

Income Opportunities: Interpreting Closed-End Fund Distributions

July 8, 2021

As interest rates remain near historical lows, investors have been hunting for yield. Compared to other income-oriented sectors like bonds and REITs, closed-end funds (CEFs) have considerably higher yields. Currently, the [S-Network Composite Closed-End Fund Index \(CEFX\)](#) has a yield of 6.97% and the [S-Network Municipal Bond Closed-End Fund Index \(CEFMX\)](#) has a yield of 4.32% (6.86% tax-equivalent). High yields in this sector can be attributed to several factors. To begin with, closed-end funds are exempt from corporate taxes on the condition that they pass through net investment income (interest and dividends) to shareholders. Most CEFs pay these distributions monthly—although some also pay quarterly—compared to traditional fixed income instruments, which pay coupons semiannually. CEFs also pay net realized capital gain distributions typically at the end of the year. Some equity and alternative strategy funds, however, expect to earn a large portion of their return through capital gains, rather than dividends or interest. In this case, they can use a managed distribution policy, which attempts to forecast capital appreciation for the year and incorporate that into the regular monthly/quarterly distribution payment. This can benefit investors by providing more stable cash flows, but it also comes with the risk that the fund may overestimate the unrealized capital gain and return principal instead.

Closed-end fund distributions are often paid monthly, with many equity funds using a managed distribution policy in order to provide the investor with stable cash flows.

Top 10 Constituents of CEFX by Index Weight (as of 7/06/2021)

Ticker	Fund Name	Price	NAV	Distribution	Dist. Rate Price	Dist. Rate NAV	Dist. Frequency	Dist. Policy	Effective Leverage	Index Weight as of 7/06/21
EXG US	Eaton Vance Tax-Managed Global Diversified Equity Income Fund	\$10.17	\$10.28	\$0.0616	7.3%	7.2%	Monthly	Managed		4.0%
PCI US	Pimco Dynamic Credit and Mortgage Income Fund	\$22.53	\$20.53	\$0.1740	9.3%	10.2%	Monthly	Income-Only	45.0%	2.6%
BDJ US	Blackrock Enhanced Equity Dividend Trust	\$10.04	\$10.40	\$0.0500	6.0%	5.8%	Monthly	Managed		2.5%
NFJ US	Virtus Dividend Interest & Premium Strategy Fund	\$15.29	\$16.73	\$0.2250	5.9%	5.4%	Quarterly	Managed		2.4%
EVV US	Eaton Vance Ltd Duration Income Fund	\$13.29	\$13.64	\$0.1000	9.0%	8.8%	Monthly	Income-Only	33.2%	2.2%
ETV US	Eaton Vance Tax-Managed Diversified Equity Income Fund	\$14.16	\$13.92	\$0.0843	7.1%	7.3%	Monthly	Managed		2.2%
PDO US	PIMCO Dynamic Income Opportunities Fund	\$22.03	\$20.53	\$0.1184	6.4%	6.9%	Monthly	Managed		2.1%
JPS US	Nuveen Preferred & Income Securities Fund	\$9.94	\$9.92	\$0.0505	6.1%	6.1%	Monthly	Income-Only	36.2%	2.1%
BXMX US	Nuveen S&P 500 BuyWrite Income Fund	\$14.53	\$14.90	\$0.2150	5.9%	5.8%	Quarterly	Managed		2.0%
DSL US	DoubleLine Income Solutions Fund	\$18.15	\$18.57	\$0.1100	7.3%	7.1%	Monthly	Income-Only	28.1%	2.0%
Average Dist. Rate					7.0%	7.0%			Total	24.2%

Source: Company data, Bloomberg, Alerian and S-Network Global Indexes
Fund data is latest available on company website as of 07/07/2021
Index weights and pricing/NAV data as of 07/06/2021

Another factor that contributes to higher yields is the difference between CEF and open-end mutual fund structures. Open-end funds must have enough liquidity to continuously issue shares, while closed-end funds typically only issue new shares during the IPO. After the IPO, CEF shares can only be bought and sold on an exchange, so the fund does not need to hold cash for redemptions and can fully invest that cash in its strategy with more focus on a long term, income-oriented view. The fixed asset base also allows the fund to better utilize leverage—arguably the biggest differentiator of income for a CEF.

Fixed income CEFs can use leverage—borrowing at lower, short-term rates and reinvesting in higher rates—to enhance earnings and income. According to Bloomberg data, over 2/3 of CEFs use some form of leverage, which includes debt and preferred stock. Lower interest rate environments, like our current environment, are particularly beneficial for funds that use leverage. As short-term interest rates decrease, the cost of leverage (i.e., the cost to borrow) decreases and the fund’s earnings increase as the spread between borrowing cost and investment rate widens. Higher earnings help support the fund’s distribution, which can be measured by the distribution coverage ratio. A fund with earnings greater than its distributions will have a coverage ratio >100%, whereas a fund with earnings below its distribution will have a coverage ratio <100%. A fund with a low distribution coverage ratio may have more risk of cutting its distributions, although another factor to consider is the fund’s undistributed net investment income (UNII), which is the total balance of available funds outside of current earnings that the fund can use for future distributions. It is also worth noting that while leverage can potentially enhance a fund’s yield, it can have the opposite effect if interest rates rise and can result in greater losses than an unleveraged fund.

Municipal bonds use leverage in order to enhance income; earnings still healthy relative to distributions.

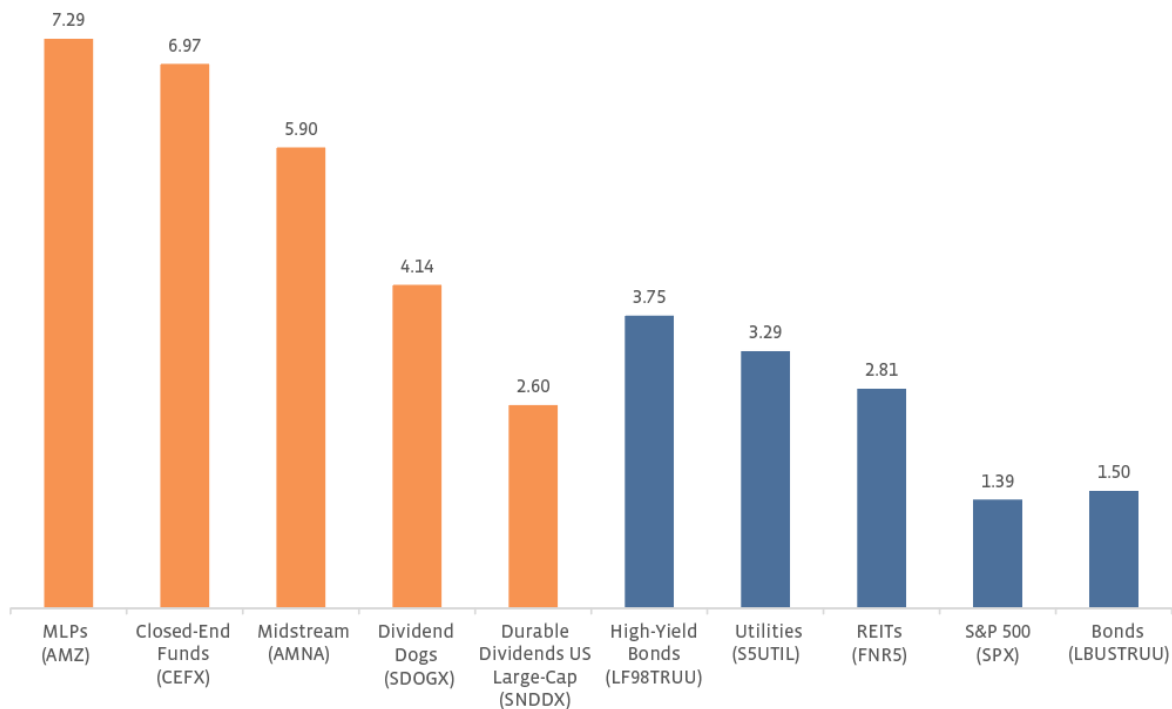
Top 10 Constituents of CEFMX by Index Weight (as of 7/06/2021)

Ticker	Fund Name	Price	NAV	Earnings	Distribution	Dist. Rate Price	Dist. Rate NAV	Dist. Frequency	Coverage Ratio	Effective Leverage	Index Weight as of 7/06/21
NEA US	Nuveen Amt-Free Quality Municipal Income Fund	\$15.78	\$16.15	\$0.0571	\$0.0585	4.4%	4.3%	Monthly	97.7%	36.9%	8.0%
NAD US	Nuveen Quality Municipal Income Fund	\$16.13	\$16.54	\$0.0591	\$0.0595	4.4%	4.3%	Monthly	99.3%	36.5%	8.0%
NVG US	Nuveen AMT-Free Municipal Credit Income Fund	\$17.71	\$17.78	\$0.0679	\$0.0675	4.6%	4.6%	Monthly	100.6%	36.8%	7.9%
NZF US	Nuveen Municipal Credit Income Fund	\$17.36	\$17.40	\$0.0646	\$0.0660	4.6%	4.6%	Monthly	97.9%	36.4%	5.8%
BTT US	Blackrock Municipal 2030 Target Term Trust	\$26.38	\$27.16	\$0.0811	\$0.0624	2.8%	2.8%	Monthly	129.9%	34.1%	4.9%
NUV US	Nuveen Municipal Value Fund Inc	\$11.58	\$10.81	\$0.0282	\$0.0310	3.2%	3.4%	Monthly	90.8%	1.3%	3.4%
MQY US	BlackRock MuniYield Quality Fund Inc	\$16.78	\$16.74	\$0.0535	\$0.0630	4.5%	4.5%	Monthly	84.9%	36.8%	2.9%
MYI US	Blackrock Muniyield Quality Fund III Inc	\$14.93	\$15.56	\$0.0535	\$0.0515	4.1%	4.0%	Monthly	103.9%	35.8%	2.7%
EIM US	Eaton Vance Municipal Bond Fund	\$13.74	\$14.26	\$0.0475	\$0.0496	4.3%	4.2%	Monthly	95.8%	41.7%	2.6%
MHD US	BlackRock MuniHoldings Fund Inc	\$16.97	\$17.56	\$0.0611	\$0.0605	4.3%	4.1%	Monthly	100.9%	37.5%	2.4%
Average Dist. Rate						4.1%	4.1%			Total	48.6%
*Tax equivalent						6.6%	6.5%				

Source: company data, Bloomberg, Alerian and S-Network Global Indexes
 *Calculated using a 37% federal tax rate
 Fund data is latest available on company website as of 07/07/2021
 Index weights and pricing/NAV data as of 07/06/2021

For a typical investor, certain concepts like managed distribution policies and leverage for equity and fixed income funds, respectively, hold risks that may require some additional consideration. Even with firm knowledge of CEFs, it is still difficult to predict when a distribution cut will occur and how to take advantage of premiums/discounts. Risk averse investors may prefer to invest in CEFs through professionally managed index-linked products which provide access to a variety of CEF managers and styles, while still providing above average yield relative to most other sectors.

Alerian/S-Network Indexes Showcase Attractive Income Opportunities Beyond Bonds, REITs, and Utilities



Current Yields vs. History

Midstream/MLP indexes continue to offer healthy yields. While below historical averages, yields remain in the 5% to 7% range.

Midstream & MLPs

Index Name	Ticker	YTD Total Return	Yield		
			Current	5-Year Average	10-Year Average
Alerian Midstream Energy Index	AMNA	40.69%	5.90%	6.56%	N/A
Alerian MLP Index	AMZ	47.84%	7.29%	8.77%	7.61%
Alerian MLP Infrastructure Index	AMZI	49.08%	7.32%	8.72%	7.48%
Alerian Midstream Energy Dividend Index	AEDW	41.40%	6.94%	7.57%	N/A
Alerian Midstream Energy Select Index	AMEI	42.76%	5.61%	6.35%	5.38%

Source: Alerian and S-Network Global Indexes as of June 30, 2021

Among the Sector Dividend Dogs, yields are close to historical averages. EDOGX is the only index in the suite to offer a current yield above the 5-year average.

Sector Dividend Dogs

Index Name	Ticker	YTD Total Return	Yield	
			Current	5-Year Average
S-Network Sector Dividend Dogs Index	SDOGX	21.01%	4.14%	4.42%
S-Network International Sector Dividend Dogs Index	IDOGX	10.65%	5.10%	5.17%
S-Network Emerging Sector Dividend Dogs Index	EDOGX	10.04%	5.48%	4.93%
S-Network REIT Dividend Dogs Index	RDOGX	19.97%	4.57%	N/A

Source: Alerian and S-Network Global Indexes, Bloomberg as of June 30, 2021

Multiple screens for dividend durability, including evaluating cash flows, EBITDA, and debt-to-equity ratios, help ensure reliable income from the durable dividend indexes.

Durable Dividends

Index Name	Ticker	YTD Total Return	Yield	
			Current	5-Year Average
S-Network Durable Dividends US Large-Cap Index	SNDDX	18.90%	2.60%	3.67%
S-Network Durable Dividends US Mid-Cap Index	SNDDMX	20.27%	2.01%	3.35%
S-Network Durable Dividends Developed International Index	SNDDIX	16.47%	4.07%	4.60%

Source: Alerian and S-Network Global Indexes, Bloomberg as of June 30, 2021

Though current yields are slightly below historical averages, closed-end funds continue to represent an attractive option for enhancing the yield of an income-oriented portfolio.

Closed-End Funds

Index Name	Ticker	YTD Total Return	Yield			
			Current	Tax-Equivalent ¹	5-Year Average	10-Year Average
S-Network Composite Closed-End Fund Index	CEFX	13.34%	6.97%	N/A	8.08%	8.42%
S-Network Municipal Bond Closed-End Fund Index	CEFMX	7.57%	4.32%	6.86%	5.00%	N/A
S-Network Option Income Closed-End Fund Index	CEFOIX	15.22%	6.34%	N/A	8.39%	N/A

¹ Calculated using a 37% federal tax rate.

Source: Alerian and S-Network Global Indexes, Bloomberg as of June 30, 2021

Related Research:

[A Smarter Approach to Closed-End Funds](#)

[Midstream Income Opportunities: Dividends Resilient Throughout Recent Quarters](#)

[Biden's Tax Proposal and Tax-Efficient Income Opportunities](#)

[Finding Income and Value in a Robust Economic Recovery](#)

Underlying Index

Midstream/MLPs

[Alerian Midstream Energy Index \(AMNA\)](#)

[Alerian MLP Index \(AMZ\)](#)

[Alerian Midstream Energy Dividend Index \(AEDW\)](#)

[Alerian MLP Infrastructure Index \(AMZI\)](#)

[Alerian Midstream Energy Select Index \(AMEI\)](#)

Sector Dividend Dogs

[S-Network Sector Dividend Dogs Index \(SDOGX\)](#)

[S-Network International Sector Dividend Dogs Index \(IDOGX\)](#)

[S-Network Emerging Sector Dividend Dogs Index \(EDOGX\)](#)

[S-Network REIT Dividend Dogs Index \(RDOGX\)](#)

Closed-End Funds

[S-Network Composite Closed-End Fund Index \(CEFX\)](#)

[S-Network Municipal Bond Closed-End Fund Index \(CEFMX\)](#)

Associated Product

ETRACS Alerian Midstream Energy Index ETN (AMNA)

JP Morgan Alerian MLP Index ETN (AMJ), ETRACS Alerian MLP Index ETN Series B (AMUB), ETRACS Quarterly Pay 1.5X Levered Alerian MLP Index ETN (MLPR)

ETRACS Alerian Midstream Energy High Dividend Index ETN (AMND), Alerian Midstream Energy Dividend UCITS ETF (MMLP)

Alerian MLP ETF (AMLPL), ETRACS Alerian MLP Infrastructure Index ETN Series B (MLPB)

Alerian Energy Infrastructure ETF (ENFR)

ALPS Sector Dividend Dogs ETF (SDOG)

ALPS International Sector Dividend Dogs ETF (IDOG)

ALPS Emerging Sector Dividend Dogs ETF (EDOG)

ALPS REIT Dividend Dogs ETF (RDOG)

Invesco CEF Income Composite ETF (PCEF), ETRACS 1.5X Leveraged Closed-End Fund ETN (CEFD)

VanEck Vectors CEF Municipal Income ETF (XMPT)

About Alerian and S-Network Global Indexes

Alerian is a leading independent index provider focused on building innovative, index-based investment strategies. Alerian acquired S-Network Global Indexes in 2020, expanding the firm's index offerings and services to partners. Combined, the firm serves the global investment community through indexing, benchmarking, and calculation services. Built on a foundation of data rigor and specialty research, Alerian and S-Network Global Indexes offer a comprehensive family of energy, income, and thematic indexes. Today, the firm has over \$23 billion in total assets benchmarked to its indexes and over 200 customers world-wide.

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