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THE SCOTT LETTER is intended to educate global investors about closed-end funds. Closed-end funds can be a valuable and profitable investment tool. To learn about closed-end funds, visit our web site, www.CEFAdvisors.com, and in particular, read our article, *What Are Closed-End Funds*. Feel free to forward this newsletter to anyone who you believe could benefit from information on closed-end funds or global portfolios.

– George Cole Scott
Editor-in-Chief

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Global Market Overview

"The pace of global growth experienced in 2004, currently estimated at close to 5%, was the fastest in two decades. However, going forward, growth should slow as the global economy transitions from an above-trend recovery phase to a slower paced expansion phase and as monetary policy is tightened," says the annual report from The Swiss Helvetia Fund.

"With regard to the much discussed weakness in the U.S. dollar, it decreased by 10.44% against the Swiss franc in 2003 and continued its decline particularly after the election in 2004. It finished the year down 8% against the Swiss franc."

What If the U.S. Dollar Keeps Falling?

What would happen if the dollar, recently $1.34 to the euro, were to slip to $1.45 or even $1.80? Economists at ING Financial Markets analyzed what the world, particularly Europe, would look like if the dollar slid to $1.80. The report says that the answer would make for some unpleasant reading, especially if your native tongue is German, French or Italian.

Even the brain trust at ING doesn't see the dollar falling another 26% from current levels. In the time period since this report was released in late December, the dollar has traded in a narrow range, from $1.28 to $1.34. During the next three years, ING doesn't see the dollar falling below $1.40, but they contend that there are good reasons to examine the impact of a much weaker dollar – and a much stronger Euro.

For one, an additional rise in the euro to $1.80 from current levels represents only about half of the percentage-point climb the euro already has achieved in advancing from its October 2000 low of $82.28 U.S. cents to its December peak of $1.3469.

"A further rise to $1.80 wouldn't be that unusual, given the tendency of currencies to overshoot their fair values," says a senior economist at ING in London.

From its 1985 highs to its 1987 lows, the dollar tumbled 54% against the yen, and from those 1985 highs to its post-World War II low in 1985, it plunged 70%. "There are good reasons that the dollar could sink further," the report continues, "one is the huge U.S. budget deficit in its current account – the broadest measure of trade in goods and services."

"Currently, the U.S. is relying on foreigners' purchases of dollar denominated assets to fund the deficit. That means that U.S. assets have to remain sufficiently attractive for them to do so, either because they yielded high enough returns or because there is a prospect for decent capital gains. If foreigners don't purchase U.S. assets – because they don't like the returns (there has been some rumbling about this prospect lately) and already hold enough investments or for some other reason – they don't need to buy dollars. That means the dollar will fall. A weaker dollar in turn helps to reduce the deficit by making U.S. exports cheaper while raising the price of imports."

Now that the deficit is running at 5.6% of GDP, many economists are projecting it to rise above 6%. Yet the trade-weighted dollar has receded only about 15% from its 2002 peak.

Bottom line: "The dollar's decline hasn't yet run its course, if the current account deficit is to be brought down to sustainable levels," says the report. A lot depends on how much Asian currencies, accounting for a lion's share of the U.S. trade deficit, eventually rise against the U.S. dollar. The more they climb, the more pressure there is on the euro to rise.

Here's good news: The odds of the euro rallying to $1.80 aren't very high. The European Central Bank is likely to act aggressively to stem further rallies.

Source: *The Wall Street Journal.*

Analyst Comment

We will keep hedging U.S. dollar investments any way we can, using closed-end funds. On the other hand, at press time, the euro fell to $1.2940 on March 24. – Editor

Dividends Are Larger Abroad

"Investors looking for yield plays will find slim pickings in the Standard & Poor 500 Index. Recent dividend yields have averaged 1.7%, not far above their all-time low of 1.1% hit near the 2000 market peak, and well-below the 20-year high of 5% that prevailed through much of 1984," says *Institutional Investor* magazine.

The story is different abroad, particularly in Europe and the dividend yield on the FTSE all share index is 3.17%. Besides, the price-earnings ratio of the S&P 500 is 20.3 versus the Dow Jones World Index multiple of 17, and the Euro Stoxx 50 is at 13.8%. Historically, dividends have accounted for 40% of total returns. This is a prime reason we have been investing in Europe lately.

Our choices, so far, are Swiss Helvetia Fund and The Europe Fund. The European markets offer investors a wider range of sectors with higher-yielding stocks than can be found in the U.S. European CEOs are also more reluctant to cut dividends when earnings weaken than U.S. managers.

The best of them, however, screen for stocks that are selling at attractive discounts to their intrinsic value, and we particularly look for companies with the ability to grow their dividends. Some money managers have also found that stocks in other regions, such as Australia and even China, pay good dividends. Research has found that buying high yielding stocks pays-off over the long term. It also fits our mantra of finding funds that have policies of paying our larger than average distributions.

In Europe, "lackluster European economies aren't deterring managers from the region," says a report from Reuters. "On the contrary, they are finding compelling reasons to buy shares of eurolands's biggest companies." This fits into our 2005 focus on Western Europe, with Swiss Helvetia Fund and The Europe Fund. "The key factors are relatively inexpensive valuations, restructuring and cost cutting efforts; attractive dividend yields and the under-performance of larger companies versus the smaller ones." And now corporate taxes are set to be cut in Europe, led by Germany.

A Merrill Lynch survey of global fund managers taken in early March show increased interest in eurozone equities, while backing away from U.S. stocks. On a price-to-earnings basis, European companies are trading at an average of 14 times forward earnings, whereas the U.S. market is trading around 16.5.

"They're doing restructuring [that] American companies undertook years ago to really compete in the global economy. Emerging markets are doing well, and small caps internationally are doing well. It's part of an overall, better market trend outside the U.S."

Source: Reuters, Limited

Emerging Markets Investing: China

A recent issue of the *Wall Street Journal* has an article on "Emerging Ways to Invest in the Wild, Wild East," referring to how Americans can profit from investing in China. They list four ways to play China, starting with what is considered the least risky approach and ending with the riskiest.

1. **Mutual funds and exchange-traded funds (ETFs)** own broad baskets of Chinese stocks, offering diversity and thereby mitigating the risk of owning any one particular stock. Most actively managed funds own ADRs, Hong Kong-based companies and Hong Kong-listed China related stocks. ETFs, on the other hand, typically track an index of China-related stocks, and there is no way they can outperform their index.

We will follow this list with reasons why we have found closed-end funds are the best way to invest not only in China but also in any foreign market. We only use the equivalent mutual funds when the closed-end fund trades at a premium larger than 5% to its net asset value for a considerable period.

2. **American depository receipts (ADRs)** offer U.S. listed stocks that trade on the New York Stock Exchange. Those that are listed must abide by generally accepted U.S. accounting principles.

3. **H shares and Red Chips.** H shares and so-called Red Chips are Chinese companies whose shares trade in Hong Kong.

4. **A and B Shares.** The A shares represent the largest lot of domestic Chinese companies but are available only to Chinese investors. Brokerage firms in Hong Kong and Singapore are exploring plans to eventually offer clients of its U.S. and European private banks access to A shares, though only to institutional investors at the moment. Once available, they are likely to represent the same level of risk as the B shares. B shares represent the Shanghai and Shenzhen listed companies that foreigners are allowed to buy. These shares are priced in Hong Kong and American dollars, but are not subject to the regulatory scrutiny as shares trading in Hong Kong, Singapore and the U.S.

B shares, which represents a smaller market denominated in U.S. dollars, have made an encouraging start in 2005. After falling sharply last year, Shenzhen's Class B share index has risen 22%, and Shanghai is up 7.7%, outperforming Class H shares as of March 20, 2005. However, the B share market has poor liquidity and possible corporate malfeasance. Also, the Chinese government now has a program to allocate a limited amount of A shares to foreigners, which has dampened interest in the B share market.

The primary risk of investing in mutual funds overseas is the redemption risk about which mutual fund companies never discuss. A sudden downdraft in the markets means that the portfolio manager has to dump his shares to meet the redemptions by panicked investors. The discount and the stability of the closed-end fund portfolio never have the problem of liquidating shares. The discount can widen, but it also serves to protect the investor in down drafts.

The new ETFs for China, issued by State Street Global Advisors and Barclays Global Advisors, can serve as a viable alternative for China investment, and are highly liquid but pay little in distributions. They seldom can be bought for a discount to net asset value that closed-end fund investors are used to having to leverage their investments. However, CEFA is

keeping an open mind on using ETFs as an alternative to closed-end funds which trade at premiums.

Shefin Ke, manager of a China fund at Edinburgh-based Martin Currie (whom we once visited) said about ETFs: “These might be useful if you don’t have research ability. But we are active managers. We think stock selection is a better way.” Other institutional investors agree. They may only use ETFs for short-term purposes and see them as competition for what they do. ETFs may only be part of the answer.

The 25 companies in the China index are heavily weighted toward the telecom and oil sectors. Most of the big banks are not quoted. They seem to want more diversification in stock selection. Other problems are a lack of liquidity and restrictions on the structure of the portfolio which can cause headaches for the money manager.

For closed-end fund investors, only mutual funds and ETFs come close to any of the strategies that are working for us. We have had great success using the closed-end format for investment in China and the China region as well as other areas.

Trying to research individual investments in most foreign markets, particularly in the emerging markets, is difficult and risky for individuals and even for investment advisory firms who know these markets. The diversification, leverage of the discount and ample distributions of closed-end funds are the best way to enter markets as large and diverse as China.

Templeton Dragon Fund Reports Higher Earnings

For the year ended December 31, 2004, Templeton Dragon Fund posted cumulative total returns of +0.36% in market price terms and +16.22% in net asset value terms, as the Fund’s market price declined more than the Fund’s net asset value. For the 12 months ended December 31, 2004, the Morgan Stanley Capital International (MSCI) China Index posted 1.89% total return.

“Our investment strategy employs a fundamental, value-oriented, long-term approach. In selecting companies for investment, we will consider overall growth prospects, competitive position in export markets, technologies, research and development, productivity, labor costs and sources, returns on investment, capital resources, government regulation, management and other factors in comparison to other companies around the world which we believe are comparable.

“During the year, we reduced the Fund’s exposure to China H shares (Hong Kong-listed Chinese companies) as valuations increased after their strong performance. In particular, we sold oil and gas transportation infrastructure holdings as high commodity prices and robust infrastructure in China boosted stock prices. As a result, the Fund’s exposure to China H shares fell to 10.6% of total net assets on December 31, 2004, from 29.5% on December 31, 2003.

“As we continued our search for value stocks in the greater China region, we undertook significant purchases in Taiwan, increasing the Fund’s exposure to 25.4% of total assets at year-end from 19.7% a year earlier. The purchases enlarged the Fund’s exposure to the commercial banks, semiconductor and semiconductor equipment, and wireless services sectors.”

Net assets of Templeton Dragon Fund (TDF) on December 31. 2004 were $706,138M versus $626,959M in 2003. The expense ratio was 1.52% versus 1.64% in 2003; the portfolio turnover rate was 19.42% versus 29.91% in 2003. Total distributions in 2004, from income and capital gains, were $0.5608. The Fund has a share repurchase program.

CEFA clients hold shares (also included in family accounts of the portfolio manager) in TDF. For an **interview with Dr. Mark Mobius**, the portfolio manager, see The Scott Letter, March 2005 (http://www.cefadvisors.com/ScottLetter/2005-03.pdf). For more information about TDF, call 1-800-342-5236.

Brazilian Equity Fund to Liquidate

New York (Dow Jones) March 14, 2005 – Brazilian Equity Fund Inc. (BZL-NYSE) said the Securities and Exchange Commission issued a notice giving “interested persons” until March 30 to request a hearing related to the fund’s application to settle litigation and liquidate. The SEC notification comes about two years after shareholders of Brazilian Equity Fund voted to terminate the fund as part of a settlement over a rights offering in 1996 and advisory fee arrangements with Credit Suisse Asset Management. In a press release, Brazilian Equity said it will receive requested relief from the SEC as part of its liquidation within 30 days of the SEC order, as provided in its settlement plan. ■

Real Estate Focus: REITs Go Global

REITs have gained tremendous popularity in the U.S. over the past 20 years, where the market for real estate securities has grown to $284 billion. Still, the U.S. REIT markets may only be the tip of the iceberg. As REITs began to spawn similar structures around the world, investors are being presented with new ways to invest in global real estate markets.

“I believe the global market for real estate securities has significant potential for growth,” remarked Martin Cohen, co-chairman and co-chief executive officer of Cohen & Steers. He added that he believes that the global market for real estate securities today is similar to the early 1990s, when U.S. REITs were beginning their strong growth phase. To take advantaged of the growth potential of the global market, Mr. Cohen noted that Cohen & Steers recently acquired an interest in Houlihan Rovers, a Belgian-based global real estate securities asset manager.

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Joseph Houlihan, managing director of Houlihan Rovers, said, "In my view, Europe and certain Asia-Pacific markets are moving quickly to adopt REIT-like structures, creating new investment opportunities around the world." Houlihan also noted that global universe of public real estate companies is more than twice the size of the U.S. market, providing potentially wider breadth of investment opportunities.

He added that while the size of the universe, as represented by the S&P Citigroup BMI World Property Index, has grown significantly since 1990, just 10% of the world's commercial real estate is owned by public companies. The growing acceptance of REIT-like entities, in his view, is expected to drive the growth of public real estate companies around the globe.

Portfolio Diversification Potential

Historically, investment returns for real estate markets and property types have tended to rise and fall in different cyclical patterns. Houlihan believes that investors who invest in a globally diversified portfolio of real estate securities can benefit from these different cycles. In addition, global real estate securities have historically had a low correlation to global stocks (S&P Citigroup BMI World Property Index vs. MSCI World Index.) These characteristics suggest that globlal real estate investments, in addition to attractive return potential, may offer significant diversification benefits.

What does the globalization of the REIT phenomenon mean for U.S. investors? Houlihan believes it will offer investors a broader range of choices in real estate securities, increased opportunities for diversification and the potential for attractive total returns over longer periods of time. He adds, "There are currently over 20 countries with REIT-like structures in place. I believe this trend will continue, creating new investment opportunities around the world."

Risks of investing in real estate securities include falling property values due to increasing vacancies or declining rents resulting from economic, legal and/or technological developments. Foreign securities involve special risks, including currency fluctuations, lower liquidity, political and economic uncertainties and differences in accounting standards. Some global securities may represent small and medium sized companies, which may be more susceptible to price volatility and less liquidity than larger companies.

Martin Cohen was asked about the total return of 38.48% for Cohen & Steers Realty Shares in 2004 versus the NAREIT Index's total return of 31.58%.

SL: What accounted for this performance?

Cohen: At the beginning of 2004, we believed that the economy would continue to grow, leading to improved fundamentals for REITs and positioned the fund's portfolio accordingly. In particular, the fund benefitted from an overweight in the mall sector, one of the best performing sectors of the year. While many commentators suggested early in 2004 that REITs would be hurt by rising interest rates over the long term, we continued to believe that there is little correlation between the two.

Note: Cohen and Steers has five real estate closed-end funds, each of which raised its annual dividend, starting in January. We use the only one that is not leveraged, Cohen & Steers Total Return Realty Fund (RFI-NYSE). RFI raised its dividend in January 2005 by 29%. Their other realty funds raised their dividends from 11% to 25%. On a recent visit to Cohen & Steers in New York, they told this editor that they are going to bring out an international real estate fund later this year. ■

Lazard Total Return and Income Fund

Lazard Total Return & Income Fund, Inc.(LGI-NYSE) is a closed-end management investment company. LGI began trading on the New York Stock Exchange on April 28, 2004; and as of December 31, 2004, the Fund's performance, as measured by its Net Asset Value per share ("NAV") is comfortably outperforming the Morgan Stanley Capital International (MSCI) World Index. During the fourth quarter of 2004, the NAV of LGI increased by 15.6%, versus a 11.9% increase for the Index. Shares of LGI ended the fourth quarter with a closing price of $19.37, representing a 10.8% discount to the Fund's NAV. At year-end, the Fund's net assets were $208.6 million, with total leveraged assets of $299.5 million (30.4% leverage).

As of December 31, 2004, 65.3% of the Fund's total leveraged assets consisted of global equities, and 33.2% consisted of emerging market currency and debt instruments. The remaining 1.5% was in cash and other net assets.

Declaration of Dividends

The Fund's Board of Directors declared a monthly dividend distribution of $0.1042 per share. This distribution represents an annualized market yield of 6.5%, based on the share price of $19.37 at the close of trading on December 31, 2004. All of the distributions that have been paid out in 2004 were composed of dividends and short-term capital gains, with no return of capital.

The funds of LGI are invested primarily in 35 to 45 global equity securities of large, well-known global companies with strong financial productivity and attractive valuations all based in developed-market regions around the world. The Fund also seeks enhanced income through investments in short duration (typically below one year) emerging markets forward currency contracts and local currency debt instruments. The Fund's emerging market currency and debt holdings are highly diversified across 25 countries with Eastern Europe (33.6%), Asia (30.3%), Latin America (12.9%), the Middle East (10.7%), Africa (3.9%) and the Commonwealth of Independent States and the Baltic Countries (7.4%). ■

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TCW Convertible Securities Fund

From the President's Letter: "The roller coaster ride that was 2004 is finally over ...." Against this backdrop, the shareholders of TCW Convertible Securities Fund, Inc. (CVT-NYSE) realized a total return of 13.02% with dividends reinvested. This compares favorably with the S&P 500 Index which returned 10.88% and the First Boston Convertible Securities Index which returned 7.90% for the same period. The Fund paid four quarterly dividends totaling $0.2385. The year-end market price of $5.36 represents a discount of 7.3% of the Fund's net asset value of $5.78 at December 31, 2004.

In October, the Fund announced that the Board of Directors approved a managed distribution plan and authorized a new share repurchase program for up to one million shares. In addition, the Fund announced changes in the portfolio construction designed to enhance the potential for increased current yield.

The Board of Directors of the Fund believes in putting "the interest of shareholders first. As a central part of this commitment, we have made good corporate governance and reducing the Fund's discount a priority. The managed distribution plan, share repurchase and changes in the portfolio are all efforts to close the discount between the Fund's share price and net asset value. The managed distribution plan will be paid quarterly, and based on the year-end net asset value of $5.78 per share, the quarterly distributions will be $0.10 per share."

CVT is a new holding for CEFA this year. We applaud them for their managed distribution and share repurchase plans which boosted performance. ■

Portfolio Manager's Review

During the first quarter of 2005, we felt it necessary to sell most of our high-performing Aberdeen Australia Equity Fund (IAF-NYSE) because investor demand pushed it to a premium of 7%-12%. This is always a hard decision, but it had to be made because premiums like that seldom last.

Our long experience tells us this is the right thing to do. Often a fund with a good distribution will run-up just prior to the ex-dividend date and then drop sharply. We have seen this over and over.

Because much the performance of IAF was China-related, we decided to put much of the proceeds into Asia-Pacific Fund (APB-NYSE) and Templeton Dragon Fund (TDF-NYSE) We also added The Europe Fund to our 2005 focus area.

In the down market of March, General American Investors acted well so we increased our holdings here as well as adding it to new accounts because it is a core holding. The remaining cash is being held for future opportunities.

Ten Largest Holdings as of 3/31/05

1. General American Investors
2. Lazard Global Total Return & Income
3. Asia Pacific Fund
4. Swiss Helvetia Fund
5. Adams Express
6. Brazilian Equity Fund
7. Cohen & Steers Total Return Fund
8. Latin America Equity
9. Central Securities Fund
10. The Europe Fund

"I don't look to jump over seven-foot bars. I look for one-foot bars that I can jump over." – **Warren Buffett, Financier**

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