Read the transcript from the AICA Bootcamp and Round Table Presentation Titled: "Deep Analysis of The 70+ Active UITs Focused on CEFs/BDCs. Which Sponsors Have More Success for Various Investment Goals?"

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Randy Watts, Co-Founder of UIT Investing, talked about various aspects of UITs focused on CEFs and BDCs at the AICA Boot Camp and Round Table held on November 6th in New York City. The moderator of the discussion was John Cole Scott, CIO at CEF Advisors and Executive Chairman at AICA. Read the transcript below.

Randy Watts

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John Cole Scott: I met Randy when he went from Capita to Nuveen, when Nuveen had a UIT business. As most of you may know, Nuveen shut down their UIT business, and he and his brother launched a UIT research website. What you may not know is that my for-profit RIA firm Closed-End Fund Advisors, we have a UIT or unit investment trust of BDCs. We just deposit Friday, Series 17, where we put a third of a billion dollars in a passively held wrapper of BDCs. And when I met Randy, I'm like, "Oh, this is great. Because so many UITs have closed-end fund guts. And we have a closed-end fund data business, and you know all the craziness about UITs." He goes, "What's even cooler is I have a patent on a process to do rolling performance to really benchmark and compare UITs over time." I go, "Wow." I've watched a lot of Shark Tank and they always like patents. At the same time, we were talking with both NASDAQ and NYSE about ways to support closed-end funds and BDCs with data research content. And I was talking to some folks at NASDAQ and I kind of learned that now it's official, Randy works at NASDAQ. NASDAQ bought his data business. So what's a really, really cool thing with this presentation, is he thinks about the UIT wrapper, which is historically been broker and commission sold. But I can tell you from our UIT, almost half of the inflows in the last two years have been fee-only CUSIP. And if you don't know what a UIT is, it's a 40 Act fund of something. Historically it had a commission and was sold by commission brokers. Still an option for it. But the fee-only share usually is 50 basis points for a two year hold.

At the end of the two years for some structures, 15 for others, you can either roll or liquidate, or take the guts in kind. And so what I love about this is, this is a wrapper of a lot of closed-end fund and BDC stuff, and it's a way of putting a flashlight on this wrapper. Because I think there's an opportunity for UITs to make a lot of sense for fee-based advisors, family offices. People that they like a theme but they don't want a lot of cost, but they want be able to pick a strategy. I'll let Randy talk now, but I loved all the content today. But obviously it's my conference, so I liked everything I did. It's kind of like asking a butcher if they like meat. I like meat too. So, so excited for Randy's talk, some good deck, and I'll turn it over to him. Thank you, ask him some good questions.

Randy Watts: Thank you. I appreciate the great introduction here. I'm happy to be here to speak about UITs. That last question was a perfect intro because that's what I'm going to talk about; the market of UITs that invest in closed-end funds and BDCs. I was going to start with saying, "Hey, why are we talking about UITs at an active management conference?" Because UITs is a passive product. But it's also a conduit to different types of investment strategies. And one of the largest ones is UITs that invest in closed-end funds and BDCs. There's also some of ETFs. There's also some market linked products and so forth. But we've seen the assets grow massively in terms of UITs that invest in closed-end funds.

So to start, John gave a little bit of a background on UIT Investing. I'll cover it pretty quickly here. But we are the first dedicated resource to UIT analytics and research reports, and basically data on the UIT market in general. UIT Investing is the first research and analytics platform to provide investment ratings and comparative analysis to the unit trust market. That's where it comes in, where he talked about our patent that we developed. About two years ago, I've been in the unit trust market for 15 years on the product management, on the trading, developing prospectuses, and coming up with my own algorithms and formulas to be able to track unit trust over a long period of time. As he said, we're proud to announce that as of September 30th, 2019, UIT Investing is apart of the NASDAQ information services, and everything we have now is available on the NASDAQ Fund Network. Our company is based into two different components, like I mentioned the UIT research and analytics, which is online tools, research reports, comparison functionality, things like that on our website. As well as a UIT data platform, where we actually submit raw data to issuers, to other companies and so forth, that want to use the data to create their own analytics, their own research and so forth.

So in the past two years, we have become the go-to resource for unit trust analysis. We're used by primarily financial advisors, by individual investors, by UIT issuers, by the UIT issuer sales force. To obviously increase the transparency, the information that they get out about their products. We combine modern technology, a very specified dataset, as well as the customized formulas, to be able to deliver accurate and reliable analytics of unit investment trust for investment analysis. And we do offer a full-service web platform, which is also where you can customize searches, and compare and contrast UIT strategies. We do process and put up their proprietary research reports, with a rating and so forth. You can compare to other comparable UIT strategies. And as well as we keep updating the site and give a very comprehensive list of any UIT offered on a daily basis in the primary market.

The two things that are very unique about UIT investing, is that our system is specifically designed to analyze and rate UITs. UITs may look like a similar package product on a high level, but when you get down to the weeds, the data points, the way it trades, everything is very different. So we developed our system specifically to cover all these data points. And finally, there was no data warehouse that could encompass these data points. We created it from scratch in-house, and built the algorithms to pull those data points.

So why UIT invest in closed-end funds and BDCs? Well, UITs are actively selected but they're passively managed. And because of this, utilizing closed-end funds is a good conduit to invest in certain securities, certain markets that the UIT structure just can't do. I gave some examples here. One is fixed-income securities. UITs have to be invested at all the time, and they have to be able to process daily redemptions and buying every day. So if you're any security that's bought in block, usually the UIT will use a closed-end fund, a BDC, some sort of instrument inside the portfolio to access those types of securities. UITs are not allowed to use leverage, so investing in UITs gives them access to obviously have some leverage inside the portfolio.

Less liquidity constraints, UITs have to be able to offer daily liquidity to every investor in on a daily basis. So every security in there has to be liquid, no matter how large or small the position. Access to different investment strategies, like we talked about, the UIT in general is an investment product, but it really is an avenue to invest in all types of different investment strategies using different types of securities. And then it also allows some limited active management. UITs by structure are not allowed to trade in and out of the portfolio. Once that portfolio is set, it is set. Using some active management obviously allows the UIT to be able to adjust its portfolio from the underlying assets. And we know in times, where your decision may be going against you, the active fund manager underneath the UIT can actually trade in and out of the products if it turns out a favor.

So UITs using closed-end funds and BDCs in part, in full, are not designed to outperform an index. That's probably the most important. They're designed to add different dimensions to a portfolio allocation, and potentially lower volatility to different allocations. So what are the benefits of buying a UIT consisting of closed-end funds or BDCs? I put three up here specifically that people look at. First one is diversification.

At any time, any one of these UIT strategies will invest in anywhere from 10 to, say, 25 or 30 different closed-end funds. So not only do you get diversification among the funds, but across hundreds of underlying securities in those funds.

Professional selection, the issuer, the research staff at the issuer, or portfolio managers from a portfolio consultant are the ones selected these closed-end funds for the portfolio. Obviously looking at different metrics, different factors for what they see to invest in at that point in time. The UIT will hold them for anywhere from 15 months to two years. So it's not something we suggest the retail investor to do on their own, but utilize the UIT and the investment manager research to pick these funds for them. And then finally ease of management. You can get a diverse portfolio of 10 to say, 15 or 30 closed-end funds in one purchase. So it actually makes it a really ease of business for one, the financial advisors and also for the individual investor.

Okay, let's get into the different types of UITs of closed-end fund and BDCs. There's over 70 or 80 different types of UITs out there that invest either in part or in full in closed-end funds or BDCs; all the major sponsors that all have different suites offering multiple UITs of different strategies. But for the analytics we're going to go over now, we used specifically 56 different UIT strategies that we broke down to 12 different categories in our system. The requirements for this is that the strategy had to be in existence for three years, and had to consist of one hundred percent either closed-end funds or business-development companies. You'll find a lot of UITs out there that are allocated around, may have 80% equities and 20% closed-end funds. Or could be 80% closed-end funds, 20% equities. We excluded those for the purpose of this analysis.

So out of those 12, these are the most popular ones used. We defined mostly equity strategy ones as the covered-call strategies and growth and income. You'll see tactical allocation UITs that are focused on monthly income, or thematic portfolios based on anything going on in the marketplace. And then obviously different taxable income categories depending on the different fixed-income structures that they're using. And then overall general, it's taxable and tax-free. You'll see a lot of muni bond UITs of closed-end funds, probably two of the most popular strategies that they use. People invest at either the state or national level.

So before we get into the analytics, I want to give you a little definition of how we come up with our performance. We use at UIT Investing, multiple different types of calculations. For this one, we used what we call a historical connection process. And what that is, is that a UIT may only be anywhere from 13 to 15 months to two years in length. That means it terminates. And the typical investor will invest in a UIT strategy, hold it to termination, and then move those proceeds into the new series of similar strategy, and on, and on, and on. And this could go for three, five, 10, 15 years, depending on the strategy. So what our database does, and what we track is, is we track the offering periods of every UIT strategy out there.

So for example, we're going to look at three-year portfolios. Our system will go back exactly three years to the day and look at what series was available for purchase that day it was on the primary market. We assume that we start with that day as the purchase point, hold that to termination, and then move those proceeds and roll it on, and on, and on. So we basically track what is available for purchase at that time, and that's how we recreate an investor's experience, and actually can see what investor would have made over the long period of time, and over multiple series.

So what we did here is we took the 56 different types of strategies, and took the average cumulative return of them. Like I mentioned, this is going back three years to the day. So we started on October 31st of 2016 to October 31st of 2019. And some of these different categories will have more strategies than others, but regardless of sponsor, we took the average performance of that category to compare what it looked like against the indexes. And I thank CEF Advisors for allowing me to uses their indexes to apply applicable comparisons to the different strategies. I'll leave this up here for a second to let you look, but we'll go into a little bit more detail here in the next slide.

This one's a little more visual content based on the last slide. And like I mentioned, the UIT structure of closed-end funds is not designed to out preform and index. That's not the purpose of it. It's to add a different dimension. Now at our side at UIT Investing, we do try to monitor this and see it's at least close to an index or not drastically underperforming. So you'll the majority of categories do underperform the index on a communicative basis, but what we're looking for is not by much. You'll see the majority of them are trailed by a small amount.

This is probably the most important part of it. Like I mentioned, the structure buys closed-end funds to lower volatility of a portfolio of an allocation. So we ran the same time period, using the same cumulative performance, we looked at the average standard deviation to look at the volatility of these categories of UITs of closed-end funds and BDCs. I also threw in the S&P 500 there; the standard deviation of the general equity market as a comparison to see how these different strategies compare in terms of standard deviation along with the equity market as well. So I'll leave this up for a second as well.

This is probably the most important slide that we're showing in this deck here, because it basically shows exactly that what these UIT sponsors are trying to do with their closed-end strategies, it's effective. You'll see that the standard deviation compared to its index, the majority are slightly lower. They're not trying to outperform, they're trying to lower volatility and add a different dimension to a client's portfolio. It could be any one of these categories, or multiple categories.

This is a little bit deeper in the weeds, but these are the trusts that made up the different categories that we showed in the last two slides. Like I mentioned, all five major issuers for UITs, all offer a suite of different types of UITs of closed-end funds. First Trust is the largest, and offer one, the most UITs in general, but also the most amount of closed-end fund and BDC UITs. There's also Advisors Asset Management, Guggenheim Investments, Invesco Capital Markets, and Hennion &Walsh. The one thing on this slide, you'll see is that when we look at issuers and trends and who does better than who and others when we're comparing, we try to do our best to be agnostic on our side. But we also look at trends and so forth, to see who does better at what asset class and so forth.

On this slide, you'll see there's no real trends saying one sponsor is better than the other. You'll see First Trust claim the top one spot, or two spots in some. You'll see Guggenheim, you'll see AAM, it's really spread around. This is the tax-free UITs of closed-end funds. You'll see the one trend we see here is obviously most of the sponsors offer tax-free on both the state level and the municipal level. First Trust does seem to take the top spots. It won't always be the case, but obviously from the past three years, their performance of the tax-free UITs took the top spots.

So in summary, there's three points I'd probably like to get across based on this presentation. Is one, UITs of closed-end funds of BDCs allow the UIT structure to gain access that it normally couldn't based on the rules applied on the UIT structure. Things like specific securities, investment strategies, leverage, some active management, and more. We saw that many of the UIT strategies on a three-year basis, show lower volatility than the index, as well general equity market in general. Which is the whole goal of what these issuers are trying to do when they develop a strategy based off closed-end funds or business-development companies. Three, there's a couple of benefits of why investors like it, and why financial investors use them for their clients. It provides a simple way to one, if you want to increase yield. Obviously the structure - investing in closed-end funds can use a little bit of leverage, raise the yield on a normal UIT structure could. Increase the diversification, that's adding the different element to any allocation. And then like I said, lower volatility by adding a different asset class to different portfolio allocations.

We showed one type of analysis here, the three-year of closed-end funds and BDCs. We do offer a lot more on our VR website. We do per series information and analytics. We do two types of long-term calculations, which is the connection process which I mentioned. We also do a composite process, and we do show from inception, three, five, ten years' worth of performance and risk analytics on our website. So we just covered the three years here, but there's a lot more you can find at UITInvesting.com. In our reports, we also look at the primary UIT out there, and do a little portfolio analysis. So you'll see average PEs, average price to books, market caps, and so forth. As well as expenses, so we do an in-depth analysis of, what is a client paying annually, on an annual basis for some specific UITs? With that, I'll leave the disclosures page up there. We do do a lot of data and it explains how we do it and so forth. But like John said, we'll make this available so you can really read how we actually do it. But with that, I'll open up with any questions if anyone has anything. Yes, sir?

Audience: How do you actually measure volatility in the UITs?

Randy Watts: Well, we look at the daily change of any type of NAV. We use the liquidation price in UITs, so we're measuring the daily change over whatever timeframe we're looking at; three, five, and ten, and take the standard deviation of those changes. If that makes sense?

Audience: I've been doing some work in measuring risk in closed-end fund portfolios, and I basically think that what you should look at is the volatility of the dividend stream. If you do that, you get extremely low volatility. And the portfolio within UIT doesn't change very much, I imagine you would probably do the same sort of thing.

Randy Watts: Yes, so we are. These metrics or these data points, it's a total return. We're not looking at it individually, but obviously it's include in the NAV every day. So every X date, whether it's a principal or income distribution, it gets thrown into that NAV on top of it.

Audience: Okay. Well, ultimately what I was going to ask is, do you break down returns between price return and dividend yield?

Randy Watts: We offer just the dividend yield on the primary, but we track the distributions. That's something on our list to produce, is actually historically and the change of dividend yield over these dividend trusts. Luckily with NASDAQ resources, maybe we'll get it sooner than later. Yes, sir?

Audience: All of the sponsors talk about active selection, but if you look at the link in the series of UITs, how much active selection do you think is actually taking place? There's obviously many of the same names.

Randy Watts: You do.

Audience: Concentrations year after year, or 15 months.

Randy Watts: Yeah, the longer it goes, you'll see more. But typically some of these are offered for three months, and it closes, the new one opens in three months. And if it's 15 closed-end funds, you may see one or two different at that time, and then another two different six months later, and so forth. So when you get down to a year, you'll see maybe half. In two years it starts to change a little bit more. But you're absolutely correct. The offering periods can be anywhere from one month to three months really, in very few you'll see six months. So not a lot may change in the eyes of the portfolio manager or the analyst doing this. So you'll see a lot of overlap in short-terms. But like I said, the connection process, you should not get the same investors one time, and then three months later. Typically you'll have different investors at that point, and then the rollover 15-month process.

John Cole Scott: I'll speak to the fact that every four month I see a new portfolio of BDCs, it was about 30 liquid ones, probably 15 that I regularly use. I was just talking with the last panelists. I did the portfolio a week before it goes live, and I always wish it was after earning season for BDCs. But yeah, there's kind of some workhorse ones, but I'm trying to think, what's the best two-year goal for the UIT? Because I'm not going to actively change it, and that's why we typically have 12 to 14 BDCs in there. In our separate accounts we have half that allocation, because I'm actually picking it and can trade it. And that's how I've thought about it as I spent the last five years selling a UIT of BDCs.

Randy Watts: Yeah, and you make a good point. They make it very clear when they're selecting the securities. They're looking at the termination of their UIT. They're saying, "We're selecting these because this terminates in 12 months," or "This terminates in 24 months." And they may change based on the specific UIT they're selecting for.

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