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# CEO Finds `Advantage' in Closed-End Municipal Funds

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Minimizing duration risk and maximizing leverage to boost returns can be tricky – especially when the tax-exempt market has its share of interest rate volatility and overall uncertainty.

For James C. Robinson, a veteran bond trader turned entrepreneur, those challenges are second nature.

Robinson is putting his more than 30 years of fixed income management experience to the test as chief executive officer and chief investment officer of Robinson Capital Management LLC, the independent investment advisory firm he launched in 2012.

In addition to being at the helm of the Gross Pointe, Mich.-based firm, he serves as portfolio manager of its Robinson Tax Advantaged Income Fund, whose assets have grown to over $65 million in a little more than a year since its inception.

While the fund itself is an open-ended mutual fund, it invests primarily in national municipal closed-end funds.

CEFs are appealing because they are known to be more liquid than individual municipal bonds. What makes them unique is that they usually raise all of their capital at the onset of the fund, so shares are not redeemable and no new shares are created, keeping it "closed" to new and departing investors.

However, most of the CEFs trade on a recognized stock exchange where their shares can be bought and sold throughout the day.

Since shares cannot be redeemed, a manager can remain fully invested, or over-invested since CEF's are allowed, by law, to use up to 50% leverage.

Robinson said his tax advantaged income fund employs a unique strategy that helps it deliver attractive total returns, while also providing income, and helps allay investors' fears.

"Everyone is spooked about the Fed's lift-off and what it means for rates," he said in a recent interview. "Our goal is to be agnostic about it."

His strategy calls for hedging against interest rate risk and decreasing exposure to duration risk by using short positions, primarily in U.S. Treasury futures contracts of various maturities – a discipline he believes sets his firm apart from other investment advisors.

He said municipal CEFs typically have a levered duration of 10 to 12 years.

"If we can reduce that duration to about one year, then 90% of the risk lowered," Robinson explained.

With duration under a year – 0.60 years to be exact – Robinson said his fund has less duration than an intermediate index and that is a characteristic that has helped attract new investors. It is also currently being sold and distributed by registered investment advisor platforms at large wire houses, including UBS and Morgan Stanley ( MS ), Robinson said.

The fund is diversified with between 30 and 40 CEFs that invest in investment-grade municipal bonds that are largely exempt from federal taxes, have an average credit quality of between A and A-plus, and generate higher cash flow yields than stock and bond markets.

It owns less than 1% of Puerto Rico exposure, according to Robinson, and offered a 4.94% average yield as of Dec. 31, down from 5% in the prior month, according to Robinson.

"The fund had a strong finish to 2015 as the much anticipated Fed rate hike caused municipal bond yields to narrow versus U.S. Treasury yields," he said this week.

He considers the fund's yield attractive in a market that is which is still recovering from recent dislocations from everything from the Taper Tantrum and to the more recent Detroit bankruptcy and Puerto Rico's financial debacle, in which municipals are paying 1%.

Managing risk – be it interest rate, liquidity, credit, or duration risk – is an occupational hazard for a portfolio manager, he said.

"Clearly there is a risk that munis and Treasuries don't always move in lock step, so on days where you have a risk-off trade and a geo-political event that spooks investors, Treasuries will rally and everything else will fall out of bed," he said. "You could have munis going down in value and Treasuries going up in value … it doesn't last long and it's a great buying opportunity, but it's a risk to the strategy."

Robinson honed his fixed-income management savvy and skills over three decades in the financial industry.

Prior to founding Robinson in 2012, Mr. Robinson was chief executive officer and chief investment officer of Telemus Capital Partners, LLC, and its subsidiary Beacon Asset Management, LLC. He also previously served for five years as the chairman and CEO of Munder Capital Management and president of the Munder Funds. From 1987 to 1999, he served as executive vice president and chief investment officer of fixed income with Munder Capital Management.

He holds a master's of business administration from Carnegie Mellon University, as well as a bachelor's of business studies degree in finance and economics from Wayne State University.

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Robinson said another advantage to his fund is that it also seeks to identify CEFs that trade at discounts to the true market value of the CEFs' municipal bond holdings, including undervalued discounts.

The firm tracks 200 hundred municipal closed-end funds in real time, and uses proprietary value investing strategies to enhance total return.

That proved to be a winning strategy in 2015 given the sectors' performance for the year to date through November, according to Morningstar ( MORN ).

The average closed-end fund gained nearly 4% on net asset value and 5% on share price, the mutual fund data tracker said in a Dec. 10 report.

Without taking the tax advantages of municipal bonds into account, that compares favorably to both the year to date Barclays Municipal Total Return Index's 2.6% gain, and is far better than the Barclays' ( BCS ) Aggregate Bond Index's 88-basis-points gain, noted Morningstar ( MORN ) closed end fund strategist and senior analyst Cara Esser.

She said in the report that closed-end funds have benefited from an overall healthy municipal market that has recovered nicely since the 2008 financial crash – despite a few recent negative headlines from Puerto Rico, Illinois, and Chicago along the way.

Performance was most promising in the fourth quarter of 2015, when four of the top 10 performing Morningstar ( MORN ) categories in November were municipal-bond categories. The Municipal New York Long, Municipal Massachusetts, Municipal New York Intermediate, and Municipal Single-State Long categories posted year to date share prices as of November of 6.72%, 4.57%, 2.10%, and 6.55%, and net asset value of 3.97%, 3.60%, 1.37%, and 3.68%, respectively.

Esser pointed out that this occurred in a year where some categories suffered double-digit losses.

At the same time, there is a tailwind in the municipal market due to the supply and demand imbalance, she said. The tight budgets and reluctance for state and local governments to fund new projects with public debt is being offset by the heavy demand for high-yielding and tax-advantaged investment options.

The imbalance has recently pushed prices up and the tailwind has helped municipal bonds and funds perform well – even in the face of potentially rising interest rates back in the fourth quarter of 2015. "For municipal CEFs as a whole, this has meant a general narrowing of discounts, from an average of 7% at the end of 2014 to 6% as of November 2015," Esser wrote. "The average discount actually narrowed to under 5% a few times in 2015."

As of Dec. 31, the municipal CEF universe traded at a negative 6.62% average discount, versus a five-year average discount of negative 2.59%, Robinson said.

He said he recently observed CEFs at a 7.5% discount in November, which he believed was at the wide end of the range, judging by a five-year average discount of negative 2.70%. Discounts temporarily increased to a high of 9.5% in August, which was previously seen in late December 2013, Robinson noted.

"Much of the discounts can be tied to market uncertainties, and the pretty high correlation to the volatility index," known as the VIX, Robinson said. This causes the discounts on municipal closed-end fund to widen, he noted.

Some other causes of this phenomenon can include: performance, expenses, transparency, dividend distributions, sentiment, unrealized capital gains, vintage tax issues, cost of leverage, liquidity, and governance, according to the firm's website.

The Federal Reserve Board waiting to increase interest rates also put pressure on the discounts, Robinson said. "The Fed not pulling the trigger in September hurt us a little, and waiting hasn't helped anyone."

But Robinson believes the fund should continue to benefit from the Fed's commitment to raise short-term interest rates "slowly and steadily" over the next couple years.

"In such an environment, we believe municipal bond yields will continue to narrow versus U.S. Treasuries and municipal bond closed-end fund discounts should also narrow," he said. "It's a big win for our strategy because the spread relationship will move back to pre-financial crisis normalcy."

Establishing the tax-advantaged fund, Robinson said, has satisfied a need in a short time since its inception, while also being an attractive and unique alternative in the mutual fund world.

"You want to make sure you're not just another fund out there investing in munis," he said. "You need to solve someone's problems."

"We think a 5% tax-exempt yield without taking any crazy credit risk and interest rate risk is a compelling value proposition right now."