Diligent Market Intelligence (DMI) speaks with Phillip Goldstein and Andrew Dakos of Bulldog Investors, about the allure of closed-end funds, recent market disruption and what it takes to be a shareholder activist.

Bulldog has invested in closed-end funds (CEFs) since the 1990s, and launched activist campaigns at around 80 of them, often with an emphasis on how they are managed. What's behind this love-hate relationship with an asset class that many investors may never have heard of?

A closed-end fund, if run by a strong manager, is a great vehicle because you don't have to worry about the inflows and outflows. You know you have a stable asset. And you have a good sense of what discount they are trading to their net asset value (NAV). The bottom line is, we think the opportunities for activists in the closed-end fund space are better now than they've been in years.

The average discount to NAV across the closed-end fund universe has widened this year. What is driving this?

Closed-end funds in general often exhibit varying discounts, particularly in sectors that were previously more stable. For instance, municipal bond funds have become increasingly attractive due to wider discounts, and we anticipate greater activism in this area, possibly even from our own organization.

In some instances, however, discounts can be elusive. About two years ago, many energy-oriented funds experienced substantial discounts, some as high as 30%. Over time, these discounts have started to align more closely with other funds in the market.

Does that optimism apply to Bulldog's other alternative investments, such as real estate investment trusts (REITs) and special purpose acquisition companies (SPACs)?

SPACs are in a bearish environment. There are some IPOs coming, but nowhere near the level that they were a year and a half ago. But, with interest rates having moved up, we're getting at least some nominal returns on the trust accounts. We don't look at SPACs primarily as an activist investment. We look at it as a superior alternative to cash or money market funds. You can earn a higher return; you have the optionality.

REITs are a little difficult to value right now. With closed-end publicly traded securities, you generally have a very good sense of what the underlying value is. You can try to come up with a valuation for a REIT, but it's a moving target, especially in today's environment. There are certainly REITs out there that look cheap, but at this point it makes us a little nervous.

What else are you looking at?

While we usually focus on CEFs, we have in the past been active in certain operating companies. And with interest rates where they are, we think there are some undervalued micro-cap stocks where it just doesn’t make sense for them to be publicly traded. If it is a profitable company with a market cap of $75 million, but a private market value of $130 million and they’re incurring all the regulatory expenses of being public, they should really be acquired by a larger company or a private equity firm. I could see us possibly moving into those areas and becoming activists.

Since 2019, Bulldog has served as the investment advisor for Special Opportunities Fund (SPE). Is the approach different here when compared to other CEFs?

The fund used to be managed by UBS. We won a proxy fight and took control of the board. We enabled it to make monthly cash distributions to stockholders and modified the investment objective to focus on generating general, risk-adjusted total returns. To the best of my knowledge, SPE is the only mutual fund that incorporates activism as a central strategy. This doesn’t imply that we engage in activism for every investment we make, but it constitutes a significant component of our overall approach. When selecting stocks, we always maintain the capability to become activists if we find that a company’s management or its stock persistently underperforms in terms of value.

Bulldog often criticizes the managers of CEFs trading at significant discounts to NAV. But SPE is itself trading at a discount. What are you doing to close the valuation gap?

We believe SPE’s discount is excessively high, and as a result, we’ve been actively purchasing shares. Additionally, we’ve explored the possibility of increasing dividends, as investors often express a preference for higher dividend payouts.

First Trust recently rescinded “control share” bylaw provisions at several CEFs after Bulldog threatened legal action. Do you think the courts have become more sensitive to the rights of shareholders in bylaw cases?

The outcome often hinges on the specific court involved. Given the extensive coverage and discussions in the political arena regarding issues such as voter suppression, I see parallels in the context we’re discussing. Imagine if the United States Congress declared that incumbents could remain in office unless a majority of registered voters cast their ballots for someone else. Given the low voter turnout in many cases, this standard would be excessively high. In a fair system, the candidate who secures the most votes should win, regardless of the number of shareholders or voters participating.

The Delaware courts have a well-established history of safeguarding shareholder rights. While these courts grant management significant discretion when it comes to business judgments, they are particularly attuned to protecting shareholder franchise rights. This is crucial because the legitimacy of a company’s leadership hinges on these rights. Without them, the risk of entrenchment and a departure from democratic principles becomes all too real.

You started your career as a civil engineer. Has that training influenced the way you operate and the way you think about finance?

I spent nearly 25 years working as a civil engineer for the city of New York. While this career may not seem directly related to activism, it has certainly influenced my approach to investing. Engineering is rooted in hard science, where you either design a bridge that remains structurally sound or one that collapses. There's no room for ambiguity in this field. In investing, I believe it's essential to view things as they truly are, rather than how we might wish them to be. There's no place for politics or vague sentiments in this endeavor. It's about facing the realities and making sound decisions accordingly.

What other attributes have proven helpful as an activist?

I've always held a keen interest in constitutional law, politics, philosophy and psychology. In the realm of activism, you often find yourself in opposition to others, striving to influence the management of a company in which you've invested, steering them away from the status quo. Unlike engineering or mathematics, activism involves dealing with real people, necessitating negotiation skills.

In the past, some of us activist investors engaged in somewhat acerbic correspondence with company management, employing sarcasm and humor to lampoon their actions. While it personally gratified me, I eventually realized that this approach wasn't as effective as adopting a more measured strategy. Nowadays, we often use a combination of incentives and consequences, a "carrot and stick" approach, if you will.