



ATR Advisors

ABSOLUTE TOTAL RETURN THIRD QUARTER 2015 COMMENTARY

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The Brighter Side of Market Volatility

The 3rd quarter of 2015 will be remembered as the time when Market Volatility returned with a vengeance. After a year of extraordinarily low volatility (measured by a VIX Index almost continually below 20), the 3rd quarter saw roller-coaster ups and downs. The VIX Index shot up to over 40 in August and stayed above 20 for the rest of the quarter.

Of course, this surge in volatility had many negative consequences, including an almost 7% decline in the S&P 500 and a 7-1/2% decline in the Dow Jones Industrial Index, as well as similar declines in most of the world equity markets.

In addition, the correlation between different markets surged as well. This means that most of the asset markets went up and down together. So there were few places to hide from the volatility in stocks, bonds, and commodities.

However, like almost everything else in life, the surge in volatility in the 3rd quarter did have its brighter side as well. In this case, the good side was that it finally created some legitimate “bargains” in the stock market.

In the Absolute Total Return Strategy, we were most impressed with the creation of buying opportunities among Closed End Funds. As you may know, Closed End Funds are an old fund structure, which preceded the modern Mutual Fund structure created in 1940. The main difference between Closed End Funds and 1940-Act Mutual Funds is that Closed End Funds issue shares only once, and after that new buyers have to buy existing Closed End Fund shares from other investors who already own them.

This can result in some interesting anomalies sometimes, in which Closed End Funds actually sell at a discount to the value of the securities that the Closed End Funds own themselves. When this happens, it's like being able to buy publicly-traded stocks and bonds at a discount.

This is exactly what happened in the 3rd Quarter. There was so much market volatility in almost all of the publicly-traded asset markets that many owners of Closed End Fund shares got squeamish and wanted to

sell their shares in a “fire sale.” This resulted in extraordinarily large discounts among a broad range of Closed End Funds – discounts that we haven’t seen since the end of the Financial Crisis of 2008.

As a result, the average Closed End Fund discount at the end of September was 9.3%—among the widest discounts seen in the past two decades. These discounts could get even wider in the 4th quarter due to “Tax Loss Selling,” in which Closed End Fund owners “harvest” tax-losses to reduce 2015 taxes. Tax Loss Selling usually peaks in the months of September, October, and November and then reverses in late December and the 1st quarter of the following year.

For us in Absolute Total Return, this is like our bread and butter. We specialize in identifying strong companies with attractive fundamentals and good dividends that we can buy at a discount. The 3rd Quarter opened up this kind of buying opportunity not only in Closed End Funds, but in other “Value” categories as well.

Therefore, we will focus this quarter on purchasing the best of these buying opportunities. Fortunately, we entered the 3rd Quarter with considerable cash percentages. We intend to put this cash to work in the 4th Quarter.