

## Unlocking Value in Closed-End Funds:



### DISCOUNTS DON'T CLOSE THEMSELVES

From the beginning, Thomas J. Herzfeld emphasized that identifying discounts is only the first step in disciplined closed-end fund (CEF) investing. The next question is: what will make that discount close? More often than not, the answer is...

Catalysts—corporate actions, policy changes, or market events—are what turn potential into performance.

In this issue, we explore the role of catalysts in realizing value, examining how Herzfeld Advisors identifies and assesses the forces that drive change within CEFs.

## Original Investment Principle

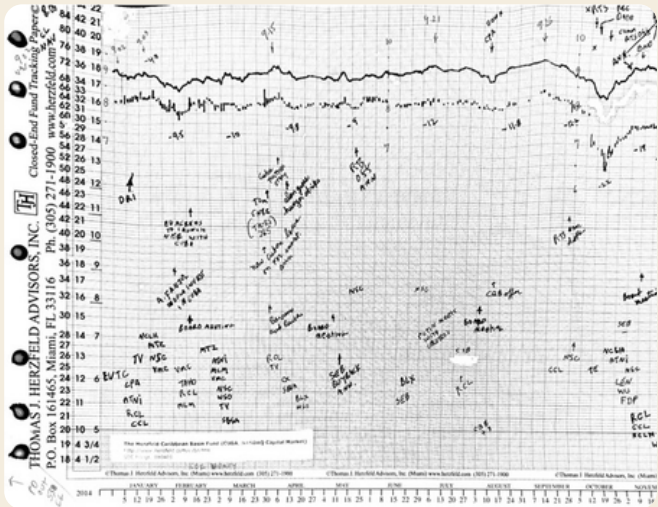


A catalyst is any event or structural change that narrows the gap between a fund's market price and its net asset value (NAV). Tom Herzfeld's research over four decades shows that discount narrowing — not price appreciation — is often the most reliable driver of alpha in the CEF space.

"Excessive discounts should not be regarded as signs of internal weakness but rather as indications of unusually fine buying opportunities."<sup>1</sup>

— Thomas J. Herzfeld

<sup>1</sup> Thomas J. Herzfeld, *The Investor's Guide to Closed-End Funds* (New York: McGraw-Hill, 1980), 68.



Identifying a discount is valuable. Understanding why it will close is essential.

## Spotlight Principle: Catalysts Create the Path to Value

Catalysts are not random occurrences; they tend to arise where investor pressure, structural inefficiency, and management incentives intersect.

As Erik Herzfeld, President of Herzfeld Advisors, has said, "We will get into a fund with the idea that there has to be a catalyst that the discount will narrow. If there is a fund that is always at a premium and it goes to any type of discount, that is always quite interesting to us."<sup>2</sup>

This discipline — waiting for the right convergence of conditions rather than chasing yield alone — is central to how Herzfeld Advisors approaches opportunity.

The firm focuses on anticipating these inflection points by asking three key questions:

- **Who has the power to act?** (Board, activist, or institutional holder)
- **What levers exist?** (Tender, conversion, merger, or liquidation)
- **When might they occur?** (Proxy windows, activist filings, or policy reviews)

Common catalysts include:

- **Tender offers and repurchases** – returning capital to shareholders at or near NAV
- **Conversions and liquidations** – changing structure to eliminate the discount entirely
- **Activist campaigns** – prompting boards to act in shareholders' best interests
- **Distribution policy changes** – realigning payouts with sustainable earnings
- **Sector re-ratings** – market sentiment shifting as fundamentals improve



Our team continually monitors activist filings, corporate announcements, and fund board actions to gauge catalyst probability. This data-driven framework helps us position portfolios where change is not just possible — but probable.

<sup>2</sup> Citywire, April 2017

## Market Insights: Catalysts in 2026

2026 began with closed-end funds trading at an average discount of -4.78%, against a backdrop of moderating inflation expectations and a market that had priced in two Federal Reserve rate cuts over the course of the year. However, as the first quarter progressed, geopolitical tensions and persistent inflation concerns have clouded the near-term outlook. In response, CEF discounts have widened by roughly 200 basis points to approximately -6.70% at the end of March.

Wide discounts are an activist's playground, and the current environment is no exception. High-quality funds across asset classes are now trading at levels that, in many cases, approach historically wide discounts, increasing the likelihood of activist engagement and strategic action. A useful parallel can be drawn to 2022, when rising rates and broad market volatility pushed CEF discounts to similarly wide levels. That environment sparked a meaningful wave of activist activity, with dozens of funds targeted and a sharp increase in tender offers, proxy contests, and structural outcomes, including mergers, conversions, and liquidations. The playbook was clear: as discounts widened, activists stepped in to unlock value through liquidity events and governance pressure.

Against this backdrop, 2026 has already seen a notable pickup in catalyst-driven activity. Fund sponsors have leaned into share buyback programs and structural actions, including conversions, mergers, and rights offerings, as tools to address persistent discounts. At the same time, activist investors have become increasingly aggressive, capitalizing on dislocations and pushing for liquidity events, governance changes, and broader strategic alternatives.

In short, the evolving macro environment has set the stage for a catalyst-rich year in the CEF space. If history is any guide, sustained discount pressure tends to be self-correcting, either through market normalization or, more often, through catalysts driven by engaged shareholders. As volatility persists and discounts remain elevated, we expect continued pressure on fund sponsors to act, creating a dynamic landscape of opportunities for investors focused on special situations and catalyst-driven returns.

## Looking Ahead

Catalysts unlock value, but liquidity determines how efficiently that value can be realized. In our next issue, we'll explore the principle: "Liquidity Comes at a Price — Pay It Carefully."

We'll examine how liquidity premiums, trading volume, and bid-ask spreads shape opportunity — and why the cost of liquidity in closed end fund investing is rarely what it appears to be on the surface.

### Did You Know?

The "Herzfeld Hedge," introduced in Thomas J. Herzfeld's 1980 McGraw-Hill book, was one of the earliest documented strategies for systematically exploiting the discount between a closed-end fund's market price and its NAV — the foundational idea behind what we today call catalyst-driven investing.

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