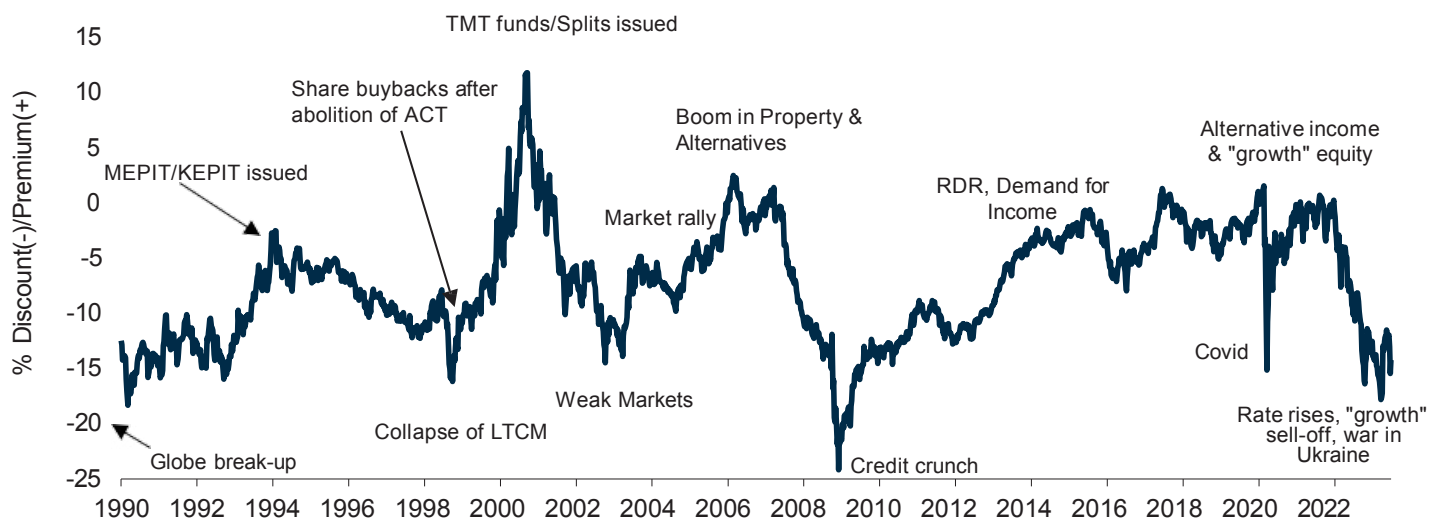




UK Listed CEF Discounts in Long-Term Perspective . . .

1/1/1990 to 6/30/2023



Source: Numis Update, Investment Companies, Issuance & Corporate Action in H1 2023, published July 12, 2023

Why are we optimistic?

The listed closed-end fund (CEF) universe has derated dramatically over the last eighteen months.

- Valuations are now highly asymmetric to the upside,
- Mean-reversion is alive and well, for reasons we will explore below, and
- A structural shortage of arbitrage capital is beginning to correct.

Being the provider of capital to distressed sellers has historically worked well for allocators at the bottom of every CEF discount cycle. We do not believe this time is different.

Why have discounts widened so much?

The CEF universe as a whole is priced around its widest levels for three decades and is cheaper than any point barring a few days in March 2020 and the period immediately following the Lehman Brothers bankruptcy, both times of abnormal market stress. Why?

- Competition from rising risk-free rates has changed the risk preferences of typical CEF buyers, who have re-allocated accordingly.
- The marginal propensity to save has been impacted by cost-of-living considerations.

- There is insufficient institutional liquidity active in CEFs to absorb the resultant flows.

As evidenced by the chart above, this has driven a substantial widening of discount spreads over the last 18 months. The shift in risk-free rate exhibits a high correlation with the discount de-rating. This move is likely nearer the end than the beginning.

Why is there a structural shortage of arbitrage capital?

CEFs are a persistently inefficient market. There are long-term factors restricting the application of capital to discount inefficiencies that exacerbate their cyclicity. Specifically:

- Large asset managers are sponsors and issuers of CEF paper rather than buyers of it – permanent capital is an attractive fee stream. The largest pools of discretionary capital therefore avoid CEFs.
- Opportunistic investors with the ability to act nimbly are aware of the high barriers to entry and tend to allocate only at valuation extremes.
- Mainstream institutional allocations via specialist managers are limited in size and usually confined to single sleeve “verticals”, hence slow to respond to moves in the broader universe.

Behavioural and flow-based factors therefore dominate valuation in a way that is unusual in capital markets. It leads to a strong mean-reverting tendency over time.

Is it different this time?

Might mean reversion be dead? Whilst certainly possible, it is not in our view probable. Why? Absolute valuations are now attractive enough to change the flow situation.

- The supply tap has been turned off – oversupply of CEF paper in 2021 has reversed. More capital has been returned in 2023 than has been raised in new issuance.
- Arbitrage capital is arriving in significant size with activist intent. Over \$2.5bn of activist filings have been made in 2023 and a number of proxy campaigns are underway demanding measures to narrow discounts.
- Take-privates are occurring – a very clear message from private markets that public market investors are mispricing certain assets.

In a clear tailwind to those three trends, the existing investor base is becoming less passive and more receptive to measures to realise

value. Independent Boards are equally becoming more open-minded to solutions in the face of investor patience running low.

How long do we have to wait for mean-reversion to happen?

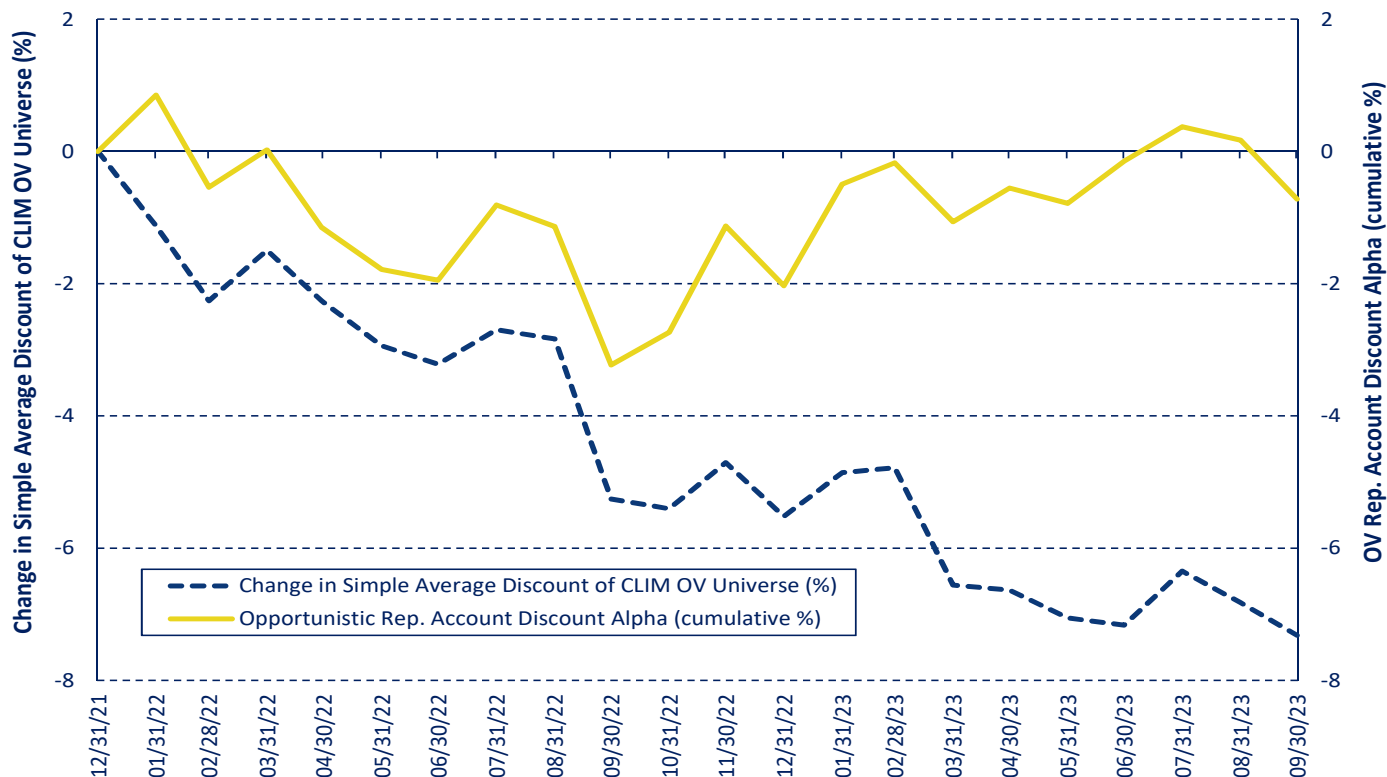
We see the situation as a process not an event – the reason nimble allocators are moving now is that they are able to access ample liquidity without market impact. In 2009 the bottoming process played out over quarters not weeks.

We believe there are numerous event-driven or catalysed situations that can generate discount alpha in closed-end funds irrespective of the wider market direction.

- As the below chart shows, our Opportunistic Value Strategy has captured significant discount alpha since the general widening trend began in Q1 2022.
- This is a consequence of a focus on catalysed situations mis-priced in the broad valuation decline, which has proved highly defensive.
- The high degree of embedded value captured in portfolios should result in full participation when more generalised mean-reversion asserts itself.

Utilizing Flexible Mandates . . .

Rebased from 12/31/2021



Asymmetry and Optimism

CEF Valuations are now highly asymmetric versus history. As a specialist manager, we see a rich hunting ground of absolute value combined with a increase in actionable, catalysed opportunities.

- Current valuations represent a significantly de-risked entry point.
- Downside from these discount levels is low, confidence of upside high.
- Arbitrage capital is responding, and the flow situation is improving.

The combination of absolute value, catalysts and shifting investor behaviour give us considerable grounds for future optimism.

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All information is as of October 20, 2023 unless otherwise noted.



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