RIVERNORTH

RiverNorth Market Perspectives: CEFs & BDCs | Transcript

ALLEN WEBB

Welcome, everybody, to RiverNorth's October Investment Team discussion about the current state of the markets we invest in. My name's Allen Webb. I'm head of Institutional Investor Relations, and I'm very excited today to be joined by three senior members of the RiverNorth Investment team. We have RiverNorth CEO and CIO Patrick Galley. We have RiverNorth Co-PM Steve O'Neill, and PM and Senior Analyst Jon Browne.

Patrick, maybe to kick us off, for those that are not as familiar with RiverNorth or haven't listened to us chat, since this is a little bit of an unusual production for us, maybe you could give us a little bit about the firm, AUM, expertise, things that you think will be relevant to viewers of this discussion.

PATRICK GALLEY

Sure. Sounds good. Thanks, Allen. And thanks, everybody, for joining us on what we hope to be many future RiverNorth podcasts. But for those that are not familiar with RiverNorth, think of us as a niche investment manager focused on inefficient investment vehicles. For the past 20-plus years, RiverNorth has been focused on trading closed-end funds. So not to be confused with non-listed, drawdown, private equity closed-end funds, but these are NYSE-listed closed-end funds.

For those that aren't familiar with closed-end funds, typically they issue a fixed number of shares. So therefore, when they start trading on the NYSE, unlike an ETF or a mutual fund, there's a premium or a discount associated with that closed-end fund. And it differs from the net asset value, the actual underlying value of the closed-end fund. So, for us, for the past 20-plus years, we've been taking advantage of those inefficiencies, which arise in the secondary market of closed-end funds, which typically means they trade at discounts or premiums to their net asset value.

For the most part, we like to, obviously, buy discounted assets, so being able to buy a dollar for less than a dollar. And if that discount narrows, that's a very unique alpha source to us and our investors. So, since 2006, we've created various investment vehicles and wrappers that take advantage of closed-end fund inefficiencies. I like to refer to us as opportunistic investors in this space. So, it's not all closed-end funds all the times, but we have some mutual funds, we have a hedge fund arbitrage strategy, and actually, not to make it confusing, but we also manage eight listed closed-end funds ourselves. All of which typically have a flavor of opportunistically investing in closed-end funds.

And given that the closed-end fund space is pretty diverse by asset classes, there's taxable fixed income, municipal bonds, and equities, we're able to create pretty interesting strategies, sometimes focused, sometimes wide-breadth, on taking advantage of the closed-end fund space as well. We're about 20 people at the firm, based in West Palm Beach and Chicago, and we manage about $5 billion. And excited to kick this podcast off. As Allen alluded to, we've got some great team members with us. Steve O'Neill, who's one of the long-lasting partners and experts. Steve and I have worked together for over 20 years.

And excited to get into the conversation today because it is definitely interesting times, a lot of inefficiencies. As volatility is increasing, there's inefficiencies to be had in the closed-end fund space.

ALLEN WEBB

Awesome. Thanks, Patrick. Great overview. So, Steve O'Neill, we'll kick it off with you, and maybe I'll set the table here for a second. So, we have not spoken to the broad market in this format since the fall all of 2023. And so clearly, if we're here talking about the markets, to Patrick's point, there must be something interesting going on that we want to make people aware of. So maybe you could set the table for us for sort of late August, September, even into October. Broad market activity, and then more importantly, how that filters into the markets that we care the most about, which would be closed-end funds and business development companies.

STEVE O'NEILL

Sure, Allen. Thank you for the question. Man, I can't remember that fall of 2023, but I'm sure we were talking about muni closed-end funds and the abrupt rise in rates and the discount widening that followed. This is similar. This is more of a credit story today. When you think about the closed-end fund market, about two-thirds of the funds are fixed income. And then, of those fixed income funds, it's roughly evenly split between taxable bond and munis. And when we say taxable bond, we're really talking about US corporate credit and mortgage credit within the closed-end fund space.

There's really not any United States Treasury closed-end funds, or very few investment-grade bond funds. And so, when we talk about credit closed-end funds, we're really talking about below-investment-grade US corporate credit. But essentially, similar to the path that Munis took back in 2023, fear started, and then discounts started to widen. And so, when you think about closed-end funds today on the taxable side, last year you could have looked at the space and the average

discount was about 1% for most of the year. And today we're at about 10% discount. And so that's a really big move within the space.

And that 10% discount, I think something like the 97th percentile of cheapness in closed-end funds going back the last 30 years. And what's interesting about this period of time is that net total returns are unchanged to plus 2%, which is hardly a catastrophe. It's certainly disappointing, but it's unique that closed-end fund discounts on the taxable bond space are so wide. Again, we're talking about the 97th percentile going back 30 years. This includes a lot of periods of credit distress, economic problems, default problems in the market. And yet here we are at such wide discounts during a period of time when total returns are actually positive. So, I think that's really interesting and really the defining feature of the closed-end fund market today.

PATRICK GALLEY And Steve O'Neill, just sorry to cut you off, but when you talk about cheapness, I want to make sure the audience understands when we're talking about the 97th percentile of cheapness, we're talking about the discount, right? Not necessarily just market price and total return, but rather where is the discount today relative to where it's historically been. And I think we go back over 30 years to gathering that information. So only 3% of the time have discounts been wider than where they are today. Fair?

STEVE O'NEILL Yeah, that's exactly right. I think it would surprise most people that closed-end funds on average across equities, taxable bonds, and munis typically trade around a 3.5 % discount going back 30 years. Most people are looking for wider discounts, and those are investors such as ourselves. But the closed-end fund space exists to generate a higher yield. And that yield brings investors in. And most of the time, closed-end funds trade close to par. But there are periods of times that are often caused by fear and greed in the broader capital markets, which drive discounts.

And today, I was making the point that the asset class has not been troubled. Think US corporate credit to this point. But yet the discounts on the closed-end funds are very wide. And so, I guess to repeat the point, going back 30 years, if you looked at the taxable closed-end funds in the market, they've only been wider 3% of the time.

ALLEN WEBB Hey, Steve O'Neill, on that point, that 3% of the time, is that COVID, fall of a 08-type periods, or are there other periods for whatever reason where discounts could be this wide? The point I'm making is, is this an environment you would expect to see discounts that wide based on broader market activity, or is this a little bit unusual?

STEVE O'NEILL I think it's unusual. I mean, I guess keep in mind the tail on that distribution, although it has a full 30 years of data, it's pretty wide. And so, the three of us, or the four of us, have certainly seen discounts wider during the periods you mentioned. But those last for kind of a handful of days. You really don't see 15% discounts on average. I think maybe the widest discount during COVID was 16, 17 percent, and that lasted for an hour, essentially painting the close with really wide discounts, and they bounced back the next day. So, the absolute levels of discounts are wide.

But to your question about when these discounts occur, it is unique to have discount widening on taxable bond funds, like what we're seeing today, without economic or default problems beneath the surface. Patrick likes to remind us that closed-end funds certainly follow asset class returns and sentiment towards those asset classes. But a trump card that's often played on valuations is interest rates. And so, even though total returns for most high-yield bond funds are positive, they still have an interest rate component in them. And investors, such as closed-end fund investors in the market, they just have a knee-jerk reaction.

And so, when you see a really weak month like September, where the Bloomberg Aggregate is down 2.5%, high-yield bonds are down 2.5%, that's interest-rate-driven. We really didn't see much credit spread widening during the month. Investors got scared, nonetheless. And so, it's certainly true that historically, if you would have shown me these discounts, I would have said, "Oh, high-yield bond spreads are 500, 700 over, maybe 1,000." I would be surprised. But I guess it's also surprising to see the 10-year move up 30, 40 basis points in a short period of time.

And so that's the part of the explanation, which is discounts are wide because there is capital markets volatility. It happens to be interest rate volatility today. But maybe just to add a quick point on another reason why discounts are wide, when you go from 1% discounts to 10% discounts, that's an additional 10% loss on top of the asset class loss. And so, it's almost hard to imagine the experience of the retail investor or the individual investor that owns these at net asset value. It's a really big loss. And so, you could have something like a 10, 15 percent loss on an asset class that's flat. And that's hard to understand, which creates nervousness, which creates selling, which is part of the discount today.

PATRICK GALLEY Yeah. And just so everybody knows, closed-end funds, for the most part, are owned by retail investors. So, there's approximately 270, 280 billion dollars in closed-end fund assets out there. But the vast, vast majority, by our estimates, over 90%, are in the hands of retail investors. Maybe there was a financial advisor in the middle, but ultimately retail investors. And so, to Steve's point, when you have a loss like that, investors are just concerned about protecting their principal. They're not looking at discounts. They're not looking at premiums. They're concerned about the price moving down. In fact, when there's less volatility, most investors are more focused on the yield, what's the distribution rate?

And that's probably the biggest attractiveness to closed-end funds for investors, is what's that distribution rate. So, when there's volatility, the mentality is protect principal. When there's lower volatility, hey, where can I get the highest yield? And so, we like to say a lot of times, it's not discounts that mean revert, but rather it's yields that are mean reverting. And it's probably worth mentioning to our listeners is that our strategies-- we're talking a lot about discounts and the absolute level of discounts and the cheapness. But really, it's the relative move of discounts that gets RiverNorth excited. And so, we want volatility. We want uncertainty because that gives us trading opportunities to extract that unique alpha. Buy something at 10%, sell it at 5%, buy it again at 12%, hopefully sell it at 4%. So, the more volatility there is in discounts, the better for us to generate alpha. What we don't want is just complacency. If discounts just stay at 10, 15 percent discounts for a very long time, yes, we own a dollar for 85 cents, but there's really no alpha to be harnessed. And again, when I refer to alpha, for those that understand the Greeks, alpha is just another term for excess return on top of an underlying portfolio. And our alpha source is pretty unique in that it comes from discounts.

ALLEN WEBB Hey, Jon Browne, I'm going to kick it over to you for a second. Steve made one interesting point in there about how the weakness in September was mostly taxable fixed income or credit-driven, yet the catalyst for that was interest rate movement, interest rate volatility, the rise in rates, change in Fed policy, all those types of things. I, for one, find it interesting that muni closed-end funds, which I would think are mostly or more tied to interest rate movements due to their long-duration posture, would have seen wider discounts and poorer performance in September. Can you talk a little bit about the changes in muni closed-end funds and why they don't look as, at least statistically, interesting from a valuation perspective as maybe taxable fixed income does?

JON BROWNE Yeah. No, that's a great point. So similar to taxable fixed income closed-end funds, municipal closed-end funds struggled in September. I mean, I think most people have probably seen the headlines where cash muni bonds had their worst monthly returns since 1987, where I think we saw rates start the year around 7.5 and spike to around 10%. And so, cash muni bonds were down a little over 4%, and municipal closed-end funds were down right around 10% for the month. And so, part of that was the net asset value move, as we saw interest rates move meaningfully higher. We saw Fed increase rates. NAVs got hit, but also, we saw discounts widen pretty meaningfully as well. So, we saw discounts widen a little over 3% on the municipal bond space. Now, that was coming off of a fairly narrow base. And at the end of August, municipal closed-end funds, as a universe, was trading at around a 1.5% discount. And so, 3% of widening took these out to around 4.5% discounts, which that move in one 30-day stretch is pretty significant. But you would maybe think that those discounts should have gapped out wider. Well, there's a few reasons why I think they sort of held in there. One, if you just look at the level of rates that municipal bonds are yielding, we haven't seen these types of absolute yields in several decades. And so, when investors are starting to see those high, elevated yields, especially on a tax-exempt basis, we started to see investors come back into the space, whether that was traditional muni investors, whether that was crossover investors, munis had gotten relatively cheap to corporates and other asset classes. And so, I think a handful of different factors played a role in sort of keeping a lid on how wide those discounts got. You flash forward to October, and we saw a lot of strength in the cash muni bond market. We also saw strength in the municipal closed-end fund market. Now, it didn't make up for all of those September losses. But in October, muni closed-end funds were up nearly 6%. So, they recouped a big chunk of that. And that was just investor demand coming back to sort of lock in those higher yields that they, quite frankly, haven't been able to get in years and years. And so, discounts still remain on average around that 5% level for the space, which is around the 60th percentile of cheapness looking back over the last 30 years. So maybe you might say, "Well, at the surface level, municipal bond closed-end funds maybe don't look that cheap from a discount perspective." But I think you really need to dive into the underlying funds on a fund-by-fund basis. We're seeing quite a bit of bifurcation in the space where we see a handful of municipal closed-end funds trading near net asset value. But then we have a laundry list of closed-end funds that are trading at 8 to 10 percent discounts, which are historically around as cheap as they get. And so, I think that in the current environment, while one may look and say, "The overall asset class doesn't look cheap," we are seeing tons of opportunities

that really lends itself to an active management style. And so, someone like RiverNorth, who's looking at municipal closed-end funds on a day-in and day-out basis, I think we really understand that there is an interesting opportunity set still within municipals even though the overall universe may seem to be trading at somewhat average discount levels.

PATRICK GALLEY And Jon Browne, the average duration in a muni closed-end fund, including the leverage because most closed-end funds utilize leverage to enhance the yield, what is that today? Is it around 12, 13 years?

JON BROWNE Exactly. Yeah. It ranges but generally between 12- and 14-years duration.

PATRICK GALLEY So put that in perspective, a 1% move in rates. We're not talking about discounts at all. We're just talking about the muni portfolio as well. You're talking about a 12 to 14 percent net asset value move hit to net asset value. And personally, and I think we could all debate about this, I think that move is just so drastic, given where the 10-year went and how fast rates moved, that the net asset value got hit so fast that the market price could almost not keep up with that net asset value drop. And so therefore, discounts didn't widen out as much. And to your point, though, yields are getting more attractive. And these are tax-free yields to investors. And so that does cause a ballast and a stop for how far discounts can go ultimately.

JON BROWNE Absolutely. And then one last point. I mean, at the end of September, we did see rates sort of stop rising, right? And so, we don't need rates to necessarily come back down for investors to sort of stop panicking and come back to the space. You just need them to stop; those yields to stop rising. But here in October, we've already seen-- in October, we saw yields come down pretty significantly off their peaks. And so, I think that was helpful for retail investors to sort of calm that fear and those flows away from muni closed-end funds and really put a cap on how wide discounts were going to go.

STEVE O'NEILL Jon, I'd add, sitting next to you on the desk, I think it was interesting in September to Patrick's point, the move was so significant that it brought in buyers. But it wasn't just retail investors that were putting capital to work. We saw institutional investors. And you would think that the institutional investors would be buying the 10, 11, 12 percent discounts, but that wasn't necessarily the case. We saw a lot of demand, actually a disproportionate amount of demand for narrow discount closed-end funds, which you might find surprising. Why buy a 3 or 4 percent discount closed-end fund on the market when you can have a well-managed 12 % discount with a, quote-unquote, "larger margin of safety"? And the answer goes back to Patrick's point, which is 90% of the investors in the closed-end fund space are retail. So many institutional investors try to buy the funds that retail investors will come back to. And so, the funds that are trading at narrow discounts have higher yields. They might not be earning it. It's a return of capital. But if you look at the closed-end fund space and you see some munis yielding 6 and some munis yielding 9, there tends to be a lot more demand in the 8 and 9s for those closed-end funds. And so, you actually see institutional investors trying to get ahead of the retail buying. And so, I thought it was just interesting. Again, you had such a huge decline in price. Everything was on sale at the same time, but we saw a disproportionate amount of institutional demand for some of the narrow discounts. And as Jon said in October, those actually became some of the best-performing funds.

STEVE O'NEILL And so, the market is one where, I guess, again, repeating once something that Patrick said, we're looking at discounts, and we certainly have a value bias in our strategies. But there's certainly another component of mean reversion, which is trading around volatility and really just taking on excess supply from retail for hopefully short periods of time and then selling it back when the market normalizes. And that's really what we saw across the space for firms like RiverNorth, but also institutional investors in the space, providing liquidity across the discount range for munis last month.

ALLEN WEBB Hey, Steve, you guys have brought up this point a couple of different ways about the retail ownership in this market, the attractiveness to the retail market of elevated distribution yields. If you move to what would cause retail investors to be excited now about this market, since they're not particularly discount-focused, in our opinion, is it now this even higher yield on a price basis that now attracts retail investors back into the space from the things that they sold in late August, September? What would drive retail back to the market and improve sentiment?

STEVE O'NEILL I think just price stability. Again, it's scary to own something that went from a 5% premium to a 10% discount. That's a 15% loss that's hard to explain. And then you had the NAV decline on top of that. And so that is a scary-looking chart. It's a scary-looking statement. But if things kind of stabilize as they had in October, you could start to see investors come back for the reason that you mentioned, which is yield. The other part of that is you also need distribution stability.

There have been a number of distribution cuts within the closed-end fund space, not on the muni side, but on the taxable bond side, which is a reason why I think investors have been maybe a little bit slower to come back to closed-end funds. They see that high yield, but during a period of fear, you don't necessarily turn on the greed and say, yeah, yeah, I'm ready to buy this 15% yield: you're more worried that it's an outlier that's going to be cut. And so maybe just to repeat the answer, which is I think you need price stability, which we're starting to see, and then you need distribution stability. It's no coincidence that the first or second of the month tends to be really strong for closed-end funds because the boards declare the dividends. Investors say, okay, we've got another 30 days of runway before we have to worry about that today. And so, looking over at my Bloomberg now, you can see some of the highest closed-end funds today, as we're recording on the 3rd of November, outperforming because that distribution risk is at least taken out of the market for a short period of time.

PATRICK GALLEY So, Steve O'Neill, we've had big losses. We have some stability, but now we're also in November. And as we know, as closed-end fund investors for over 20 years, we know that's typically a recipe for what's known as tax-loss selling season. Are you seeing any pressure there for those that are harvesting tax losses? Because obviously, for investors to go through their statements and see the red, they're like, "All right, sell this, harvest tax loss, sell this, sell this, sell this." And frankly, there's a lot of red in client statements today. So usually, you see the pressure in October, November, and December, start to see discounts start to mean revert in end of December. And then I think historically, the average discount mean reversion in January alone is 1.7% plus, and that's on average. What are you seeing today as far as tax-loss selling pressure, if anything?

STEVE O'NEILL Sure. Well, I guess, as Patrick Galley said, we've been doing this for a while. Patrick Galley and I have seen almost 20 years of tax-loss selling. And we often think that August is a time to maybe spend a little extra time at the pool because buying closed-end funds in August is potentially risky ahead of any tax-loss selling. What happens seasonally is that investors, essentially institutional investors, which again, 10% of the market on ownership, but certainly a disproportionate amount of the market in terms of liquidity providing, investors start to pull their bids in August and September. So, it was interesting that the weakest month for munis and whatever it was, 40 years, and the Barclays aggregates had one of its worst months. You had this huge drawdown in a period of time where investors institutionally were, I think, looking at the calendar and saying, "I'd rather wait for October or November." So that actually caused the volatility to increase. But then discounts got to the point where you couldn't wait. I like to say, "Get your portfolio by Thanksgiving and everything from Thanksgiving to Christmas is additional gravy." But this year, you couldn't wait. September presented some opportunity, and it really carried through for most of October. We've seen some relief. I said stabilization, but it's really only been a handful of closed-end funds that have actually been able to narrow in the month of October. And that goes back to Patrick Galley's point, which is, classically, you're not buying closed-end funds in August, September, and October. You're really trying to put everything into November. But that pattern, given that it's repeatable, people start to pull their bids a little bit earlier. And so, I certainly think accumulation has begun.

Just from our seat, I think we're a liquidity hub within the closed-end fund market. We haven't seen a lot of institutional tax-loss selling. We haven't really seen many large prints between closed-end fund traders or across desks, but we did see tons of volume. When I say tons, the closed-end fund market typically trades 600 to 750 million dollars of daily dollar volume. It kind of gets down to maybe 500 in the summer months. But we had a number of days in September and October that were a billion-and-a-half plus. And so, you can see the volume from investors. You can feel it. The equilibrium discount had to widen. And so, yeah, I think it's already happening. Maybe we've seen the lows in discounts because, again, if you think about Patrick Galley's point about January mean reversion, it tends to be a strong month. The end of the year tends to be strong for closed-end funds. And that's not because of the magic of mean reversion. It's that the supply is gone. The watch sale rule passes after 30 days, and people come back to the market, and they put their portfolios together. That demand exceeds supply, and the discounts narrow. And so, it's certainly, I would say, an optimal setup, right? You want your 97th percentile of cheapness to happen in the month of October and November because then you don't really have to wait, right? If it happened in June, you might say, "Oh, boy, I better do nothing until October." But here we have this opportunity here and now to put capital to work. And this might be a question I'm going to get ahead. We're not necessarily saying that investors should take on new risk. I think it's always a relative value. Investors look at asset classes, and they make their own decision on how much risk to take and how that asset class compares to others. But it certainly is a no-brainer to look at the closed-end fund space today and say, "If you've got a high-yield bond portfolio, you're much better owning closed-end funds today." If you've got a muni bond portfolio or an SMA, Jon Browne's got, like he said, a laundry list of names that are much more attractive than the cash bonds of the market. And so, it's just one of those rare

opportunities where you can make a relative value trade and pick up discounts that have moved 500, 10% type of moves, which are really rare.

ALLEN WEBB Got it. Steve O'Neill, while you're on this point, and maybe Jon Browne, you as well, you've touched on this a little bit when you talked about munis a minute ago. I mean, what does stand out across the closed-end fund market today? We haven't talked about equity closed-end funds, there may be a reason for that. Maybe nothing is interesting. But what stands out? One of the most common questions we get after a move like September is investors like us to rank the current opportunity set versus other years. They like us to talk about 7 out of 10 or 9 out of 10 or 4 out of 10 type opportunities, which is obviously always an interesting exercise. But just as we talk here today, how interesting is this, and what is grabbing your attention versus maybe what's not grabbing your attention?

STEVE O'NEILL Sure. I mean, obviously, you would love 97th percentile discounts on top of really cheap asset classes. We've seen that a number of times over our 20 years, but you can't--

PATRICK GALLEY A double discount, right?

STEVE O'NEILL Yeah. A double discount. But you can't control the market, right? You can only make relative value decisions within the market. And so, the way we think about it is every investor, including RiverNorth, has a credit budget. Here's the allocation we want to this asset class. What's the best way to get it? We have funds where we partner with best-in-class fixed income managers. We can ask them to buy the cash bonds, or we pull the capital from them, invest in closed-end funds ourselves. This is certainly one of those times where the asset classes, right, like high-yield 350 over, I'm not saying that's unattractive, but it's not 750 over. But you're able to buy closed-end funds that own that asset class at a really attractive discount. So again, it's a no-brainer from that perspective. And so, I'd say for your risk budget, it's a 10 out of 10 to own closed-end funds versus cash bonds. Is it a 10 out of 10 across 30 years from an absolute return standpoint? No. Not necessarily. I don't think many people would argue that for credit as an asset class. But it certainly is one where, just to be transparent, not only have we utilized closed-end funds to put our credit budget to work, but we've also decided to take more risk. I would say the discounts are so good that you should be tempted to take more credit risk than you otherwise would because this is a unique opportunity.

JON BROWNE Just to add to those points, I think it's also important to note that, beyond just the absolute level of discounts, like Steve O'Neill's talking about, being extremely attractive, I think it's also important, as Patrick Galley stated earlier, to note the heightened volatility of those discounts. And so, with rate uncertainty, geopolitical tensions, midterm elections, etc., a lot of unknowns have created sort of two-way volatility, right, which is what we want to see from retail investors. So, we want to see those discounts moving on a day-to-day basis, and the reason being is that allows us to take advantage of buying from retail on the days that they're fearful and selling their closed-end funds and discounts are widening and turn around, whether it's a day later or a week later, and hopefully sell those back to them. As that short-term fear has subsided and they're pushing prices higher or discounts narrower, we'll sell that back to them. And so, it really is an important source of alpha when there is heightened volatility of discounts that we can take advantage of. But when you couple higher volatility with absolute wide discounts, that really does create a strong sort of forward-looking return-- or I should say opportunity set that we don't see every day. So, I think the combination of absolute wide discounts and higher-- or more volatile discounts is really compelling right now.

ALLEN WEBB Question to any or all of you. Today's November 3rd, midterm elections. How important are things like midterm elections, war in Iran, other types of exogenous factors that can affect broader markets, which then can obviously flow down into the markets we are interested in? Are those on your radar? Are they just curiosities? How do you think about actual events that some people may look at to be market-moving?

PATRICK GALLEY Well, I'll start off. I mean, as I like to say, we're reactive to investor sentiment, right? And so, uncertainty is frankly, unfortunately, a good thing for us, as if there's uncertainty with elections, war, interest rates, inflation, ultimately, that typically creates volatility and discounts, which creates opportunity for RiverNorth to take advantage of and be reactive to that volatility. So that's a good thing. We oftentimes get asked what's the worst market environment for us. Frankly, it's not a 10% drawdown or anything like that, especially if it's coming from discounts, because that usually creates more opportunity. It's complacency, right? When discounts are not moving and, frankly, maybe they're even trading at premiums, like we've seen in the past, that's not a great environment for us. Not a lot to do, and we got to be more-- we're opportunistic investors, and there's not opportunity in those environments. So, I think all that uncertainty creates opportunity for us.

ALLEN WEBB So, in and of itself, those events aren't particularly that important. It's just how important retail investors think the outcome of those things is.

PATRICK GALLEY Yeah. And obviously, we're not smart enough to know how they're going to impact asset classes. I mean, I'm just being blunt, right? We're on the other side of the trade of what we said to be retail investors. And so, if retail investors are going to overreact from a fear or greed standpoint, we're happy to be a liquidity provider: buy more if discounts are widening, selling if discounts are narrowing. So don't necessarily get hung up or have to speculate on how that's going to impact the underlying asset classes our strategies all have some kind of component where we have beta in there. I say beta to these various asset classes or whatever type of investment objective they're trying to deliver. And it's not closed-end fund exposure. And the reason being is when there is an event, we can sell that, I'll call it beta, and buy that beta in a wrapper vis-à-vis a closed-end fund at a wider discount through the closed-end fund wrapper. When it narrows, sell it and rotate that capital back to the beta.

ALLEN WEBB Makes sense. Makes sense. All right. Let's pivot to business development companies for a minute here. A market that we are very interested in shares some of the characteristics of the traditional closed-end fund market. Patrick, I'll pick on you here for a second. Maybe if you could just tell our listeners a little bit about how BDCs differ from traditional closed-end funds, anything else people should know before we kind of talk about how those behaved in September and the opportunity set there, in particular as it relates to the comparison to maybe taxable fixed income closed-end funds.

PATRICK GALLEY Yeah. So, business development companies, first and foremost, they are a subset of closed-end funds. They are a regulated investment company. So, the 1940 Act regulates them just like a closed-end fund. They're typically trade on the NYSE. So, it's a listed product. How they differ is that the underlying assets are typically fair value. These are private credit loans. And listed BDCs have been around for many, many years. Kind of the more popular wrapper more recently has been the non-listed BDC vehicle. We like to buy the listed one. Why? Because when there's times of fear, especially what we've had over the past year, there's fear over credit. What do we call it? SaaSpocalypse and how that impacts the private credit market. When you have a portfolio of private credit loans in a BDC wrapper, it creates opportunity. Oftentimes, BDCs have historically traded at premiums to their net asset value. A lot of that, we think, has to do with the attractive yields with BDCs as their capital structure is levered as well. But again, when investors are more concerned about protecting their principal, they don't care about the yield, and they're selling those assets. And as there's more sellers than buyers, those premiums go to discounts. And as Steve was mentioning before, now you've got investors with losses, and they're like, "Well, I don't like this. Get me out of this." And so, the discounts continue to go wider and wider. So, we could let Steve chime in, but it's a pretty bifurcated space as far as the underlying managers go. But you do have grade A managers managing listed BDCs that historically have traded at premiums and now are at attractive discounts to their net asset value.

ALLEN WEBB Yeah. Thanks, Patrick. Steve is our resident BDC analyst and portfolio manager. Maybe I'll turn it over to you. And if I'm hearing, Patrick, one of the distinctions here is if you buy a traditional high-yield closed-end fund, that underlying portfolio is a portfolio of 100 or several hundred high-yield bonds. Here, if you buy a listed BDC, the underlying portfolio is a portfolio of private loans. So that's just one of the distinctions that people need to be aware about that differentiates taxable closed-end funds and BDCs. That said, what was the experience like-- sorry, Patrick.

PATRICK GALLEY I'm sorry. I'm going to chime in just with one point because you're going down the right path. The other difference is that traditional closed-end funds, their net asset value, the underlying value is priced on a daily basis. So, you know exactly what you're buying on a given day and what discount it is. BDCs are priced on a quarterly basis. And again, those underlying loans, those private credit loans are fair valued.

ALLEN WEBB Got it. So yeah, Steve, did that change the experience for BDC investors in kind of late August, September, or was it sort of similar to the experience of just straightforward taxable closed-end fund investors?

STEVE O'NEILL I mean, it was certainly similar. Both markets started to weaken last fall, 2025. I mean, I think just to maybe continue on Patrick's point, closed-end funds have level two assets, which are priced daily. And when you think about the discount on that, it's only so wide, right? People know high-yield bonds. They own high-yield bonds. They own broadly syndicated bank loans and non-agency mortgage-backed securities. Level two bonds, there's a market for it. There's giant mutual funds that own them. And so, when they trade at a discount, there's only so wide that discount can get because everybody has some form of this allocation in their portfolio across their retirement funds or their PAs. And so closed-end fund discount ranges are plus 20 to minus 20 to the extremes,

whereas BDCs are level three. And so that means the business development company has a valuation policy. There's a third-party pricing service in conjunction with the internal review. And essentially, it's a fair value mark, which doesn't mean it's bad. It just means that it's not market-verified on a daily basis. And so therefore, the range of confidence can be a lot wider.

And so, as Patrick said, BDCs can trade to premium. That tends to be yield-driven. But when they trade at a discount, it's partly because people don't believe the NAV in a way that you can't say that on a large high-yield closed-end fund. The NAV is what it is. And so, I think the discount range is a lot wider. And actually, it's the widest I've ever seen. We've seen closed-end funds trade at 50% discounts. I mean, Patrick and I have been trading BDC since 2008. And I've seen that a handful of times, maybe a day or two during COVID and maybe a day or two in 2016 when oil went 20 bucks, and 2008, 2009. But this is really rare. And I certainly agree the discounts are attractive, and there's a lot of fear in the market. But the other part of it, which I think is a reason why discounts exist, is that the returns have been disappointing. I mean, it's been disappointing everywhere. I think I started by saying taxable closed-end funds are flat for the year. Everybody expected 7 or 8 percent returns. What happened to that? Well, there's credit spread widening and some losses on the underlying bonds. And so taxable fixed income has disappointed investors. And BDCs are no different.

But BDCs, I think, are a satellite. Private credit's a satellite to, I'd say, a more traditional taxable fixed income allocation. And so, people are more sensitive. And it certainly was the hottest part of the market for a while. And so, it just has more eyes on it. But the way I think about it is that private credit was sold to deliver a 10-plus percent return. And now we're looking at ROEs across BDCs and interval funds less than 5%. And so, investors are disappointed. And the question is, why is that happening? Well, interest rates have come down. Base rates have come down. The market's really competitive for private credit still. So, spreads on the new loans have come down. And then you went from a period of no defaults to average defaults. We're not even at high defaults. We're just at average. and so, the 10% returns have been eaten away to 5%. And investors are unhappy and so they're selling. And you see that in the interval funds. There's more sellers than liquidity provided on a quarterly basis. In the closed-end fund space, the market finds its equilibrium when buyers step in. And so again, going back to the competing valuation forces here, one is investors-- most investors don't follow BDCs or follow these managers. And so, they don't really know where to provide a market for a BDC that's down 30%, trading at a 40% discount. They don't necessarily have a strong view of the asset class. They don't have the market verification of level two marks. And so, part of the valuation is uncertainty.

But then the other part's ROE, right? If the BDC is-- best-case scenario now, private credit's delivering 8 to 10% returns, and that's before credit losses. If credit losses are eating away half your return for your average private credit BDC manager, what is the right discount for that, right? You could go buy Meta bonds and make 7%. Why get a bag of private loans to make 5? And so, I think part of the discount just is reflecting the fact that you want a higher return. And so, I think it's interesting. Patrick mentioned grade A managers. There's really a total bifurcation. There's the managers that the market believes will get 10% returns. And those managers are trading great, as if nothing's happening. And then you have the tier two managers, which-- the market is defining them as tier two, where they're saying, "I'm not so sure you can compete with the grade A managers. And so, we have no price for you." And so, I'd say there lies the opportunity. My colleague Jack has a scatter plot which shows ROE and discount. And there lies the opportunity where you say, "Well, this BDC is earning a really competitive ROE. It's not that far off the best ROE in the space. And yet this one trades at 70 cents a dollar or 60 cents a dollar whereas the grade A manager with the very similar ROE is trading at NAV." And I think that's where we're trying to play. We're not looking for big turnaround stories. You could go buy 50% discounts. Maybe not today. Things have bounced back a little bit. But you could have easily bought 45, 50% discounts on dodgy credit funds last month.

But I don't think that's the opportunity. I think the opportunity is really one where you have to have a point of view that, yes, defaults are going to be normal. We're not going back to 0.5% default rates. But even with average default rates, the ROE can be competitive. Maybe you do expect some discount on that. But I think the market is presenting us with an opportunity where there's a handful of names that people trade and care about, and everybody else has just been abandoned. And I think the forward return from here is trying to identify managers and BDCs that will have competitive ROEs that are trading at a discount. So, you can truly say what Patrick Galley mentioned, which is you're buying fear. You're not necessarily buying fear on top of an inferior return stream. You're buying a fair return stream at a very attractive discount.

ALLEN WEBB Got it. Makes sense. All right. We've been talking about markets we care a lot about for half an hour. So maybe we could have some key takeaways for our viewers. Those would be opportunities, risk. I

know we're not talking about specific strategies here, but just broadly speaking, the calendar, distributions, all those types of things. So, what would we like to leave people with who have been patient enough to make it this far through our podcast? Steve, I'll maybe start with you and see if Jon and Patrick want to fill in any details.

STEVE O'NEILL I just think, for fun, I think it's worth emphasizing that the discount volatility we're seeing now is almost unprecedented because you went from a period of rich valuations for credit to the 97th percentile. And on average, you had about 10 points of discount widening, which is a lot of discount widening. But then you also have funds that were trading at 20, 30% premiums that are trading at 5 to 10% discounts. And so, I mean, outside of '08, I don't think Patrick and I have seen 30-point moves in discounts. It doesn't mean things are going to bounce back 30 points, but the volatility is really interesting. And so, it provides investors with two ways to try to capitalize. One is trading this volatility within some of these more extreme moves. And then there's also the value. And our job is to always kind of combine portfolios of things that we think have short-term mean reversion alpha that have, I would say, really coil valuations, but also just the, I would say, kind of no-brainer, "Why wouldn't you buy this high-yield bond fund at a 12% discount?" It's just one of those markets where, again, I found myself giving you a long answer to the short question. You can really have it both ways. If you want to be a value investor and just buy 10 to 15% discounts, great. That's a great strategy. If you want to trade retail-owned high volatility mean reversion names, it's also about the best you've ever seen. And so, for us, it's keeping us busy on both sides. It's keeping us busy on our five-day mean reversion trades, and it's keeping us excited about building kind of these portfolios, which are almost museum pieces where you say, "Wow, remember when we bought this fund at X percent discount? How great was that?" I mean, you can kind of sit on that type of allocation for a while. So, I think it's for fun, I guess, is a trading perspective. There's a lot of stuff to do.

ALLEN WEBB I'm assuming that means that in order just to make it into any RiverNorth portfolio, it's got to be better than just an average idea. There's enough opportunities to sort of squeeze out the okay ideas.

STEVE O'NEILL Well, that's always the challenge. Are you generating alpha from a top-down or bottom-up perspective? From a bottom-up perspective, it's actually any idea that's not incredible gets crowded out. But I think a key point that we'd like to leave the audience with is that the bigger mistake is getting overly selective or being uncertain. What really matters today is top-down allocation. And so even though you will do better with your top 10 ideas, the next 10 ideas are going to outperform as well. So, I think you're right. A bottom-up investor like Jon and I, we're always crowding names out given the excitement we have to a handful of names. But Patrick, thinking top-down, he certainly would have the belief that what matters now is the aggregate level of closed-end fund exposure because everything is going to at least bounce back, potentially in parallel shift in the short term between now and January.

ALLEN WEBB Jon, Patrick, anything to add?

PATRICK GALLEY I'll be super brief. Volatility equals opportunity. Yeah.

ALLEN WEBB Jon anything else?

JON BROWNE No. I mean, just the combination of if you're accepting or looking for asset class exposure or you want a unique alpha source, the absolute level of discounts right now, coupled with the volatility of those discounts, should provide a setup where looking at closed-end funds, I would imagine, should outperform those individual cash bonds or asset classes over, say, the next 12 months.

ALLEN WEBB I don't want to belabor this point because I know we were going to stop. But is a way to think about that, Jon, is investors, whether they're retail or institutional, have a menu of managers and asset classes that they allocate to. Those managers and asset classes are trading at a discount in the closed-end fund market. Is that the point you're making? So, a way if you want to earn more return on a particular asset class or even beat a manager who manages those asset classes, buying those assets in a discounted vehicle or wrapper is an opportunity to do that. Is that a way to think about it?

JON BROWNE Yeah, that's precisely. I mean, if you even just think of most of the closed-end funds being asset class beta, we allow you to invest. If you're investing in the closed-end funds, you're getting that asset class exposure. But we're also able to hopefully provide that discount narrowing, which is additional alpha source above and beyond what the individual asset class returns. And so that source of alpha should allow these closed-end funds to outperform traditional cash bonds or whatever that asset class exposure is.

ALLEN WEBB Got it. So same beta, enhanced potential alpha.

PATRICK GALLEY I'm going to add one more thing. I mean, I'm not seeing, though. I mean, what's really interesting, what RiverNorth offers is we've got closed-end funds opportunistically investing in other closed-end

funds. So, forget about the underlying assets or the asset class being potentially at a discount. Now we're talking about discounts on discounts. I think that's an interesting opportunity today as well.

ALLEN WEBB Yeah, it makes a lot of sense. I mean, in some ways, and I know the execution of this is tricky, but put that aside. But it's almost like you could go sell your manager roster or your asset class roster, buy it in a vehicle that trades at a discount, look for discount narrowing in the volatility, and then sort of go back to home base, which is your lineup of asset classes or managers. And all the while, you haven't really changed the risk profile of your underlying asset classes. Interesting.

PATRICK GALLEY Exactly.

ALLEN WEBB Interesting. All right, guys, anything else you want to add before we drop?

STEVE O'NEILL Good here.

PATRICK GALLEY Good.

ALLEN WEBB So that's it for today, everyone. Thanks, as always, for your time. We always appreciate the chance to interact with our investors on things that are on our minds. We would be very interested to see how people think about this new medium of interacting with our investors and potential investors through more of a podcast format. Hopefully, you will see more of these in the future. One thing that we do miss is a chance to have live Q&A with webcast or webinar participants. So, once you have had a chance to review this, if anyone has any questions that this has generated or other questions, you can reach out to me directly, and I'll make sure those questions are answered by myself or one of the investment team members. My email is awebb, A-W-E-B-B, at rivernorth dot com, awebb@rivernorth.com. And again, please email me with any questions that you have about topics we've covered today or any of the strategies that RiverNorth manages across the firm, and I'll make sure that those questions get answered. Thank you.

DEFINITIONS

Alpha: The excess return of an investment relative to a benchmark or other measure of expected return.

Basis Point (bps): A unit of measure equal to 1/100th of 1%, or 0.01%.

Beta: A measure of an investment's sensitivity to movements in a market or benchmark. In this discussion, beta may also refer more generally to exposure to an underlying asset class.

Bloomberg U.S. Aggregate Bond Index: An unmanaged index of investment grade fixed-rate debt issues with maturities of at least one year. The index cannot be invested in directly and does not reflect fees and expenses.

Business Development Company (BDC): A type of closed-end investment company that generally invests in debt or equity securities of small and middle-market companies.

Closed-End Fund (CEF): An investment company with a generally fixed number of shares that typically trade on an exchange. A CEF's market price may trade above or below its net asset value.

Credit Spread: The difference in yield between a credit security and a comparable Treasury or other reference security, generally reflecting the additional compensation investors require for credit risk.

Discount / Premium: A closed-end fund trades at a discount when its market price is below its net asset value (NAV) and at a premium when its market price is above its NAV.

Distribution Rate: The annualized amount of a fund's distributions relative to its market price or NAV, depending on how the rate is calculated. A distribution rate is not the same as an investment's total return.

Duration: A measure of a fixed-income investment's sensitivity to changes in interest rates. Generally, the higher the duration, the greater the sensitivity to changes in interest rates.

Fair Value: An estimate of the price at which an asset could be sold in an orderly transaction under current market conditions.

High-Yield Bond: A bond rated below investment grade by one or more nationally recognized statistical rating organizations, or an unrated bond determined to be of comparable quality. High-yield bonds generally offer higher yields in exchange for greater credit and default risk.

Leverage: The use of borrowed money or other forms of financing intended to increase a fund's investment exposure. Leverage can magnify both gains and losses.

Market Price: The price at which a security trades in the market. For a closed-end fund or listed BDC, the market price may be above or below its NAV.

Mean Reversion: The tendency for a value or measure, such as a CEF discount, to move back toward its historical or longer-term average over time.

Net Asset Value (NAV): The value of an investment company's assets minus its liabilities, generally expressed on a per-share basis.

Private Credit: Lending provided to companies through privately negotiated loans rather than publicly traded debt securities.

Return of Capital: A distribution that represents a return of some or all of an investor's original investment rather than solely income or realized gains. A return-of-capital distribution generally reduces an investor's cost basis and is not necessarily indicative of a fund's investment performance.

Return on Equity (ROE): A measure of profitability calculated by dividing net income by shareholders' equity.

SaaSpocalypse: A financial slang term describing the existential threat and severe 2026 market downturn facing traditional Software-as-a-Service companies due to autonomous artificial intelligence.

Tax-Loss Selling: The sale of an investment at a loss, generally to realize a capital loss that may be used to offset capital gains, subject to applicable tax rules. Investors should consult a tax professional regarding their individual circumstances.

Total Return: The change in an investment's value over a specified period, including income and distributions and any increase or decrease in market value.

IMPORTANT DISCLOSURES AND RISK INFORMATION

Risk information: investing involves risk. Principal loss is possible. Past performance is not a guarantee of future results. Diversification does not ensure a profit or a guarantee against loss.

Closed-end funds and business development companies are subject to investment risk, including the possible loss of principal. Shares may trade at a premium or discount to net asset value, and there can be no assurance that a discount will narrow. The use of leverage may increase volatility and magnify gains and losses. Investments in below-investment-grade securities and private credit involve heightened credit, liquidity, valuation and default risks. Distributions are not guaranteed and may be reduced or include a return of capital.

Index performance is discussed for illustrative purposes only. Indexes are unmanaged, and investors cannot invest directly in an index.

Opinions and estimates offered constitute our judgment and are subject to change without notice, as are statements of financial market trends, which are based on current market conditions. We believe the information provided here is reliable, but do not warrant its accuracy or completeness. This material is not intended as an offer or solicitation for the purchase or sale of any financial instrument. The views and strategies described may not be suitable for all investors. This information is provided for informational purposes only and should not be considered tax, legal, or investment advice. References to specific securities, asset classes, and financial markets are for illustrative purposes only and are not intended to be, and should not be interpreted as, recommendations. Opinions referenced are as of the day presented and are subject to change due to changes in the market, economic conditions, or changes in the legal and/or regulatory environment and may not necessarily come to pass.

FORWARD-LOOKING STATEMENTS

In addition, this video may contain certain "forward-looking statements" including statements regarding RiverNorth's or the portfolio management team's expectations, hopes, beliefs, intentions or strategies regarding the future. In addition, any statements that refer to projections, forecasts or other characterizations of future events or circumstances, including any underlying assumptions, are forward-looking statements. The words "anticipate," "believe," "continue," "could," "estimate," "expect," "intends," "may," "might," "plan," "possible," "potential," "predict," "project," "should," "would" and similar expressions may identify forward-looking statements, but the absence of these words does not mean that a statement is not forward-looking. The forward-looking statements contained herein are based on RiverNorth's current expectations and beliefs concerning future developments and their potential effects on the market strategies. There can be no assurance that future developments affecting the market strategies will be those that we have anticipated. These forward-looking statements involve a number of risks, uncertainties (some of which are beyond the control of RiverNorth) or other assumptions that may cause actual results or performance to be materially different from those expressed or implied by these forward-looking statements. Except as required by law, RiverNorth is not undertaking any obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise.

RiverNorth® is a registered trademark of RiverNorth Capital Management. ©2000-2026 RiverNorth Capital Management, LLC. All rights reserved.