Interval Funds 101

MAY 2024

Octagon XAI CLO Income Fund (OCTIX)

INTERVAL FUND EDUCATION

What is an interval fund?

An interval fund is a semi-liquid product structure that provides access to private market assets. These funds operate as closed-end investment companies ("closed-end funds") registered under the Investment Company Act of 1940 (the "1940 Act"). Interval funds offer shareholders the opportunity to sell their shares at net asset value (NAV) at fixed intervals, which may occur quarterly, semi-annually, or annually. The 1940 Act requires interval fund repurchase offers be at least 5% and not more than 25% of the fund's outstanding shares. Interval funds continuously offer their shares at a price based on NAV, with subscriptions often available on a daily basis.

Interval fund structural advantages

Interval funds offer individual investors a flexible structure to access alternative assets and illiquid investment strategies, including real estate, private equity, structured credit, distressed debt, specialty finance, and catastrophe bonds. Unlike mutual funds, interval funds may invest without limitation in illiquid assets, however, interval fund managers often allocate a small portion of fund assets to more liquid securities to fill periodic repurchase requests.

Key Benefits of the Interval Fund Structure

Private Market Access	Interval funds provide access to private market assets and alternative strategies.
Ability to Stay Fully Invested	Interval funds are not required to maintain cash positions to meet daily redemptions. The ability to stay fully invested may generate higher yields and returns over time.
Advisor-Friendly Features	Interval funds offer low or no suitability restrictions and often the convenience of electronic ticketing.
Investor-Friendly Features	Interval funds utilize 1099 tax forms, frequent NAVs (often daily), periodic liquidity, and 1940 Act protections and reporting, including an independent fund board representing shareholder interests.

Source: XA Investments

Benefits of investing in alternatives

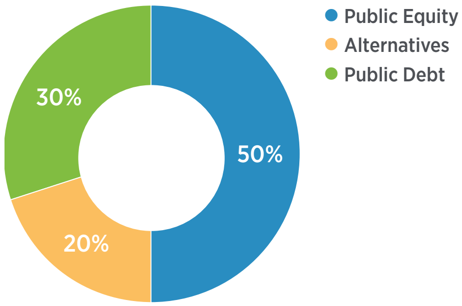
The New 60/40: Interval Funds Deliver Private Market Access

Interval funds provide high net worth and individual investors the opportunity to access strategies and managers typically reserved for institutional investors. Diversifying the investment universe with alternative and private assets presents compelling opportunities for potentially higher risk-adjusted returns and reduced correlations to public equity and debt. Since 2000, Merrill Lynch notes that private strategies have outperformed public equity strategies during both Federal Reserve interest rate hiking and cutting cycles. The Merrill Lynch Chief Investment Office recommends an allocation to alternative investments of 20%–30% for many investors.[1]

Bain & Company found that fewer than 15% of companies with over $100 million in revenue are publicly held, limiting investor exposure to the broader economy. This makes achieving "true diversification in the public markets harder over time."[2] Incorporating alternative and private assets offers investors more options for attractive risk-adjusted returns and diversification.

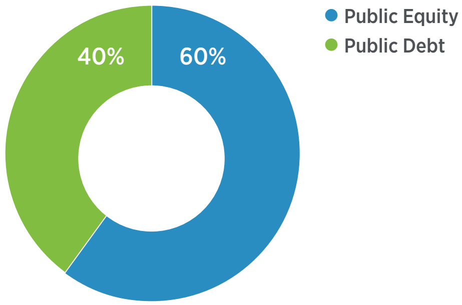
New "60/40"

Portfolio allocations with a mix of public and private investments. J.P. Morgan Asset Management recommends that investors develop the next generation of 60/40 by turning to private as well as public markets.[3]



Old 60/40

Portfolio allocations with only public investments



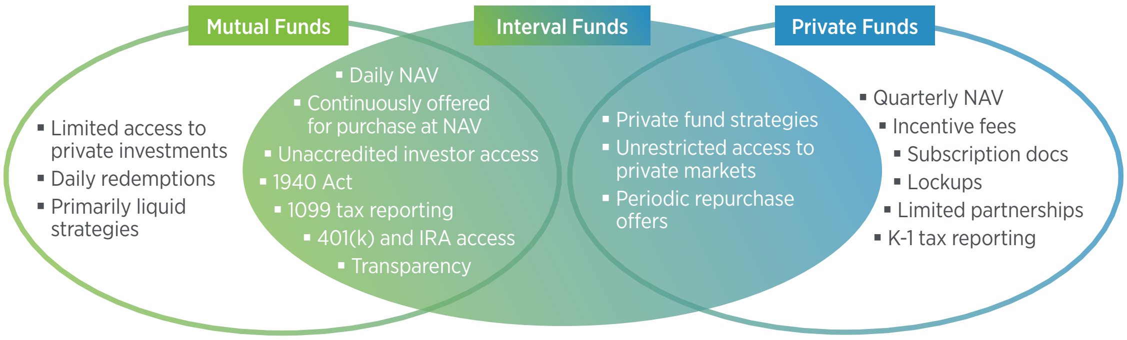
A Marriage of Alternative Investment Strategies and Registered Funds

Alternative investments are less liquid than publicly traded securities and less liquid assets may offer higher expected returns. The intuition is simple: investors need to be compensated for locking up their money in relatively illiquid assets. This trade-off of excess return in exchange for less liquidity is one that alternative investment managers seek to capitalize on and is commonly referred to as the "liquidity premium."

Interval funds preserve the integrity of alternative investment strategies and harness the power of liquidity premiums. While interval funds have been around since 1989, the structure has experienced impressive growth in the last decade as investors and advisors have become increasingly aware of the potential benefits of alternative investments.

Interval Funds Are Designed to Fit Alternatives

Interval funds offer a distinct ability to hold alternative assets in a widely accessible registered fund structure.



1 "Alternative Investments can help you pursue your goals across market cycles." Merrill Lynch Chief Investment Office. March 15, 2023. **2** Global Private Equity Report 2023. Bain & Company, Inc.
3 J.P. Morgan Asset Management 2024 Long-Term Capital Markets Assumptions (28th Annual Edition). October 2023.

Understanding interval fund liquidity limitations

It is critical for investors to understand that an investment in an interval fund should be made with a long-term horizon in mind. Taking a long-term approach helps align the benefits of the structure with the investor's objectives. Interval funds have a rules-based redemption process that provides investors with advance notice for redemption requests. The process enables investors to submit redemption requests and gives portfolio managers between 8 to 21 days, depending on the fund's operations, to distribute proceeds to redeeming investors.

> "Interval funds provide shareholders with limited quarterly liquidity, which is often considered an attractive feature. However, these semi-liquid funds may at times encounter proration when demand for liquidity surpasses the repurchase offer amount. To optimize the structural benefits of these funds, advisors and investors should expect to hold their interval fund investments for a longer term and plan to source short-term liquidity needs from liquid public debt and equity investments."
>
> *Benjamin McCulloch, General Counsel, Managing Director*
> *XA Investments LLC*

Interval Fund Repurchase Timeline

Shareholder Notification	Repurchase Request Deadline	Repurchase Pricing Date	Repurchase Payment Deadline
Notification to shareholders 21 to 42 days before the repurchase request deadline (includes NAV calculated within 7 days of notification)	Repurchase requests must be received from shareholders; fund determines any required proration; NAV calculated daily during the 5 business days before the repurchase request deadline	NAV applicable to repurchase is determined; orders are processed	Proceeds to shareholders due
T minus 21 to 42 days	T minus 1 to 14 days	T minus up to 7 days	T

Fund must maintain liquid assets equal to the repurchase offer amount (e.g., 5% of net assets if offer is 5% of outstanding shares) from time of the shareholder notification until the repurchase pricing date.

What Happens if Repurchases Are Oversubscribed?

The table below outlines the three main interval fund repurchase option scenarios.

Interval Fund Repurchase Scenarios

Scenario 1 **Fund Fills All Shareholder Redemptions**	Scenario 2 **Fund Fills All Shareholder Redemptions by Repurchasing an Additional 2% of NAV**	Scenario 3 **Fund Must Prorate Repurchases**
The total amount of assets requested for redemption by shareholders is below the maximum amount initially offered by the fund. e.g., 5% NAV repurchase offer amount; 3% NAV aggregate repurchase request amount	The total amount of assets requested for redemption by shareholders exceeds the maximum amount initially offered by the fund by no more than 2% of NAV. Rules allow the fund to repurchase up to an additional 2% of NAV. e.g., 5% NAV repurchase offer amount; 7% NAV aggregate repurchase request amount and shareholders receive full repurchase request amount	The total amount of assets requested for redemption by shareholders exceeds the maximum amount initially offered by the fund by more than 2% of NAV. e.g., 5% NAV repurchase offer amount; 8% NAV aggregate repurchase request amount, shareholders are prorated on repurchase based on total demand for liquidity

Source: XA Investments

Frequently asked questions

Why is the Octagon XAI CLO Income Fund structured as an interval fund?

The Octagon XAI CLO Income Fund (OCTIX or the "Fund") is structured as an interval fund because it invests in collateralized loan obligation (CLO) securities, including the debt tranches of CLOs and the subordinated tranches of CLOs (often referred to as the "residual" or "equity" tranche). These securities are high yielding, less liquid investments that are not typically suitable for a mutual fund or ETF. Given the asset mix, OCTIX has the potential to generate attractive income that is more compelling than other similarly rated corporate credit strategies.

How large is the interval fund market and what has propelled its growth?

There were 100 interval funds with $77.3bn in net assets as of March 31, 2024. The growth of the interval fund market has been fueled by investor demand for alternative strategies in an investor-friendly wrapper. Private credit has attracted a disproportionate amount of new capital in the interval fund market because of demand for alternative income, but other strategies such as private equity and real estate have made meaningful contributions to market growth.

For advisors and investors, what is compelling about the interval fund structure?

Interval funds are semi-liquid products that appeal to investors with longer investment horizons, higher risk tolerance, and fewer liquidity needs. Alternative assets can offer compelling risk-adjusted returns with minimal correlation to public equity and debt, and can improve portfolio diversification and investor outcomes. Investors who can tolerate limited liquidity and stay invested over long time horizons are likely to benefit from the interval fund structure, which helps prevent panicked "buy high/sell low" behavior.

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For more information on OCTIX or interval funds, please contact us with questions.

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