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# Yield to term

Term trusts, as this publication was saying only two weeks ago, are closed-end funds that liquidate on a date certain. Nowadays, many of the type change hands at discounts to net asset value. As the clock winds down to maturity the discounts tend to narrow, then vanish; sooner or later, the shareholders get NAV. Out of two dozen such funds, we shine a spotlight on four, each listed on the New York Stock Exchange and each doing the best it can with the meager interest rate and credit materials at hand. They are Western Asset High Yield Defined Opportunity Fund (HYI) and Western Asset Global Corporate Defined Opportunity Fund (GDO), Nuveen Build America Bond Fund (NBB) and Nuveen Build America Bond Opportunity Fund (NBD). The thing to be said on behalf of the four is that they will, eventually, return NAV. The thing to be said against them is that they do business in this picked over, credit swollen, ZIRP strafed bond market of ours. Widows and orphans, proceed with caution—big grown men, too.

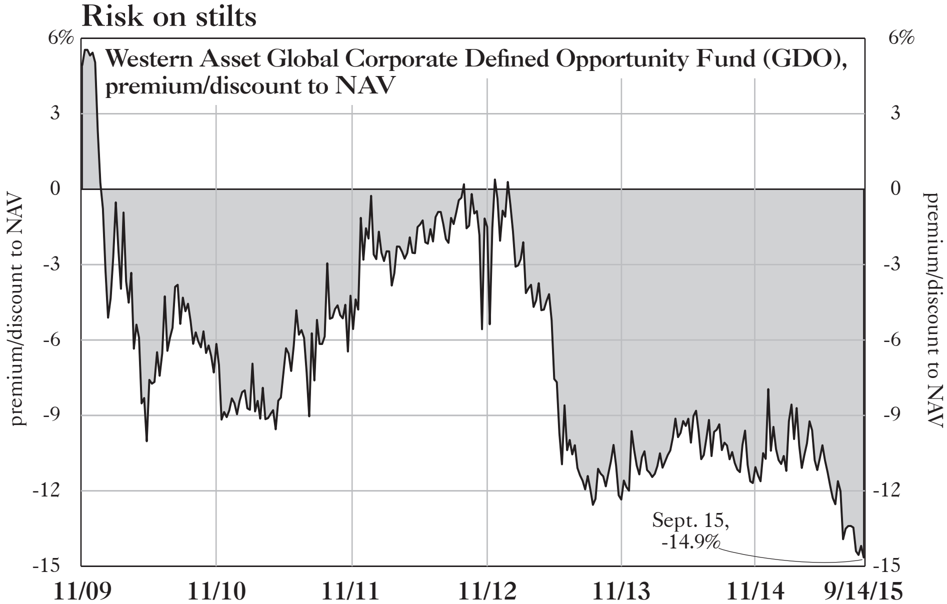
Term trusts come in different sizes, styles and maturities. All generate income, because all hold debt instruments of one kind or another: municipal bonds, corporate bonds, mortgages, bank loans. None is outsize—only BlackRock Municipal Target Term Trust boasts a market cap above $1 billion, and three weigh in at less than $100 million. Five liquidate by year-end 2019, seven trade at a discount to net asset value of greater than 10% and three change hands at a premium to NAV. There are investment-grade term trusts and speculative-grade term trusts. Many use leverage, some abstain from it.

In the bond market, the defining shorthand valuation metric is yield to maturity. There's a comparable notion in the market for term trusts. "Yield to term" is that analogue, and it can be calculated as follows: dividend yield plus or minus the discount or premium to NAV, divided by the number of years remaining to term. This is a highly contingent yield, of course. The dividend stream is variable; NAV calculations are likewise in motion. Reinvestment rates can vary—as maturity date approaches and bonds mature or are called, one's reinvestment rate can plunge. Indeed, call activity by municipal issuers nicked as much as 5.8% off the distributions of municipal closed-end funds in the second quarter, Nuveen reports in its latest closed-end fund review.

Blackstone/GSO Senior Floating Rate Term Fund (BSL on the NYSE), mentioned in the prior issue of *Grant's*, will serve as an arithmetic test dummy. BSL has an indicated dividend yield of 6.61%, and trades with an 8.1% discount to NAV; it is slated to dissolve and distribute its net assets by May 31, 2020. Yield to term is therefore 6.61% + 8.1%/4.75 years = 8.32%. Wise heads, wary of spurious precision and cognizant of the complicating factors mentioned above, might rather express the result as "more than 8% if the creek don't rise."

Tucked away in the vastness of Western Asset Management Co. is a pair of attractively discounted term trusts. Mind you, they are attractively discounted if you like the assets and,

**Risk on stilts**

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in one case, if you like the leverage. If you don't care for junk bonds at this particular moment of the credit cycle, or if you believe that interest rates are going to rise by more than just a little, or you have no use for Turkey, say, or for oil and gas, you are unlikely to be enamored. We ourselves are bearish on credit and suspicious of rates, though we try to bear in mind A.J. Liebling's quip about the opinionated Henry Luce, founder of the Time-Life empire. Liebling said that Luce reminded him of the owner of a shoe store who stocked his own size and no other. Here we write for the people who may disagree with us, or who, faintly agreeing, must own high-yield debt (or emerging market debt or taxable munis), or who are stockpiling ideas for the opportunity afforded by some future washout.

The Western Asset High Yield Defined Opportunity Fund (HYI on the NYSE) has a $324 million market cap, yields an unleveraged 9.3% and trades at a 16.1% discount to net asset value. The discount, while a little tighter than the 16.9% recorded only last month, is nonetheless among the steepest since the fund's inception in October 2010. HYI, declares its management, "provides a non-leveraged high-yield corporate fixed-income portfolio with a limited term structure that will liquidate on or about Sept. 30, 2025." As of June 30, the duration of the portfolio was 3.6 years. Credit quality stacked up follows: 3% rated BBB, 16% BB, 43.8% B, 29.6% CCC, 0.3% CC, 1.3% C and 5.9% not rated. Yield to term computes to 10.9%, which may be translated approximately: "10%, more or less, barring—just for instance—a blight of defaults, which could meaningfully reduce projected returns, especially if recoveries in bankruptcy prove to be subpar, as well they might given the weakness in covenant protections of the current crop of junk bonds."

Since its debut five years ago, HYI's net asset value has grown by 6% a year, assuming reinvested dividends. Colleague David Peligal asked Michael Buchanan, head of credit at Western Asset and co-portfolio manager of HYI, what he was doing to close the discount. "First and foremost," Buchanan replied, "the discounts or premiums are, to some extent, beyond our control. What we can control is the NAV. And certainly we manage this fund to, one, provide a high stable level of income, and secondly, we want to get capital appreciation. So our view has been that if we deliver on those two goals, ultimately, the fund will trade at less of a discount during periods like this, where there is an extreme discount in the market."

The Western Asset Global Corporate Defined Opportunity Fund (GDO), founded at the end of 2009, is the same but different. It is the same in that it owns corporate debt, is co-managed by Buchanan and trades at a big discount—14.9%—to NAV. It is different in that it is leveraged and owns foreign as well as domestic securities. At last report, almost 19% of the portfolio was allocated to emerging market debt, both corporate and sovereign, most of it U.S. dollar-denominated. Turkish government sovereign bonds—the dollar-pay 5 ¾s of 2024—ranked as the 13th largest holding. Brazil, Russia and Mexico are other points of exposure. NAV has grown by 7.9% a year with the assumption of reinvested dividends. As of June 30, the duration of the portfolio was 4.4 years, the market cap was $245 million and the yield was 8.43%; termination is slated for December 2024. As to credit quality, 19.8% of the assets were rated A, 40.3% BBB, 16.4% BB and 13.4% B; 7.5% of the portfolio was invested in oil and gas. The yield to term works out to 10%—with, of course, some important provisos, notably the success of the portfolio managers in dodging the whistling bullets in energy and the emerging markets.

"Interestingly," Peligal observes, "GDO is the only fund in the Western Asset stable with a share repurchase plan in place. Management doesn't buy much—a shade over 1% of the outstanding shares between March 10, 2014, and April 30, 2015—but it does seem a step in a shareholder friendly direction."

Nuveen Investments, which has been around since the Spanish-American War, is the name behind a pair of discounted, Big Board-listed taxable municipal closed-end funds: Nuveen Build America Bond Fund (NBB) and the Nuveen Build America Bond Opportunity Fund (NBD). NBB is considerably larger than NBD but that is the only substantive difference between the two. Each invests in direct-payment Build America Bonds, securities partially subsidized by the U.S. Treasury and issued, beginning in 2009, to speed participating cities and states on the road to recovery by promoting Keynesian fiscal schemes.

Both funds came into the world in 2010, and both are expected to leave it in 2020 (Bill Gross's favorite, BlackRock Taxable Municipal Bond Trust, mentioned here two weeks ago, has no such termination date); both are leveraged to the tune of 30%. NBB, with a $506 million market cap, yields 7% and changes hands at a 9% discount to NAV; its yield to term is 8.9%. NBD, with a $140 million market cap, yields 6.7% and trades at a 9.6% discount to NAV; its yield to term is slightly in excess of 8½%. NBB has a duration of 11.1 years, NBD a duration of 11.3 years.

NBB, as of Aug. 31, showed assets rated thus: 11.5% rated AAA, 60.4% AA, 21.2% A, and 5.2% BBB. NBD, also as of Aug. 31, showed a similar credit profile: 13.1% rated AAA, 65.9% AA, 13.9% A, 4.5% BBB, and 2.1% B. Call activity took its toll on second-quarter distributions. For NBB, the monthly payout dropped by 3.4%, to 11.2 cents from 11.6 cents. It was the first such reduction for NBB in more than three years.

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