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The Portfolio Is the Foundation —

EVERYTHING ELSE IS CONTEXT:

Discounts get the headlines in closed-end fund investing, but a discount by itself doesn't tell you everything. It only becomes meaningful once you know what's sitting behind it. A fund trading well below net asset value is not automatically attractive. The question that matters most is what the fund actually owns.

That is the foundation.

Leverage, discounts, and yield all describe how a fund behaves. The portfolio provides insight and rationale for that behavior. A well-constructed portfolio can absorb volatility, support consistent distributions, and recover from drawdowns. A poorly constructed one can turn a modest market decline into a permanent loss of capital, regardless of how attractive the discount looked going in.

Original Investment Principle

At its core, a closed-end fund is only as strong as the securities it holds. Discount narrowing, catalyst-driven strategies, and leverage management all operate on top of the underlying portfolio; none of those actions can manufacture quality that isn't there. Before any other characteristic of a fund is evaluated, the composition of its holdings must hold up on its own merits.

“One must continually evaluate which industry groups are the strongest. Careful attention should be given to being invested in funds whose portfolios have large concentrations in currently strong industry groups.” [1]

- Thomas J. Herzfeld

[1] Thomas J. Herzfeld, *The Investor’s Guide to Closed-End Funds* (New York: McGraw-Hill, 1980), 14.

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Tom Herzfeld recognized that portfolio analysis is where disciplined closed-end fund investing begins, not where it ends. A discount and a yield are outputs of the market's view on a fund's holdings, they are not a substitute for examining those holdings directly. That distinction is central to separating durable opportunity from a value trap.

Spotlight Principle: The Portfolio Is the Foundation — Everything Else Is Context

A fund can carry modest leverage, sit at a wide discount, and offer an attractive yield, but none of those figures mean much if the assets generating them are weak. At Herzfeld Advisors, we treat the portfolio itself as the starting point for evaluating any closed-end fund, not as an afterthought to its price.

In practice, this means evaluating four key components of a fund's underlying holdings:

- **Credit Quality:** Determine the creditworthiness of the securities a fund holds, and how that composition would perform if conditions deteriorated. A portfolio concentrated in high-yield credit carries a different risk profile than one anchored in investment-grade or government-backed securities, even when both trade at similar discounts today.

- **Sector Concentration:** Understand how much of the portfolio is tied to a single industry, asset class, or investment theme. Diversified portfolios spread risk across sectors, while concentrated ones can outperform sharply when a theme is in favor and underperform just as sharply when it isn't.

- **Geographic Exposure:** Evaluate where a fund's underlying assets and revenue streams are based. Regional or country-specific exposure introduces currency, regulatory, and political risks that portfolios containing geographically diverse holdings do not face.

- **Manager Track Record:** Review the experience and consistency of the team making portfolio decisions. A manager who has navigated multiple credit cycles brings a different level of confidence than one without that history.

Together, these four factors form the foundation of how Herzfeld Advisors evaluates a fund's underlying holdings - not as a single data point, but as the variable that gives every other characteristic its meaning.

Market Insights: Portfolio Positioning in 2026

Recent activity in private credit and BDCs has reinforced why the underlying portfolio must be evaluated before any headline yield or discount. Investors have become more selective across credit-oriented vehicles with redemption pressure rising across several non-traded BDCs and public market scrutiny increasing around portfolio credit performance.

Goldman Sachs BDC provides a clear example. Software represented approximately 17% of its invested portfolio and remained its largest industry exposure, making the quality of its software borrowers an important part of the investment analysis. Pressure across software and SaaS companies has resulted from questions about how artificial intelligence may affect established business models, competitive advantages, customer retention, and future growth. For highly leveraged SaaS borrowers, slower growth or weaker renewal rates can reduce the cash flow available for interest payments and make refinancing more difficult. The concern is not that software exposure is inherently problematic, but that a large sector concentration becomes more consequential when borrower leverage is elevated, interest coverage is limited, and the industry faces structural pressure. This focus on portfolio composition was also visible across the closed-end fund market in June. Senior Loan CEFs experienced the largest discount widening, moving from -8.38% to -11.46%, while Convertible CEFs showed relative resilience, tightening from -5.69% to -4.56%. The market was not treating all discounts or yields the same. Investors were differentiating based on portfolio composition, credit exposure, and confidence in the durability of underlying cash flows.

Did You Know?

Under the Investment Company Act of 1940, a fund can only market itself as "diversified" if it passes the 75-5-10 test: at least 75% of its assets must sit in a specific "safe bucket", spread across cash, government securities, shares of other investment companies, and "other securities". That "other securities" portion can only be used to meet the 75% test if within that "other securities" bucket, no single issuer makes up more than 5% of the fund's total assets, and the fund doesn't own more than 10% of that issuer's voting stock (with some notable exceptions related to funds of funds structures). Cash and government securities count toward the 75% test without any per-issuer limit. Funds that don't meet this bar must disclose themselves as "non-diversified", a label worth checking before assuming a fund's holdings are spread as broadly as its name suggests.

That is what makes portfolio analysis so important in 2026. Discounts and yields may create the initial opportunity, but the portfolio determines whether that opportunity is durable. In a more selective market, the key question is not simply whether a fund looks cheap, but whether the assets inside the fund can support the income, withstand volatility, and justify the discount.

Looking Ahead

A strong portfolio can support a fund through volatility — but it doesn't operate in a vacuum. Price action in the closed-end fund space is also shaped by who is buying and why. In our next issue, we'll explore the principle:

"Retail Flows Move Markets."

We'll examine how media narratives, ETF adoption, and shifting retail sentiment influence CEF pricing and discounts — and why understanding investor behavior is as important as understanding the underlying holdings themselves.

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