

CEF Specialist

Should PIMCO CEF Investors Jump Ship?

What Bill Gross' departure means for CEFs

Cara Esser
CEF Strategist
Cara.Esser@morningstar.com

Sumit Desai, CFA
Analyst
Sumit.Desai@morningstar.com

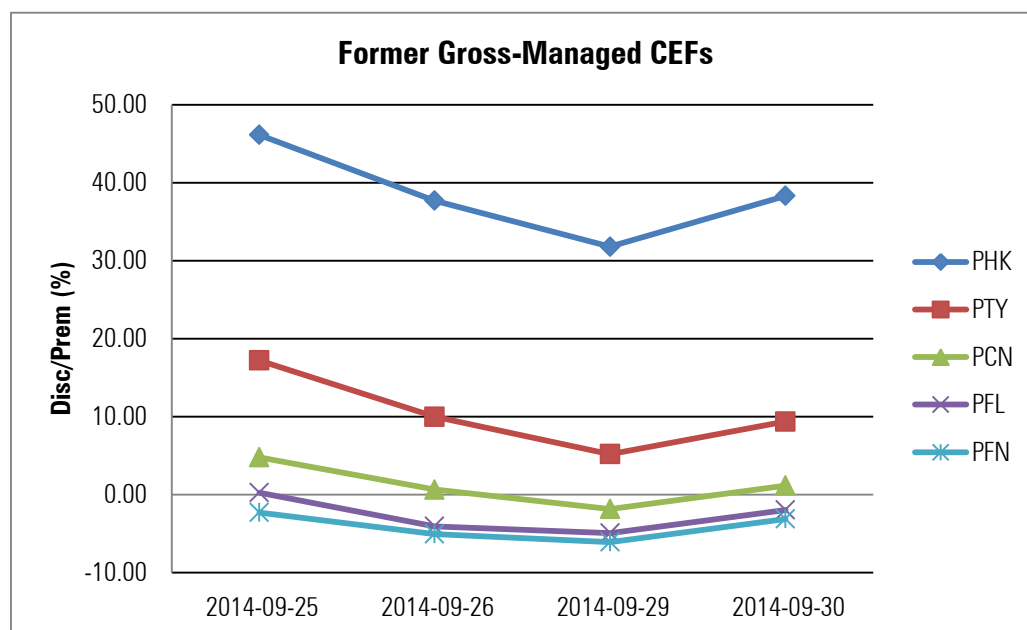
The sudden departure of PIMCO founder and CIO Bill Gross on Friday, Sept. 26, rocked the investment world. As pundits mulled over who might be crowned the next "Bond King," closed-end fund investors had concerns of their own. Because several PIMCO CEFs have historically traded at relatively high premiums, some CEF watchers predicted extreme share price declines, particularly for the five CEFs that Gross managed. It's also widely known that Gross owned a significant amount of shares of many PIMCO CEFs. Some wondered whether Gross would dump all of his shares, putting further downward pressure on share prices and premiums.

Premium Collapse

The concern over collapsing premiums is not unfounded. Many PIMCO CEFs tend to sell at persistently high premiums, which can be quite fragile in times of panic. Those premiums stem from the cachet of the PIMCO brand name and distribution rates that tend to be well above average for similarly invested funds. At the close of market on Thursday, Sept. 25 (the day before Gross' departure was announced), 14 of PIMCO's 20 CEFs traded at premiums. Four of those traded at double-digit premiums, including a 78% premium for PIMCO Global StocksPLUS & Income (PGP) and a 46% premium for Gross-managed PIMCO High Income (PHK).

The chart below shows the premium and discount movement for the five CEFs previously managed by Gross between the close of the market on Sept. 25 and Sept. 30. Each of the funds saw a dip on Friday, the day of the announcement, and the decline continued on Monday. As valuations looked more attractive for some of the funds--PHK's share price, for example, dropped 10.5% on Friday and Monday--buyers snapped up shares, pushing share prices up, narrowing discounts, and widening premiums a bit.

Exhibit 1
Discount/Premium
Changes of CEFs
Formerly
Managed by Bill

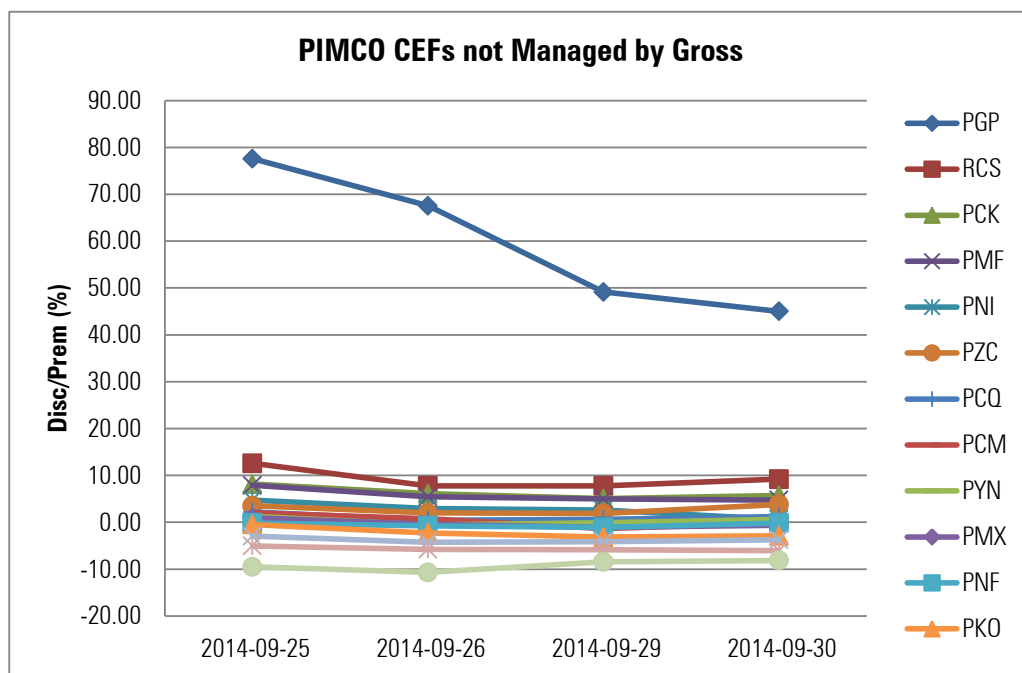


The discount and premium movement of PIMCO CEFs not managed by Gross shows a steep drop in the highest-premium PIMCO fund, PIMCO Global StocksPLUS & Income (see PGP in the chart below). That

fund's share price dropped nearly 17% on Friday and Monday, closing the three-day trading period down 19%. Not to get too far afield on this topic, but the potential for losses of that magnitude and quickness is one reason we've long maintained a stance of avoiding funds trading at [double-digit premiums](#). Gross did not manage PIMCO Global StocksPLUS & Income, but its share price took a larger hit than any other PIMCO CEF over the three-day trading period. What's more, the fund didn't participate in the slight bounceback that nearly every PIMCO fund experienced thus far.

Exhibit 2

Discount/Premium
Changes of PIMCO
CEFs not Managed
by Bill Gross



Gross' Ownership Stake

As of Aug. 26, Gross owned nearly 13 million shares of PIMCO CEFs. By sheer number of shares, his largest stake was in go-anywhere bond fund PIMCO Dynamic Credit Income (PCI). When the now \$6 billion fund launched in late January 2013, it was the largest CEF IPO in years. Gross' successor, Dan Ivascyn, was named a co-portfolio manager on the fund in early 2014. He joined four other comanagers including Alfred Murata, who was named a co-portfolio manager for the Gross-managed CEFs following his departure. By ownership percentage, Gross' largest stake was in PIMCO Corporate & Income Opportunities (PTY), a fund for which he was sole portfolio manager since late 2009.

Assuming he still owned those shares as of Sept. 30, in sum, Gross' stake was worth nearly \$241 million. And, based on distribution rates at share price as of Sept. 30, he earns upwards of \$20 million in distributions each year.

Gross' stake in PIMCO CEFs is not insignificant, and investors are right to be concerned about downward share-price pressure should he decide to sell all of his shares en masse. Although we can't know for sure, this seems an unlikely scenario. Gross often spoke highly of his CEFs (some in the media have referred to them as his "babies") and touted the benefits of leverage, high distribution rates, and the closed capital structure. What's more, selling 13 million shares in one fell swoop would damage his own return on investment as those funds' share prices would surely collapse under the pressure. Assuming he still owns the shares that he did at the end of August, Gross' holdings lost more than \$6 million over the past three trading days alone. Those losses would be far greater if he sold all of his shares at once.

The table below details Gross' ownership of all PIMCO CEFs based on ownership data as of Aug. 26, 2014, and shares outstanding as of Sept. 30, 2014.

Exhibit 3

Bill Gross' CEF
Ownership Data

Fund Name	Ticker	Gross ownership		Dollar Amount at 9/30 share price
		of fund (%)*	No. Shares Owned**	
PIMCO Corporate & Income Opportunity	PTY	4.92%	3,451,496	58,882,519
PIMCO Dynamic Credit Income	PCI	2.23%	3,060,037	68,759,022
PIMCO Dynamic Income	PDI	3.58%	1,627,804	51,373,495
PIMCO Corporate & Income Strategy	PCN	3.06%	1,176,594	18,578,412
PIMCO Income Strategy	PFL	3.09%	779,458	9,306,725
PIMCO Muni Income II	PML	1.22%	745,902	8,689,760
PIMCO Muni Income	PMF	2.10%	533,307	7,306,303
PIMCO CA Muni Income	PCQ	2.67%	495,882	7,105,495
PIMCO Muni Income III	PMX	0.94%	305,859	3,275,753
PIMCO CA Muni Income III	PZC	1.29%	284,633	2,960,186
PIMCO CA Muni II	PCK	0.68%	215,717	1,991,065
PIMCO High Income	PHK	0.15%	186,862	2,178,817
PIMCO NY Income Muni II	PYN	1.04%	58,756	557,590
PCM Fund	PCM	--	--	--
PIMCO Income Strategy II	PFN	--	--	--
PIMCO Global StockPLUS & Income	PGP	--	--	--
PIMCO Income Opportunity	PKO	--	--	--
PIMCO NY Muni Income	PNF	--	--	--
PIMCO NY Muni Income II	PNI	--	--	--
PIMCO Strategic Income	RCS	--	--	--

*Ownership data as of 8/26/2014

**Based on shares outstanding as of 9/30/2014

Yay or Nay?

CEF investors are no doubt reevaluating their PIMCO holdings, CEF and open-end alike. Morningstar [downgraded](#) PIMCO's flagship open-end fund, PIMCO Total Return (PTTRX), to Bronze from Gold on Monday, Sept. 29, citing a high level of confidence in PIMCO's resources and overall abilities but an uncertainty around the meshing of teams in the wake of Gross' departure. For CEFs, however, investors need to consider valuation and potential share-price losses. Concerns over what Gross will do with his CEF shares (even if he does nothing) can cause volatility in share prices as investors attempt to anticipate his movements. That said, investors comfortable with PIMCO CEFs (Gross was the sole portfolio manager on only five of the firm's 20 CEFs) may be able to snap up shares at cheap valuations while the dust settles.