. I know our partners at MacKay have as well. We've increased our closed-end fund exposure. We've harvested almost every loss in the portfolio. We're putting on closed-end funds with high yields today. Certainly, our partners at MacKay are doing the same thing, rotating the portfolio, putting on high book yields. But again, when we think about these portfolios, our view is that the alpha that is embedded in the closed-end fund space, investors haven't even felt yet. I mean, we were a drag on performance last year in a big way. I think just kind of normalizing back to typically wide discounts is a big boost from here. I mean, we are really at the bottom of the barrel, couldn’t care less about levels of discounts. And I think if we can get some momentum, just kind of continued positive sentiment towards putting money to work, locking in some rates, our expectation would be that discounts could narrow quite a bit. And again, we have a good base. We've increased closed-end fund exposure. But we might look to increase closed-end fund exposure further if we start to see a trend in the market. And so, again, hard to know when that's going to happen. But I think from a positioning standpoint, it really hasn't looked any better to own closed-end funds than it does today.

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