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Gregory Cater Sr. & Gregory Cater Jr.
Is it Time to Lock in "Higher for Longer"?

Federal Reserve Chairman Jerome Powell telegraphed the end of the current tightening cycle at last week's Jackson Hole Symposium. He said he was more comfortable with the progress on bringing inflation down to the 2% target, and now was focusing on the Jobs market. And then, as if on cue, the Bureau of Labor Statistics released a downward revision to the number of jobs created (Mar'23 – Mar'24) to the tune of 818,000 fewer jobs created for the year. This was the largest downward revision in 15 years (2009). Inflation moving closer to target and job creation being revised lower shouldn't be ignored.

The Fed is maintaining higher than 5% short-term interest rates by paying over 5% on reserve balances to banks and over 5% to money market funds. When they decide to lower rates, most likely at the next FOMC meeting, the current money market rates we are enjoying will drop in lockstep. When short-term rates drop, investors will most likely look for higher yielding alternatives.

We have written extensively on the benefits (for income) of closed-end mutual funds vs the more popular open-end mutual funds. While "less common than open-end mutual funds, closed-end funds (CEFs) have been available in various forms since the late 1800s." Both structures offer professional management and diversification. CEFs, however, offer numerous advantages. Unlike open-end funds, CEFs trade on an exchange, usually the NYSE. The price is determined by supply and demand and is often at a discount to its NAV (net asset value). Buying a bond at a discount increases its current yield, or how much you get paid in interest relative to what you paid for the bond. The flip side is open-ended funds can always be redeemed at NAV. This comes at a cost. Open-end mutual funds must manage inflows and outflows daily. This can limit a portfolio manager's strategy and often causes a manager to do the opposite of what he wants to do.

The current Fed tightening cycle is a good example. Higher rates have created opportunities for managers to acquire higher yielding investments which in the long run should lead to better performance, but the higher rates make investors nervous, and many redeem their shares. This can limit the manager's ability to buy and may, in fact, cause them to sell to meet redemptions. Fund flows are a non-issue to the CEF manager. The CEF team is always free to follow their strategy.

According to a report from PIMCO in Jan'19:

"Today, there are over 500 closed-end funds in the U.S. with more than $200 billion in assets under management. CEFs invest across all major asset classes and strategies, including taxable fixed income, municipal bonds, equities and commodities."

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The numbers today are most likely higher. After the initial offering CEFs are "closed". Unlike "continuously offered" open-ended funds they see no need to advertise and get little exposure. At Cater Wealth Management we believe the best way to access CEFs is through Unit Investment Trusts (UITs).

UITs are investment vehicles that hold different investments and are sold to individuals and institutions. We focus on UITs that hold income investment including municipal bonds, taxable bonds, preferred stocks and income-oriented equities like Business Development Companies (BDCs).

We have long held the belief the current inflation was in fact "Transitory", the Fed response was too late and when started was too extreme and they are now too late in their reversal. Their mistakes have created opportunities if we have the courage to take advantage of them. When it comes to income; now may be a good time to lock in…

"HIGHER FOR LONGER"

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