Understanding closed-ends funds

Closed-end funds — a type of investment vehicle with many characteristics of traditional open-end funds, but important differences, too — represent an important option for investors seeking meaningful income in today's low-yield world. Many closed-end funds are designed specifically with income generation as the primary goal, delivered through monthly or quarterly dividends.

How closed-end funds work

Like an open-end mutual fund, a closed-end fund is a professionally managed investment company that pools investor capital and invests in stocks, bonds or other securities according to an overall investment objective.

Closed-end funds raise their investment capital at inception, by issuing shares to investors through an initial public offering (IPO). After that, shares of the fund are typically traded on a securities exchange (e.g., New York Stock Exchange), like a public stock. That means the value of each share is determined by the market, based on supply and demand; at any given time, shares may trade at a premium or a discount to the market value of the underlying securities. In addition, many closed end funds have a limited lifespan, or term, set at their inception; at the end of that period, shares are redeemed based on the net asset value (NAV) of the portfolio.

Closed-end vs. open-end funds: How they differ

	Closed-End Funds	Open-End Funds
Management Type[1]	• Most are actively managed by a specialized investment team	• May be actively managed or passively managed (i.e., index-based)
Term of Investment	• May have a limited term, with closing date specified at inception	• No pre-set limit on term of fund
Share Purchases and Redemptions	• Investors purchase shares from qualified dealers during initial public offering (IPO): after that, shares are typically bought and sold on public exchanges based on market price	• Investors purchase and redeem shares from the fund sponsor, with price based on the share's NAV at time of transaction
Investment Universe	• May invest in less-liquid, less-accessible securities	• Regulations limit investment in less-liquid securities
Use of Leverage[2]	• Can use leverage to potentially amplify income and return	• Typically do not use leverage
Trading	• Shares can be traded intraday (i.e. at any time market is open)	• Orders entered at end of trading day
Fees and Expenses	• Management and other fees (deducted from performance) • Brokerage commissions for share trades	• Management and other fees (deducted from performance) • Sales charges/brokerage commissions for share purchases[3] • May have ongoing distribution fees (i.e., 12b-1 fees)
Investment Minimum	• No minimum purchase after IPO. Minimum may apply to purchases during IPO. Brokerage firms may require a minimum investment to open an account.	• Most require a minimum investment

1. Active management does not ensure gains or protect against market declines.
2. Leverage involves the use of loans, preferred shares or other financial instruments in an attempt to increase the yield, or return, of the portfolio. Leverage may result in greater volatility of the NAV and market price of common shares, and it increases a shareholder's risk of loss.
3. Some open-end funds are available directly from their sponsor without sales charges. These are referred to as "no-load" funds.

Closed-end funds and income: Potential advantages

For many investors, the potential for attractive income relative to traditional fixed income strategies is the primary reason to invest in closed-end funds.

Use of leverage

A closed-end fund may choose to borrow capital in order to amplify the results of an investment position. The goal is for the gains earned from additional capital to outweigh the cost of borrowing, making it possible to increase distributions and/or total return. However, the total leverage available to a closed-end funds is limited by regulations to help safeguard investors; in practice, the amount borrowed cannot exceed more than 33.33% of its total assets.

Efficient use of capital

A closed-end fund's investment capital and number of shares outstanding are fixed once it completes its IPO. In contrast, an open-end mutual fund's investment capital rises and falls over time depending on the number of shares purchased or redeemed by investors. As a result, an open-end fund manager typically holds back some capital to meet potential redemptions – the alternative is to sell assets to raise cash. In contrast, a closed-end fund manager can remain fully invested at all times, expanding the potential for gain.

Access to specialized asset classes

Their stable capital structure makes closed-end funds particularly well-suited for investing in niche, less liquid securities that may be problematic for open-end funds. In addition, closed-end funds can also invest in asset classes that may be otherwise unavailable to retail investors, such as private debt. This flexibility may offer access to higher yielding sectors that can help to support ongoing income.

No investment minimums

Closed-end funds do not have minimum investment requirements, if purchased on the secondary market. And because they trade on an exchange, rather than being distributed through a broker, closed-end funds do not impose fees to cover ongoing distribution costs, such as 12b-1fees (individual brokerage requirements may vary).

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Net asset value per common share (NAV) is determined by dividing the value of the Fund's securities, cash and other assets (including the value of derivatives and interest accrued but not collected) less all its liabilities (including accrued expenses, the liquidation preference of any outstanding preferred shares and dividends payable) by the total number of common shares outstanding.

A **12b-1 fee** is a fee levied to help cover the distribution and marketing of the fund via an annual charge to investors. The fee is disclosed in a fund's prospectus and included in a fund's expense ratio.

Investment professionals include portfolio managers, research analysts, research associates, investment support and executives of Franklin Templeton and subsidiary investment management groups.

IMPORTANT INFORMATION

All investments involve risk, including possible loss of principal. Active management does not ensure gains or protect against market declines.

Unlike open-end funds, closed-end shares are not continually offered. Like other public companies, closed-end funds have a one-time initial public offering, and once their shares are first issued, they are generally bought and sold through non-affiliated broker/dealers and trade on nationally recognized stock exchanges. Share prices will fluctuate with market conditions and, at the time of sale, may be worth more or less than your original investment. Shares of exchange-traded closed-end funds may trade at a discount or premium to their original offering price, and often trade at a discount to their net asset value. The funds are subject to investment risks, including the possible loss of principal invested.

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