KARPUS INVESTMENT MANAGEMENT

Market Update & Outlook

October 2021

## Executive Summary

- Despite forward economic growth momentum, we continue to see inflation as a primary concern for both investors and central banks. Indeed, economic activity remains strong[1] but could face challenges if the Delta variant (or others) cause a spike in infection rates in the coming months. In a nutshell, the balancing act central banks are facing is essentially to make sure that a transitory inflation situation doesn't become a permanent one.
- We are noticeably lower in closed-end fund (CEF) holdings than we were at the beginning of the year. This is because each of the four areas have witnessed CEF discount narrowing throughout the year (see chart 1)[2] and because of strong net asset value (NAV) performance since 12/31/2020.[3]
- With special purpose acquisition companies (pre-acquisition) (SPACs), our investment objective is to buy them at a discount to the estimated future value of a SPAC's trust. We focus on investing in SPACs pre-acquisition through what we believe is a conservative approach. We believe SPACs are a fixed income alternative with low interest rate risk and have safety of principal.
- In the U.S. we believe we are entering the mid-cycle of the expansion and will experience a period of peak gross domestic product (GDP) growth, earnings growth, liquidity, and fiscal support. In our opinion, market fundamentals remain strong, indicating returns should continue to move higher but we anticipate they will do so at a more modest pace with a potential for more frequent sell-offs.
- We believe developed markets appear to be more attractive in both relative valuation and momentum compared to emerging markets. Developed markets also have a higher efficacy of vaccination.[4]
- The combination of strong demand, limited supply, and improving credit conditions have been supporting municipal bond prices in 2021 (as we will explain in more detail below).

To Our Clients,

At this time last year, our planned merger with the City of London Investment Group PLC (CLIG) closed after overwhelming consent or approval from CLIG shareholders and Karpus' clients. As we referenced from the merger Prospectus, "the intention [was] not to alter either investment management business. Existing offices will remain in place staffed by existing personnel. No client-facing functions will alter."[5]

This is exactly what has happened over the course of the last year.

To seek further growth and expand our team, we have brought on a Head of New Business Development, have hired an additional Relationship Manager, and have made investments in our marketing program. We have also expanded our operations, information technology, and support teams. In terms of our Investment Team, in 2021 we added one Equity Analyst and look to add to our fixed income team in 2022. A Systems Developer was also added to assist us in better leveraging our technology capabilities and to maximize efficiencies.

With our expanding team and investment approach, we feel our strategy is positioned well to capitalize on market inefficiencies. We continue to look for further ways to enhance your overall experience as Karpus' clients.

Since Labor Day, we've returned to working in our office. Our entire team has functioned well with a high level of communication and productivity since COVID began and further technological investments will aid in allowing employees to be able to work from home as needed.

Table 1. Performance of Major Indices

| | Q3, 2021 | 1 Yr. | 3 Yrs. | 5 Yrs. |
|---|---|---|---|---|
| Bloomberg Barclays U.S. Gov't Credit | 0.04% | -1.12% | 5.93% | 3.23% |
| Bloomberg Barclays Municipal Bond | -0.27% | 2.63% | 5.07% | 3.26% |
| S&P 500 | 0.59% | 30.00% | 15.99% | 16.89% |
| MSCI ACWI ex. U.S. | -2.99% | 23.91% | 8.02% | 8.94% |

Bloomberg Finance, L.P. Periods greater than 1 year are annualized. Past performance is no guarantee of future results.

## Thoughts on Today's Markets and the Economy

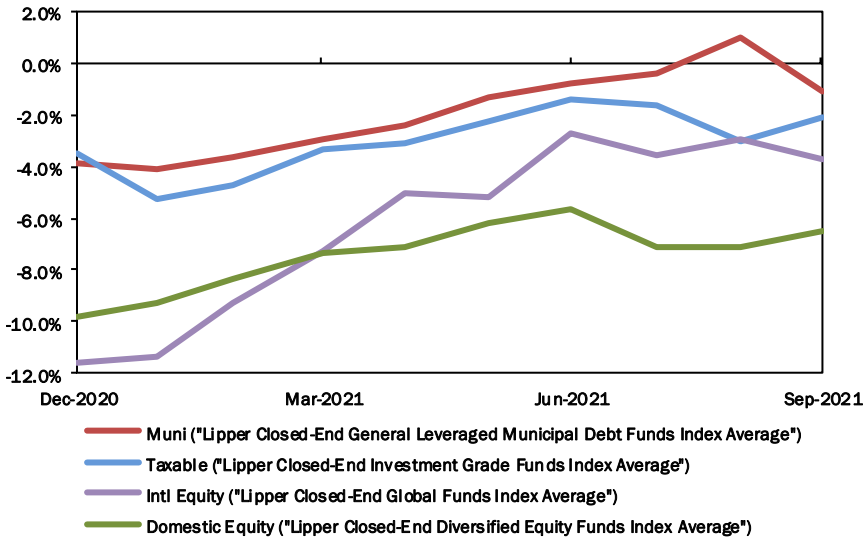
With respect to the markets, the uncertainties that ended last quarter persist today. Namely, our primary concerns lie in: (1) significant monetary and/or fiscal stimulus in many countries around the world, (2) consumers with elevated savings and pent up demand (although arguably lower than earlier in the year), and (3) inflation.

Despite forward economic growth momentum, we continue to see inflation as a primary concern for both investors and central banks. Indeed, economic activity remains strong[6] but could face challenges if the Delta variant (or others) cause a spike in infection rates in the coming months. In a nutshell, the balancing act central banks are facing is essentially to make sure that a transitory inflation situation doesn't become a permanent one.

In its most recent meeting on September 22, 2021, the Fed said "inflation is elevated, largely reflecting transitory factors" and that "if progress continues broadly as expected, the Committee judges that a moderation in the pace of asset purchases may soon be warranted."[7] Projections by FOMC officials just last week indicate that roughly half expect the Fed Funds Rate to rise at least 1% from current levels by the end of 2023[8] but the Fed has been careful to note that the test for interest rate liftoff is more stringent than the test for tapering.[9]

As you will notice when you look at your statements, we are noticeably lower in CEF holdings than we were at the beginning of the year. This is because each of the four areas have witnessed CEF discount narrowing throughout the year[10] and because of strong net asset value (NAV) performance since 12/31/2020.[11] In our experience, we've found that CEF discounts can be a telling indicator of market sentiment. What we believe discounts are telling us now is to be patient until more attractive CEF discounts become available into and through year-end.

**Chart 1: CEF Discounts**
(YTD through 9/30/2021)




Bloomberg Finance, L.P. and for the Lipper Closed-End Investment Grade Funds Index Average, Lipper Closed-End General Leveraged Municipal Debt Funds Index Average, Lipper Closed-End Diversified Equity Funds Index Average and Lipper Closed-End Global Funds Index Average, as categorized by "All Refinitiv Lipper Index Components" as of 12/31/2020. The data represents the simple average of the discounts of the funds within each index and is as of month end for all funds in an index for either all or part of the defined period.

Because our experience has also taught us that discounts can shift abruptly, accounts hold index securities to sell as opportunities arise. Additionally, in accounts with only fixed income mandates or in balanced accounts with fixed income exposure we've also invested in SPACs.

With SPACs, our investment objective is to buy them at a discount to the estimated future value of a SPAC's trust. We focus on investing in SPACs pre-acquisition through what we believe is a conservative approach. We believe SPACs are a fixed income alternative with low interest rate risk and have safety of principal. SPACs also have the upside potential of equities if a potential deal is well-received by the market. We feel that our experience with investing in SPACs, combined with market conditions of elevated equity valuations and low fixed income yields, warrants investor consideration for utilizing SPACs as a component of investors' overall portfolios.

Following is a more in-depth discussion of what we observed in each of the major asset classes in the third quarter of 2021.

## Equities

As the Fed establishes its blueprint for the path to end peak accommodation and slowly normalize monetary policy, the investment community will be closely monitoring the timing and rate of tapering their asset purchasing program, as it will have investment implications for the next phase of the expansion. With this said, in the U.S. we believe we are entering the mid-cycle of the expansion and will experience a period of peak GDP growth, earnings growth, liquidity, and fiscal support. In our opinion, market fundamentals remain strong, indicating returns should continue to move higher but we anticipate they will do so at a more modest pace with a potential for more frequent sell-offs.

To lower beta risk (a measure of the volatility of a security compared to the market as a whole) during the quarter we reduced our domestic small-cap exposure in favor of large-cap stocks, the technology sector, and a quality factor exchange traded fund. We believe these investment styles will offer higher earnings growth in a slowing economy and will be more resilient during periods of volatility. Small-cap stocks tend to outperform during the initial recovery following a recession as they are highly correlated to a rebound in growth.[12] As we advance through the mid-cycle of the expansion and the next leg of the bull market, we anticipate that large-cap companies with strong balance sheets, low debt-to-equity ratios, high return on equity, and stable earnings growth will aid in balancing portfolio risk/reward.

In the international equity markets (as measured by the MSCI ACWI ex. U.S. (ACWI ex. U.S.)), international equities returned –2.99% for the quarter and 5.90% so far this year.[13] In international equity portfolios during the quarter, we slightly underweighted emerging markets to bypass anticipated hiccups we saw from widespread regulatory overhauls in China.

Most major purchasing managers' indices retreated, though broader Europe resisted the most and remained in expansionary territory.[14] Evergrande, the world's most indebted real estate developer, shook the markets late in the quarter.[15] In the interest of stability, the People's Bank of China injected liquidity into the system as a countermeasure.[16] Unlike the U.S., China's banking system is largely state-owned and because of this the risk of systemic collapse is significantly lowered.[17] Looking ahead, we believe developed markets appear to be more attractive in both relative valuation and momentum compared to emerging markets. Developed markets also have a higher efficacy of vaccination.[18]

At the portfolio level, both domestic and international equity CEF discounts continue to narrow so far in 2021, reducing our exposure on average to approximately 21% and 14%, respectively. Looking at the median discount of all current international equity CEFs, we are seeing the narrowest discounts in nearly a decade.

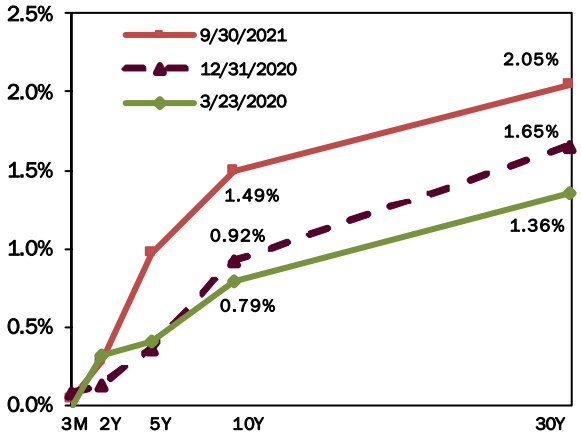
## Taxable Fixed Income

Similar to other areas, discounts on CEFs within our portfolios (both taxable and muni) continued to narrow in the third quarter. We believe that the narrowing is driven in large part by investors' demand for yield in a low interest rate environment.

With respect to SPACs, we saw yields peak mid-quarter and then rebound into the end of September. SPACs continue to be a frequent topic of conversation in the financial media. However, as we stated in the introduction, it's important to remember that Karpus invests in SPACs on a pre-acquisition basis ***only***. This is distinctly different from frequent media attention on SPACs that have become operating companies.

As a refresher, SPACs can trade above or below their intrinsic, or cash-in-trust value. Karpus purchases shares of SPACs when they trade at what we believe are attractive levels relative to their trust value. We have three distinct exit strategies when we purchase a SPAC:

Chart 2: The U.S. Treasury Yield Curve




Bloomberg Finance, L.P., U.S. Treasury Actives Curve

1. The SPAC fails to find an acquisition target and liquidates. This is our base-case exit scenario.
2. The SPAC announces an acquisition target, but continues to trade below the trust's value. At the shareholder meeting, we would then elect to redeem our shares for our pro-rata portion of the trust. This is what we consider a mid-case exit scenario where we still exit at our target price, but sooner than in a liquidation scenario – allowing us to reinvest and compound a return more quickly.
3. The SPAC announces an acquisition target and trades above the trust's value. In this case, we would sell our shares into the market. This is our best-case exit scenario.

It's important to note, again, that in each of the above scenarios, Karpus clients are never exposed to the risks of an operating company following a de-SPAC event.

As we end the year, we believe our portfolios will largely continue to be involved in SPACs as we continue to reduce CEF holdings due to discount narrowing. You will also continue to notice portfolios increasing in index-tracking investments as we await future opportunities in CEFs.

## Tax-Sensitive Fixed Income

The municipal bond market continues to be supported by strong investor demand for tax-free income, as there have been positive inflows into municipal bond funds for every month of 2021.[19] This strong demand for tax-free income has suppressed municipal bond yields to low levels versus comparable Treasury bonds throughout the 3rd quarter and all of 2021. We closely watch this ratio between these two bond investments—which currently stands at 75% as of the end of Q3, versus an average of 121% in all of 2020.[20] The combination of strong demand, limited supply, and improving credit conditions have been supporting municipal bond prices in 2021.

Credit conditions have broadly improved in the municipal bond market,[21] as state tax revenue have exceeded budget expectations, along with significant Federal Government stimulus that directly benefits some municipal issuers.[22] We have seen ongoing upgrades to municipal credits, including an upgrade to some of the lower rated states, such as Illinois, which was upgraded by Moody's in June 2021.[23] We believe this stability in the municipal bond market will persist.

Our municipal bond CEF holdings have benefited from these dynamics in the municipal bond market, as NAVs have appreciated and muni CEFs discounts have narrowed approximately 2.8% so far this year.

We continue to sell muni CEFs into this strength in the market, as we have done throughout the year, and replace these holdings with SPACs and shorter duration index securities. With this rotation out of CEFs and into SPACs, we have been shortening our duration (sensitivity to interest rate movements). As such, we are establishing a defensive position to the possibility of increasing bond yields going forward. For the near-term, we will maintain this defensive stance and focus on preservation of capital, as we await the next opportunity to extend duration by way of buying deeply discounted muni CEFs.

## Conclusion

Our perspective is that since interest rates are no more predictable than stock prices or how foreign markets can perform in comparison to domestic markets, it is always important for investors to remember that they should be patient and not try to time the markets. We feel that the best path toward one's investment goals is to choose a suitable asset allocation based on your risk tolerance and stay invested based on that strategy. This is what we aim to do for each of your portfolios.

As always, we thank you for your continued support and confidence and we look forward to helping you achieve your goals.

*The opinions and analysis expressed in this newsletter are those of Karpus Investment Management staff, are subject to change based on evolving market and economic conditions. All Karpus composite performance results and associated disclosures are available upon request. Past performance is not a guarantee of future performance. During periods of market volatility, the data provided will fluctuate according to the degree of volatility. All investments involve risk, including possible loss of principal.*

1&6. Bloomberg Finance, L.P., based on most recent data available through 6.30.2021, 2 & 10. Bloomberg Finance, L.P. and for the Lipper Closed-End Investment Grade Funds Index Average, Lipper Closed-End General Leveraged Municipal Debt Funds Index Average, Lipper Closed-End Diversified Equity Funds Index Average and Lipper Closed-End Global Funds Index Average, as categorized by "All Refinitiv Lipper Index Components" as of 12/31/2020. The data represents the simple average of the discounts within each index and is as of month end for all funds in an index for either all or part of the defined period, 3 & 11. Bloomberg Finance, L.P. and for the Lipper Closed-End Investment Grade Funds Index Average, Lipper Closed-End General Leveraged Municipal Debt Funds Index Average, Lipper Closed-End Diversified Equity Funds Index Average and Lipper Closed-End Global Funds Index Average, as categorized by "All Refinitiv Lipper Index Components" as of 12/31/2020. The data represents the simple average of the net asset value performance of the funds within each index and is as of month end for all funds in an index for either all or part of the defined period, 4. https://www.wsj.com/articles/brazil-moves-away-from-chinese-covid-19-vaccine-11631368138, 5. https://www.clig.com/investor-reports/Prospectus,%20June2020.pdf, June 30, 2020, page 33, 7. https://www.federalreserve.gov/newsevents/pressreleases/monetary20210922a.htm, 8. https://www.federalreserve.gov/monetarypolicy /files/fomcprojtabl20210922.pdf, page 9, 9. https://www.cnbc.com/2021/08/27/powell-sees-taper-by-the-end-of-the-year-but-says-theres-much-ground-to-cover-before-rate-hikes.html, 12. https://www.kiplinger.com/article/investing/t052-c008-s001-small-cap-value-stocks-this-time.html, 13. Bloomberg Finance, L.P., as of 9/30/2021 14. Bloomberg Finance, L.P., MPMIUSCA Index, MPMIEZCA Index as of 9/30/2021, 15. https://www.wsj.com/articles/china-evergrande-bondholders-in-the-dark-about-83-5-million-in-interest-payments-11632453719, 16. https://www.bloomberg.com/news/articles/2021-09-22/china-maintains-liquidity-support-amid-evergrande-s-debt-crisis, 17. https://www.uscc.gov/sites/default/files/2020-05/Chinas_Banking_Sector_Risks_and_Implications_for_US.pdf, 18. https://www.wsj.com/articles/brazil-moves-away-from-chinese-covid-19-vaccine-11631368138, 19. Investment Company Institute, Long-Term Mutual Fund and Exchange-Traded Fund (ETF) Flows, https://www.ici.org/research/stats/weekly-combined, 20. Bloomberg Finance, L.P., MUNSMT10 Index as of 9/30/2021, 21. https://www.nuveen.com/en-us/insights/municipal-bond-investing/municipal-market-update, 22. https://www.gsam.com/content/dam/gsam/pdfs/us/en/articles/muni-market-monthly/2021/Muni_Outlook_2021.pdf?sa=n&rd=n, 23. https://www.bloomberg.com/news/articles/2021-06-29/illinois-bonds-upgraded-by-moody-s-in-pullback-from-cusp-of-junk

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