

## The Discount Principle:



### DISCOUNTS ARE OPPORTUNITIES, NOT ACCIDENTS

As any Closed End Fund investor knows, CEFs typically trade at a price that is at a discount or premium to the underlying net asset value (NAV) of the fund. The idea that CEF discounts create investment opportunity has been a cornerstone of investment decision-making at Herzfeld Advisors since this principle was first articulated by our founder, Tom Herzfeld, in 1979. While many investors see a discount to NAV as weakness, we view a CEF's discount to NAV as a potential entry point—a chance to buy assets below their value. In this first issue, we revisit Tom Herzfeld's original insight and show how the “discount discipline” continues to guide our investment process today.



### Original Investment Principle

From the very beginning, Tom Herzfeld emphasized that while many factors matter in evaluating closed-end funds (CEFs), the relationship between discounts and premiums to NAV is the most widely used. A discount means investors can purchase a portfolio of assets for less than its net asset value, effectively boosting the yield on the underlying securities. That gap between price and value creates opportunity: when discounts narrow, returns are amplified.

“If you had to pick one variable ... it would have to be the discount or premium.”

– Thomas J. Herzfeld.

## Spotlight Principle: Why Discounts Matter

At Herzfeld Advisors, we view discounts to NAV not as accidents or inefficiencies, but as deliberate signals that guide our opportunity set. In practice, our team evaluates 20–25 quantitative and qualitative factors when analyzing funds, including:

- **Historical vs. current discount** – Identifying mispricings relative to long-term averages
- **Peer comparisons** – Spotting anomalies across similar funds
- **Expense ratios & tax impact** – Assessing whether costs justify or undermine the discount
- **Liquidity** – Ensuring positions can be built and exited efficiently
- **Strategic positioning** – Evaluating catalysts such as activism, conversions, or tender offers

This process goes beyond simply “buying what looks cheap.” By applying a consistent, disciplined framework, we look to separate true value opportunities from value traps.

As President Erik Herzfeld explained in a 2018 interview:

“When the discount widens, it's like a coiled spring. If you push really hard, it tends to go back the other way.”

This metaphor reflects decades of market observation. Discounts often overshoot during periods of stress, only to snap back as fundamentals reassert themselves.



*“A wide discount—when supported by sound fundamentals—offers the chance to purchase a dollar’s worth of assets for less.”*  
-Thomas J. Herzfeld.

## Market Insights: Discounts in 2026

Average discounts across all closed-end fund (CEF) sectors have widened meaningfully, moving from -3.77% in February 2025 to -4.87% in February 2026. Most sectors have experienced widening, with the exceptions of Foreign Equity and Municipal Bond CEFs, which remain relatively tighter compared to last year. The most pronounced widening occurred within Senior Loan CEFs, which include loan and CLO funds, where discounts widened from an average of -1.85% in February 2025 to -15.23% in February 2026, reflecting broader pressure seen across leveraged credit.

Since the start of 2026, however, fixed income CEFs – including bond, convertible bond, foreign bond, and municipal bond – have seen discount tightening, on average, as markets have digested shifting rate policy expectations, suggesting modest improvement in sentiment toward rate-sensitive assets and income-oriented strategies.

Despite the recent tightening in parts of the fixed income market, discounts across the broader CEF universe remain wider than levels seen a year ago. Continued volatility in credit markets, evolving interest rate expectations, and macro uncertainty have contributed to a more cautious investor backdrop. Within this environment, dispersion across sectors has increased, creating pockets of opportunity where discounts appear disconnected from underlying fundamentals. In this environment, a targeted, research-driven approach is essential for identifying mispricings and capturing value the broader market may be overlooking.

**Did You Know?**

Thomas J. Herzfeld's 1980 research was the first comprehensive study of closed-end funds, at a time when no centralized data even existed. His early newsletters became the reference point for regulators, investment professionals, and other market participants seeking to understand CEF discounts.

**Average Premium/Discounts CEFs**



**Looking Ahead**

Identifying a discount is only step one. The next question is, what else matters? Catalysts—whether a tender offer, conversion, merger, activist campaign, or a change in distribution policy—are the forces that transform opportunity into realized return.

In our next issue, we'll explore this principle in depth: "Catalysts: *Unlocking Value in Closed-End Funds*."

We'll examine the types of catalysts that matter most, how we assess their probability, and why understanding them is essential to disciplined closed-end fund investing.

For more information, please contact us.

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