

Seeking Alpha^α

Closed End Funds

OPP: A Unique CEF With A Monster Yield

Aug. 31, 2021 12:00 PM ET | **RiverNorth/DoubleLine Strategic Opportunity Fund, Inc. (OPP)** | AGG, OPP.PA, SPY | 28 Comments | 8 Likes

Summary

- Retirees continue to struggle to generate any degree of income off of their portfolios.
- OPP invests in a portfolio of closed-end funds and fixed-income securities to deliver an incredibly high yield to its investors.
- The fund is quite well diversified and has a surprisingly large amount of exposure to safe securities considering its yield.
- The 11.94% distribution yield appears to be safe.
- The fund is trading at a premium to its NAV and usual price so it may make sense to wait for the price to come down a bit.
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Labor Day Sale

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Start Free Trial

A promotional banner for Labor Day. The background features a stylized American flag with blue and red splatters. A small 'X' icon is in the top right corner. The text 'Labor Day Sale' is in red, 'SAVE 50%!' is in large white bold letters, and 'Start Free Trial' is in white on a red button.



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One of the biggest problems facing investors today is an inability to generate any significant degree of income off of the assets in their portfolios. Retirees in particular suffer from this problem because they are highly dependent on their portfolios to pay their bills and finance their lifestyles. This problem is being caused by the policies that have been pursued by the Federal Reserve over the past decade and it, unfortunately, does not look like the situation will improve anytime soon. Fortunately, there are a few possible solutions to this problem. One of the best of these solutions is to invest in a closed-end fund that focuses on generating income. This is because these funds provide an easy way to acquire a diversified portfolio that in many cases can achieve higher yields than what most individuals can achieve on their own. In this article, we will discuss the RiverNorth/DoubleLine Strategic Opportunity Fund ([OPP](#)). This fund yields a phenomenal 11.94% as of the time of writing so let us determine if it could be right for your portfolio.

About The Fund

According to the fund's [web page](#), the RiverNorth/DoubleLine Strategic Opportunity Fund has the stated objective of providing its investors with a high level of current income and total return. This is not exactly unique as many closed-end funds have the objective of providing total return and current income is typically a major component of the fund's total return. The more unique thing is the strategy that the fund uses to accomplish this goal. It almost acts as two funds in one is the fund invests its assets both in other closed-end funds as well as fixed-income securities. All of these things provide a source of income for the fund that it can then pass through to its investors. The exact allocations that the fund assigns to each of these two parts of the portfolio vary with market conditions. It is the presence of the other closed-end funds that make this fund somewhat unique but it could prove to be a good thing because of the ability of these assets to produce higher yields than the fixed-income securities alone are able to do.

Although the closed-end segment of the fund can likely produce higher income than the fixed-income segment, nearly all of the largest positions in the fund are fixed-income securities:

Top Holdings

As of 3/31/2021 reported by Fund Sponsor

United States Treasury Bonds 1.63%	\$19.30M	9.16%
LEGACY MORTGAGE ASSET TRUST 4.25%	\$6.18M	2.93%
Legacy Mortgage Asset Trust 2019-Gs7 4.5%	\$5.91M	2.81%
Oxford Square Cap Corp 0%	\$5.89M	2.80%
Government National Mortgage Association 3.5%	\$5.11M	2.42%
Federal Home Loan Mortgage Corporation 4%	\$5.04M	2.39%
PRPM LLC 3.97%	\$3.99M	1.89%
Chl Gmsr Issuer Trust 2.84%	\$3.92M	1.86%
Barings Global Short Duration High Yield	\$3.86M	1.83%
Federal National Mortgage Association 0%	\$3.67M	1.74%

Source: CEF Connect

It is admittedly surprising to see both U.S. Treasury and agency securities among the largest positions in the fund. This is due to the fact that these securities have exceptionally low yields so are not generally the best securities in the market for income. We can see this above in the fact that the U.S. Treasury bonds that make up the largest positions in the fund have a face yield of 1.63%, which is higher than most Treasury bonds yield today. As we do not know exactly what price the fund paid for these securities, we do not know if the fund is actually earning that yield. We can also see that the mortgage securities in the fund also have very low yields. This could prove to be a drag on the fund's performance compared to what it would earn were it invested in higher-yielding securities.

A look at the largest positions in the fund may lead one to think that it is much more heavily weighted towards fixed-income than it is towards other closed-end funds. This is indeed the case:

Strategy Weightings



Source: RiverNorth

These weightings are certainly in line with the fund's official strategy of putting 10-35% of its assets into other closed-end funds. Indeed, it is roughly at the midpoint of these two figures. I will admit though that I would still prefer to see closed-end funds account for a bigger portion of the portfolio due to their higher yields versus the fixed-income securities. With that said though, this fund is able to do everything that other funds can to boost its portfolio yield so its strategy of putting most of its assets to fixed-income securities allow it to remove a layer of management and their related expenses. This might allow the fund to thus pass through more money to its shareholders, which is certainly something that any income investor should be able to appreciate.

As my regular readers on the topic of closed-end funds are likely well aware, I do not generally like to see any single asset in a fund account for more than 5% of the fund's total assets. This is because this is approximately the point at which an asset begins to expose the portfolio to idiosyncratic risk. Idiosyncratic, or company-specific, risk is that risk which any asset possesses that is independent of the market in aggregate. This is the risk that we attempt to eliminate through diversification but if the asset accounts for too much of the portfolio, then this risk will not be completely diversified away. Thus, the concern is that some event may occur that causes the price of the asset to decline when the market itself does not and if it accounts for too much of the portfolio then it may end up dragging the entire fund down with it. As we can see above, there is only one position that accounts for more than 5% of the portfolio. However, that position is a U.S. Treasury bond issue so if it declines independently of the bond market (likely due to default fears) then the economy likely has far bigger problems than just investors losing money in a fund. Overall, the fund's portfolio appears reasonably well diversified.

In various previous articles on high-income funds, I pointed out that high-yield ("junk") bonds often form the bulk of the portfolio. That is the case here too, although this one has a higher allocation to investment-grade securities than many of its peers:

Credit Quality Distribution



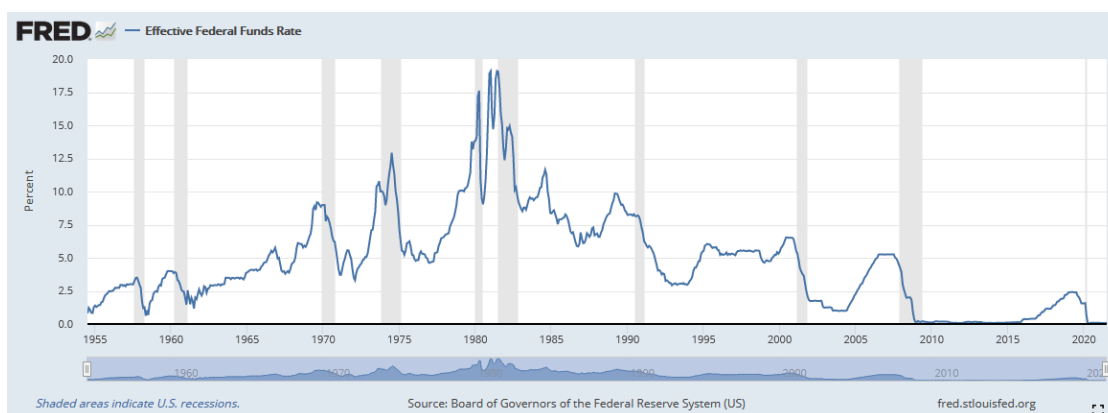
■	High Yield	42%
■	Not Rated	32%
■	Investment Grade	26%

Source: RiverNorth

It is important to note that we do not know the exact allocation that the fund has to high-yield securities. This is due to the 32% allocation to unrated securities. It is quite possible that at least some if not most of these bonds would be rated as speculative securities if they were actually rated. After all, most companies that have an investment-grade rating would want to be able to advertise the securities as such. Thus, it seems likely that these securities may give the fund more exposure to speculative-grade securities than it advertises. As I pointed out in a [recent article](#) though, this is not necessarily a problem since diversification can remove a great deal of the risk. The RiverNorth/DoubleLine Strategic Opportunity Fund has 364 holdings so it is probably reasonably diversified.

The Challenge For Income Investors

As mentioned in the introduction, one of the biggest challenges facing investors today is an inability to generate any significant amount of income off of the assets in their portfolios. This problem is particularly acute for retirees because they have a very difficult time supporting their retirement lifestyles. The reason for this problem is the policies that have been pursued by the Federal Reserve over the past decade or so, specifically its control over the federal funds rate. The federal funds rate is the rate that the nation's commercial banks charge each other for overnight loans. As we can see here, the central bank cut the federal funds rate to all-time lows in 2007 following the collapse of Lehman Brothers and left it there for over a decade. The bank did begin to raise the rate during the Trump Administration but it was still low by historical standards. The outbreak of the COVID-19 pandemic changed all that and the bank once again cut the rate to all-time lows where they remain today:



Source: Federal Reserve Bank of St. Louis

As of the time of writing, the federal funds rate sits at 0.10%. This is important because this rate influences the rate of everything else in the economy. This is the reason why things such as bank savings accounts and certificates of deposit are yielding essentially nothing. As a result, traditional strategies for the generation of retirement income are basically useless. This has naturally forced retirees to seek out other options.

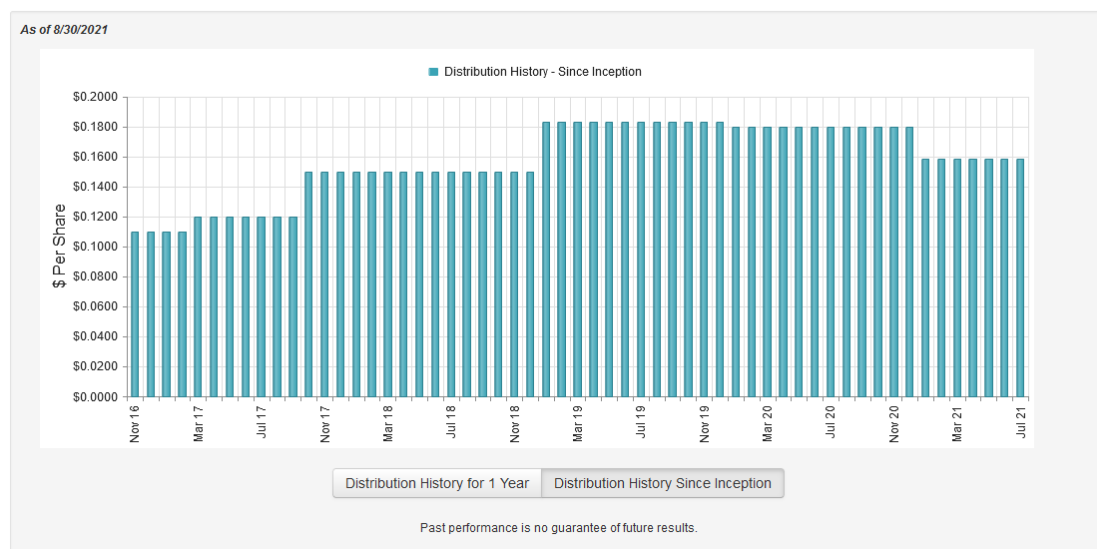
Their other option has primarily been moving money out of safe bank accounts and buying up risky assets such as stocks and bonds in search of any kind of yield. This influx of money into the capital markets is one reason why we have seen the incredible asset appreciation that we have over the past several years. Unfortunately, this steep increase in prices has also had the effect of suppressing yields. We can see this by looking at the S&P 500 index ([SPY](#)), which yields 1.23% as of the time of writing. The bond market is not really any better. The iShares Core U.S. Aggregate Bond ETF ([AGG](#)) only yields 1.84% as of the time of writing. At these yields, even a \$1 million portfolio would generate less income than a minimum wage job in the absence of asset appreciation, which is by no means guaranteed.

The RiverNorth/DoubleLine Strategic Opportunity Fund is able to do much better than this because of the assets that it invests in and because its closed-end structure lets it do things such as use leverage and pay out capital gains that boost its yield beyond what other funds are able to accomplish. As of the time of writing, the fund yields 11.94%. At this yield, our hypothetical \$1 million portfolio would generate \$119,400 in annual income. This is more than enough to enjoy a reasonably comfortable lifestyle pretty much anywhere in the country, especially when combined with Social Security.

Distribution Analysis

As noted earlier, one of the fund's objectives is to provide a high level of current income to its investors. As such, we might assume that it would pay out a regular distribution. This is indeed the case as the fund currently pays out a monthly distribution of \$0.1586 per share (\$1.9032 per share annually), which gives it an 11.94% yield at the current price. The fund's distribution has varied quite a bit over the years and while the fund did cut it back in January, the current distribution is still above the fund's long-run average:

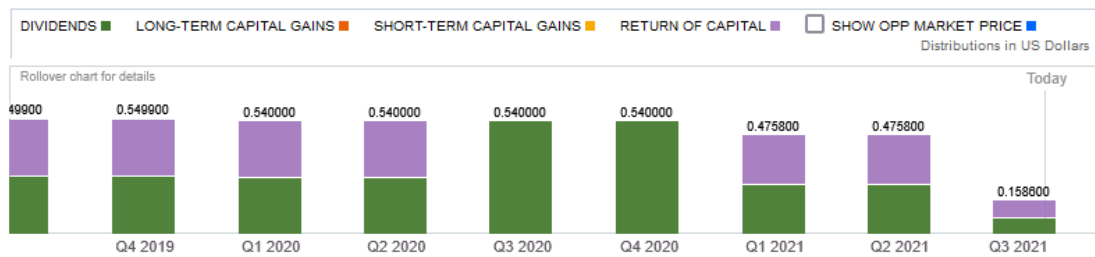
Distributions



Source: CEF Connect

Despite the distribution cut, the fact that the fund's current distribution is well above its historical average may still endear it to those investors seeking a stable source of income. These same investors may be turned off by the fund's relatively high level of return of capital distributions though:

Distributions Type by Calendar Quarter Ex-Date



Source: Fidelity Investments

The reason why they might be concerned is that a return of capital distribution can be a sign that the fund is returning the investors' own money back to them. This is obviously not sustainable over any kind of extended period. There are other things that can cause a distribution to be considered a return of capital though such as the distribution of unrealized capital gains or the distribution of money received from other closed-end funds (in certain cases). These are both things that might be relevant for this fund. As such, we should investigate how exactly the fund is financing these distributions so that we can determine how sustainable they are likely to be.

Unfortunately, we do not have a particularly recent report that we can consult for this purpose. The fund's most recent [financial report](#) corresponds to the six-month period ended December 31, 2020. As such, it will have no information about how well the fund has performed in the strong market that we have seen so far this year. However, it will be able to tell us how well it weathered through the unprecedented conditions of 2020. During that six-month period, the fund received a total of \$2,067,134 in dividends and another \$6,908,801 in interest off of its portfolio, giving it a total of \$8,975,935 in income. The fund paid its expenses out of this amount, leaving it with \$6,199,163 for the shareholders. This was nowhere near enough to cover the \$14,711,075 that the fund paid out over the period. However, there are other ways that a fund like this can make money, such as through capital gains. It succeeded at this as it had a net realized loss of \$3,464,066 during the period but was able to more than offset this with \$17,384,261 in unrealized capital gains. Thus, the fund did overall manage to cover its distribution and it appears that the return of capital distributions is simply the fund paying out its unrealized capital gains. Overall, this distribution appears to be reasonably sustainable.

Valuation

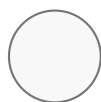
As is always the case, it is critical that we do not overpay for any asset in our portfolios. This is because overpaying for any asset is a surefire way to generate a suboptimal return off of that asset. In the case of a closed-end fund, the usual way to value it is by looking at a metric known as the net asset value. The net asset value of a fund is the total current market value of all of the fund's assets minus any outstanding debt. It is therefore the amount that the investors would receive if the fund were immediately shut down and liquidated.

Ideally, we want to purchase shares of the fund when we can acquire them at a price less than net asset value. That is because such a scenario implies that we are acquiring the fund's assets for less than they are actually worth. That is unfortunately not the case right now. As of August 27, 2021 (the most recent date for which data was available as of the time of writing), the RiverNorth/DoubleLine Strategic Opportunity Fund had a net asset value of \$14.99 per share but the shares actually trade for \$15.94 per share. Thus, the shares currently have a 6.34% premium to net asset value. This is quite a bit higher than the 4.85% premium that the fund's shares have averaged over the past month so it might make sense to wait a bit until the price comes down to a more reasonable valuation before buying into it.

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