

## Knowing When to Exit:

LIQUIDITY COMES AT A PRICE — PAY IT CAREFULLY



Thomas J. Herzfeld built his reputation on a simple but powerful insight: price and value are not the same thing — and the gap between them is where opportunity lives. But opportunity on paper is not opportunity in hand. Once a catalyst fires and a discount begins to close, a new question emerges: can you actually realize that value? More often than not, the answer depends on...

Liquidity — and the hidden cost of ignoring it.

In this issue, we examine how liquidity premiums, bid-ask spreads, and trading volume shape opportunity in the closed-end fund space — and why the team at Herzfeld Advisors has always treated liquidity not as an afterthought, but as a core input in every investment decision.

## Original Investment Principle



Thomas J. Herzfeld identified liquidity as a variable "that bears particular watching" in closed-end fund trading.<sup>1</sup> Underlying this principle is the idea that a fund's price may tell you where an opportunity is, but liquidity tells you whether or not you can reach it. A fund trading at an attractive discount may look compelling on paper, but if the daily trading volume is thin, the bid-ask spread is wide, or the shareholder base is concentrated, the cost of entering or exiting that position can quietly erode the very return you were seeking.

"If I intend to trade in any size, I would avoid initiating trading positions in inactive funds. I would look to the relatively more active funds".<sup>2</sup>

— Thomas J. Herzfeld

<sup>1, 2</sup> Thomas J. Herzfeld, *The Investor's Guide to Closed-End Funds* (New York: McGraw-Hill, 1980), 45.

Three variables reflect liquidity in the CEF space:

- **Share Price** – Investors demand a higher expected return for owning something that is less liquid. Because of that required return, a less liquid asset often trades at a lower price. In other words, investors are compensated for taking liquidity risk. On the other hand, highly liquid assets can trade at a higher price (liquidity premium) because investors value flexibility and ease of trading.
- **Bid-ask spreads** – the gap between what a buyer will pay and what a seller will accept is a real, recurring cost. In thinly traded funds, that spread can be significant enough to change the investment calculus entirely.
- **Trading volume** – average daily volume determines how efficiently you can build or exit a position without moving the market against yourself. Size matters – and so does timing. Knowing the price of an opportunity is only the beginning. Knowing what it will cost to act on it is what separates discipline from speculation.

## Spotlight Principle: Liquidity, The Hidden Variable

Liquidity is where conviction meets reality. A fund can check every box – wide discount, clear catalyst, strong underlying portfolio – and still disappoint if the trading dynamics work against you. At Herzfeld Advisors, liquidity is never the last thing we look at. It is the filter through which every opportunity must pass before we act.

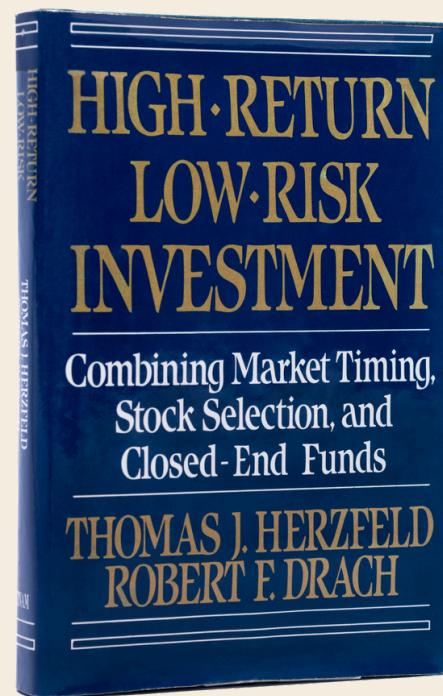
In practice, this means evaluating three things before entering any position.

First, how liquid is this fund? Average daily trading volume tells you how much of a position you can realistically build or exit without disrupting the market price. A fund trading 10,000 shares a day demands a very different sizing discipline than one trading 500,000 shares a day.

Second, what is the true cost to trade? The bid-ask spread is a tax on every transaction – one that compounds over time and across positions. In thinly traded CEFs, that spread can widen significantly during periods of market stress, precisely when you may need to act most urgently.

Third, when does liquidity matter most? Entry and exit are not equally difficult. Getting into a position is often easier than getting out, especially when a catalyst has already begun to play out and other investors are moving in the same direction. Timing matters, and so does patience.

Liquidity analysis is not about avoiding illiquid funds entirely. Some of the most compelling opportunities in the CEF space exist precisely because other investors can't or won't trade them. The discipline is in knowing the cost, pricing it in, and never letting it surprise you.



## Market Insights: Liquidity in 2026

Liquidity has increasingly become one of the most important forces shaping both public and private markets. Over the past several years, investors have moved aggressively toward structures that offer flexibility, daily tradability, or at the least, some ability to access their investments, while illiquid strategies across private equity, private credit, and real assets have simultaneously continued to grow at record pace. That tension between long-duration assets and investors' desire for liquidity has created both opportunity and dislocation across the closed-end fund market.

Recent market activity has highlighted this dynamic clearly. In 2025 and 2026, private markets experienced a prolonged slowdown in realizations and exits, leaving many institutional investors overallocated to private assets and searching for liquidity solutions. This environment fueled significant growth in secondary market transactions, continuation vehicles, NAV financing structures, and other forms of portfolio liquidity management. At the same time, publicly traded structures capable of holding illiquid assets (including closed-end funds, BDCs, REITs, interval funds, tender offer funds, and others) attracted substantial investor attention, as evidenced by the recent IPO of Pershing Square USA (PSUS), a \$5 billion closed-end fund IPO and one of the largest ever brought to market. The fund continues to trade at massive volumes on a daily basis.

The importance of liquidity becomes even more apparent during periods of market stress. In March 2020 and again during the 2022 interest rate shock, many leveraged fixed income and municipal bond closed-end funds experienced sharp discount widening as investors rushed to reduce risk exposure and liquidity conditions deteriorated. In many cases, discounts moved far more dramatically than the underlying NAVs.

These dislocations are why liquidity remains central to closed-end fund investing.

## Looking Ahead

Knowing when to exit protects your return. But there is another force working inside many closed-end funds — one that can accelerate gains in favorable markets and devastate portfolios when conditions shift. In our next issue, we'll explore the principle:

**"Leverage Amplifies Everything — Including Your Mistakes."**

We'll examine how closed-end funds use borrowed capital to enhance yield and returns, why leverage changes the risk profile of even the most attractive discount opportunities, and how Herzfeld Advisors evaluates leverage as a feature — not a flaw — when used with discipline.

For more information, please contact us.

**+1.305.777.1660**

**info@herzfeld.com**

### Did You Know?

The same characteristics that make closed-end funds attractive to disciplined investors (fixed share counts, exchange-traded structure, persistent discounts), are the very same features that can make them tricky to trade. The structure that creates the opportunity also creates the friction.