Interval Funds During the Global Financial Crisis: 2008-2009

Interval fund performance during the global financial crisis (GFC) of 2008-2009 provides a useful case study for understanding how Covid-19 might impact the sector. Although the global pandemic and economic shutdown we are currently experiencing is unique, every financial crisis has certain characteristics in common.

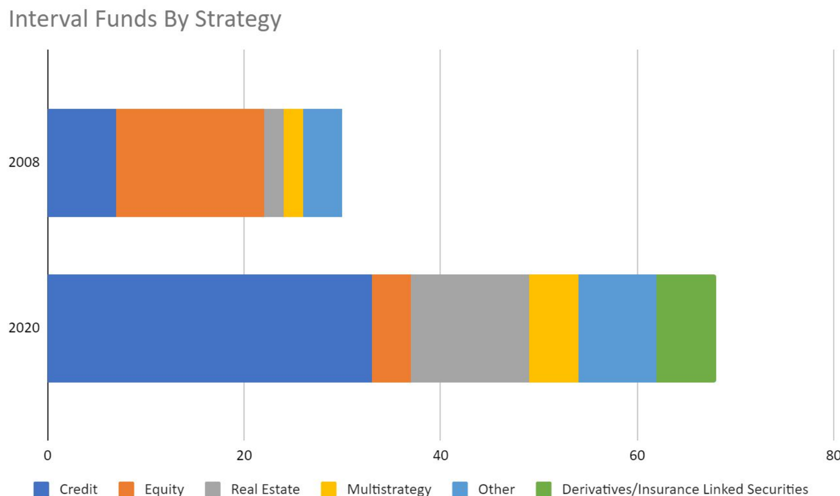
How a Financial Crisis Impacts Interval Funds

First the bad news. Tender offers were oversubscribed during the GFC, and the interval fund sector shrank significantly. Fortunately, the limited redemption requirements helped fund managers avoid firesales of assets. There were large mark to market writedowns in 2008, and most funds reported losses. On the other hand, most funds recovered rapidly after the crisis. The heightened uncertainty created opportunities for managers with capital to put to work.

Interval Fund Strategies: Then and Now

Prior to the GFC, the interval fund sector was smaller, and more focused on equity strategies than it is today. In recent years, asset managers have mainly used interval funds to implement alternative strategies not normally available to retail investors. Real estate was not a common interval fund strategy until recently, when non-traded REIT sponsors started entering the space. Additionally, prior to the GFC there were no interval funds focused on derivatives and insurance linked securities. Credit is the only interval fund strategy that has been consistently popular for over a decade.

The following chart shows a comparison of the interval fund sector by investment strategy in 2008 and 2020.

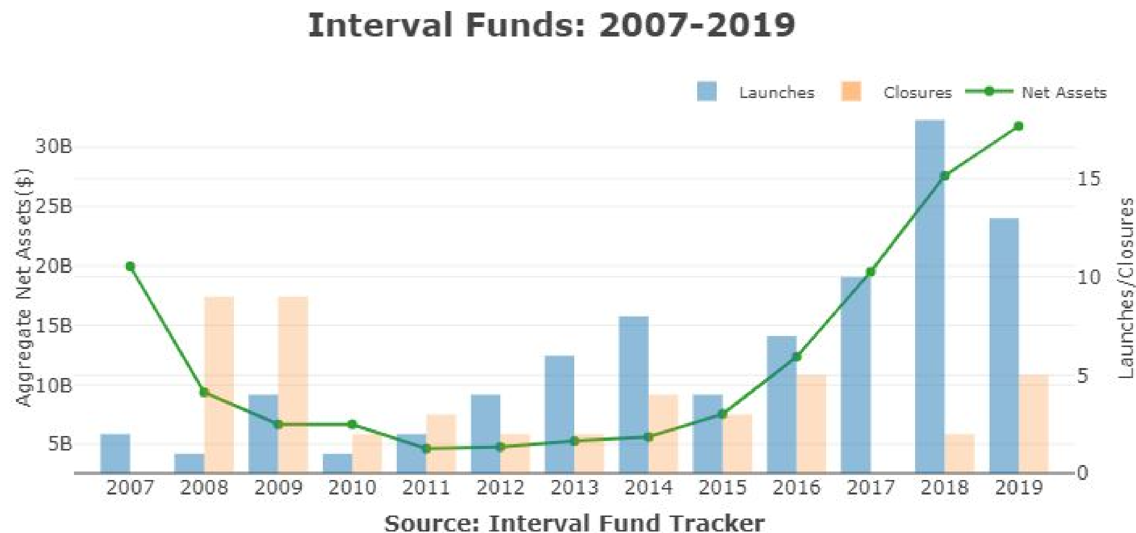


Interval Funds During the Financial Crisis

During the 2008-2009 financial crisis, the interval fund sector shrunk along with the rest of the asset management industry. At the beginning of 2008, there were 30 active interval funds with a combined total of

$20 billion in net assets. By the end of 2010, the sector had shrunk down to 14 funds with less than $7 billion in total net assets. Although the sector shrank, funds that stuck around rebounded quickly. Investors who held on to interval fund investments through the subsequent recovery typically had positive returns.

After the financial crisis, interval fund assets remained mostly flat for several years, before rapidly increasing starting in 2016. This chart shows how changes in interval fund assets, along with fund launches and closures from 2007-2019.



Fund Exits During the GFC

Fund closures exceeded fund launches for four years in a row from 2008- 2011. There are three ways an interval fund can leave the market.

(1) In a liquidation, the fund sells all its assets, pays off its debt, and returns any leftover funds to shareholders. After this is complete it ceases to exist as a legal entity. Small funds are uneconomic for asset managers and investors. If a fund fails to gain traction, it is often sensible to liquidate it. Nine interval funds liquidated between 2008 and 2010.

(2) In a merger, an interval fund acquires or is acquired by another fund. If the surviving entity is a different structure, such as a mutual fund, then the impact is a reduction in total interval fund assets. Asset managers often merge smaller funds, especially during tumultuous times. Six interval funds merged into other fund complexes from 2008-2010.

(3) In other cases, the fund converts to a different fund structure such as a regular closed end fund or an open end mutual fund. This shows up as "conversion" in our dataset. Only one interval fund converted to another structure between 2008 and 2010. However, note that many publicly traded interval funds that invested in equities obtained shareholder approval to convert to regular closed end funds during the decade following the financial crisis. Consequently, most currently active interval funds are non-traded.

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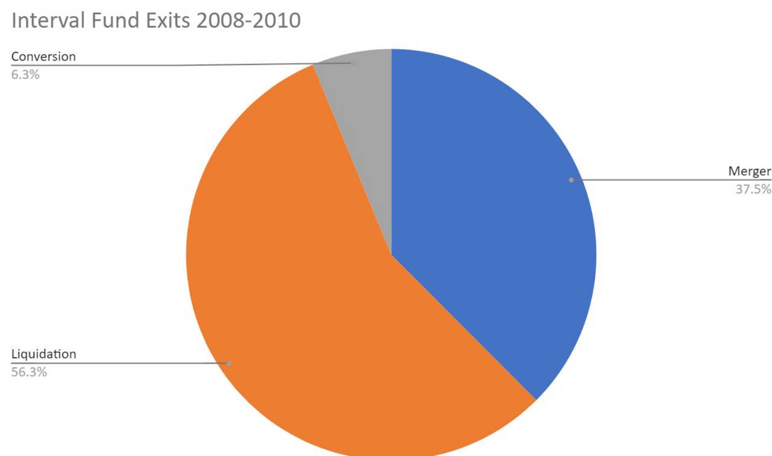
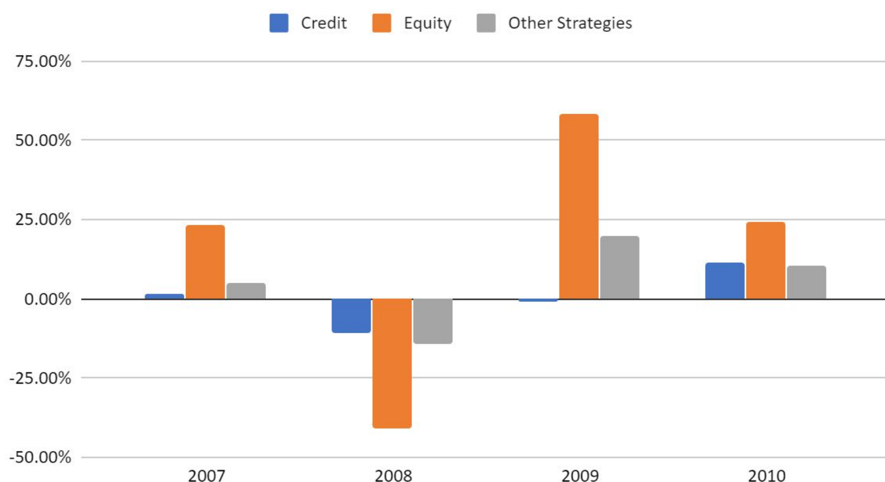
The following chart shows the reasons for interval fund exits from 2008- 2010.



Interval Fund Performance During the Financial Crisis

Investors who held on to interval fund investments through the volatility of the financial crisis were generally rewarded with positive returns. Equity focused strategies were the most volatile. Equity funds on average lost 41% in 2008, but then gained 58% in 2009. Mark to market writedowns were severe in 2008, but most credit managers navigated the crisis while avoiding permanent capital impairment. Credit funds on average lost 11% in 2008, 1% in 2009, but then gained in 11% in 2010. Individual performance varied widely with some credit funds losing over 20% in 2008, but gaining over 50% in 2009. Other strategies on average lost 14% in 2008, but then gained 20% in 2009 and 10% in 2010. By 2011, most funds still in the market had fully recovered financial crisis losses.



In the chart above, real estate and multi strategy funds are lumped together as "Other Strategies". During the financial crisis, there was only one real estate focused interval fund- the Capstone Church Bond Fund(subsequently renamed Church Capital Fund). Its focus on mortgages backed by churches allowed it to

mostly sidestep the worst of the financial crisis, delivering positive returns from 2009-2010. However, it did subsequently experience a large amount of redemptions. In 2019, it liquidated.

Although most funds returned to positive performance starting in 2010, it took several years for assets to grow again. The experience of interval funds that have been active since before the financial crisis is instructive.

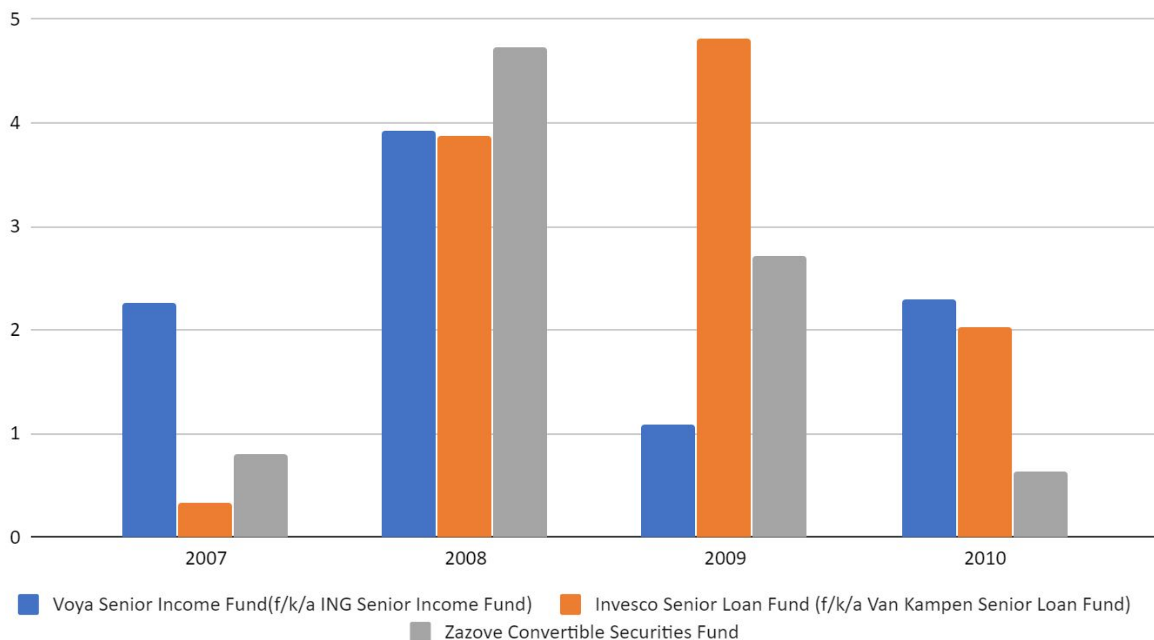
The Decade Plus Club

There are four funds currently in the market that went through the last financial crisis. The predecessors to Invesco Senior Loan Fund and Voya Senior Income Fund both invest in high yield credit, and over a decade later under their current management are among the largest active interval funds. Zazove Convertible Securities Fund is a privately offered fund focusing on convertible bonds and related arbitrage strategies. Blackrock Enhanced Government Fund invests in short term government debt and is publicly traded on an exchange.

Investor Redemptions

All interval funds experienced heightened redemptions, and a slowing capital raise during the financial crisis. However the limited redemption requirements allowed some investors to exit without forcing a fire sale of assets.

This chart shows the ratio of capital redeemed to new capital raised from 2007-2010 for select non-traded interval funds.



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Performance

The following table shows the total return of the four currently active interval funds that were in operation during the GFC. Note the fiscal years don't directly line up. However the key point is that all four funds quickly regained losses experienced at the height of the financial crisis.

Fund	**Fiscal Year End**	**2007**	**2008**	**2009**	**2010**
BlackRock Enhanced Government Fund	December 31	2.39%	-0.73%	12.60%	4.95%
Invesco Senior Loan Fund (f/k/a Van Kampen Senior Loan Fund)	July 31	4.06%	-6.70%	-18.60%	18.78%
Voya Senior Income Fund (f/k/a ING Senior Income Fund)	February 28	-8.94%	-29.08%	52.65%	11.52%
Zazove Convertible Securities Fund	December 31	-1.58%	-43.08%	77.58%	19.60%