

THE SCOTT LETTER: CLOSED-END FUND REPORT

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A Global View of the Closed-End Fund Industry

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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

Interview with Mr. Khiem Do of The Asian Pacific Fund

The investment objective of The Asian Pacific Fund (APB-NYSE), a registered 1940 Act closed-end investment company, is to achieve long-term capital growth in equity securities in the Asia Pacific countries. Because of its strict mandate, APB only invests in Asia, ex-Japan and Australia.

APB is managed by Baring Asset Management Company Ltd. of London (BAM) from its Hong Kong office. The portfolio manager is Khiem Do, who has been head of BAM's Asian investment team since 1997. Khiem joined the firm in 1996 from Citicorp Global Asset Management in Sydney, where he was the Chief Investment Officer, chair of the Australian Asset Allocation Committee and member of the CGAM International Asset Allocation Committee. Khiem's prior experience includes his seven years at Bankers Trust Australia, seven years at Equitilink Australia Ltd. and five years at Citicorp Global Asset Management. Khiem, who was born in Vietnam, is an Associate Member of the Securities Institute of Australia (the Australian CFA equivalent) and received his BA (Honors) in Economics from Macquarie University in Sydney. He has worked in Hong Kong since July 1996 with a team of nine other portfolio managers and analysts. He continues the strategy employed by the former fund manager, James Squire, who managed the portfolio for eight years.

BAM has about US \$3.2 billion of assets under management in Asia (ex-Japan), which is run out of the Hong Kong office. The firm adopts a "Growth at a Reasonable Price" ("GARP") investment philosophy and, in the long-term, tends to prefer to own inexpensive quality stocks. They like to find a company

that has the potential to be re-rated from 5-7 times P/E more than to spend a lot of time on a company that is trading on 20 times P/E. The more highly rated a company is, the higher the downside risk. For a GARP investor, this is common sense. APB is allowed to use leverage to the amount of 125%. At the end of March, APB was leveraged by about 7%, which may be increased if stocks sell down.

APB divides its region into three sections: North Asia (Hong Kong, China, Korea and Taiwan), South East Asia (the ASEAN countries of Indonesia, Philippines, Malaysia, Singapore and Thailand) and South Asia (India). The latest figures for APB indicate a country breakdown as of March 31, 2005 as shown in Figure 1. The figures

following the percentage represent the benchmark for each country.

The Fund is measured by the MSCI All Countries Far East Index (Ex-Japan). Dividends from net investment income, if any, are declared and paid at least annually. The Fund declared a dividend in January 2005 of



Khiem Do

Figure 1.
APB Country Breakdown
(March 31, 2005)

Country	Breakdown	Benchmark
Hong Kong	21.5%	18.7%
China	11.0%	11.3%
South Korea	31.0%	28.0%
Taiwan	22.0%	19.5%
Singapore	4.6%	9.7%
Malaysia	5.4%	5.6%
Indonesia	0.0%	2.8%
Thailand	7.5%	3.6%
Philippines	1.5%	0.8%
India	0.0%	2.6%

\$0.15 per share versus \$0.18 in 2004. APB will distribute any net capital gains annually in excess of net carry loss forwards. Income and capital gains distributions are determined in accordance with income tax regulations, which may differ from U.S. generally accepted accounting principles.

The total expense ratio to average net assets to December 31, 2004 was 1.91% versus 1.93% in 2003. The portfolio turnover for the same period was 71% versus 66% in 2003.

Figure 2.
Annualized Performance to December 31, 2004 (US\$ terms)

	NAV	Benchmark	Market Returns
1 Year	18.94	17.60	4.15
3 Years	16.50	15.66	20.04
5 Years	3.17	-0.86	6.10

Figure 3.
Sector Breakdown as of December 31, 2004

Top 10 Industries as Percentage of Total Equity Investments	
1. Banking	18.0%
2. Industrials	16.7%
3. Information Technology	15.6%
4. Consumer Discretionary	12.8%
5. Materials	11.4%
6. Real Estate Developers	8.7%
7. Telecommunications	8.2%
8. Financial Services	4.3%
9. Utilities	3.2%
10. Consumer Staples	1.1%

We interviewed Mr. Do on April 27, 2005.

SL: Do you plan to increase or decrease the leverage (borrowing) on the portfolio?

Do: That depends on the markets. If we find very cheap growth stocks which were sold down due to sentiment reasons, we will increase the leverage.

SL: Tell us if your investment style and strategy is any different from your predecessor, James Squire?

Do: There is no fundamental change, with the exception of one enhancement, which is to manage the portfolio more

along the line of an absolute return fund, rather than purely against a benchmark index. Otherwise, our investment philosophy and research process remain the same. At Barings, all investment professionals share a common philosophy: to buy unrecognized growth companies at a reasonable price. That means looking both at valuations and growth surprises. In the last six months, we have been able to find a good number of GARP stocks in China, Taiwan and Thailand.

SL: Isn't that using a value approach for growth stocks?

Do: In a way, yes. The Growth-at-a-Reasonable-Price approach focuses on both growth surprises and valuation factors. We combine both when we analyze markets and stocks. This approach has guided us well over the past decade, i.e., helped us to avoid getting carried away with the TMT bubble and to accumulate GARP stocks when the market sells off in panic situations.

SL: We don't hear that definition of GARP very often. Now, according to a report from the Asian Development Bank, growth in the Asia Pacific economies (excluding Japan and Australasia) is expected to slow slightly over the next three years, after reaching an average +7.3% in 2004. This is the highest growth since the Asian financial crisis of 1997-98. The report added that growth in China is likely to take-up the slack.

Do: There will be a slowdown in the region in 2005 after the fantastic growth achieved in 2004. But, note that 2004 showed an unusually high growth rate, as we compare it against a low base in 2003, affected by the SARS crisis. While China's growth last year was very powerful, surprisingly, in the year 2005 to-date, the economy remains quite robust.

SL: Do you think China will be able to continue to grow at a high rate?

Do: There are signs they will. We must point out, however, that the government wants to cool it down to an 8% annualized real GDP growth rate this year ... versus 9.5% last year. Import growth has already slowed down, and investment growth also slowed from the high rate of +30-35% per

annum in 2004 to about +15% per annum currently.

SL: How have the markets in Asia done in 2005, and how does China fit into this scenario?

Do: The markets in Asia to-date have been flat, outperforming the U.S. which is down about 4%. Earnings expectations in Asia for this year are very modest; stock-broker analysts are forecasting zero growth for Asia, which we think is too conservative. If you break it down, you'll notice analysts have forecasted negative earnings growth in Taiwan and Korea, and are even projecting an earnings decline in Singapore. This surprises us. Our own house forecasts for the region are for +8% earnings growth for 2005.

SL: How can there be so much divergence between these forecasts and your assessment?

Do: Analysts in Asia have tended to be rather conservative after the 1997-98 crisis. For instance, in 2002 and 2004, they started low and had to upgrade their earnings estimates significantly as the year progressed. Based on the fact that our house view on U.S. and global economic growth is more upbeat than that of the consensus, we believe that there is room for surprises on the upside.

SL: What is your average price-to-earnings ratio for the stocks in the portfolio now?

Do: The average P/E for the portfolio is about 11.6 times 2005 earnings.

SL: Have these markets been downgraded because so many of them are down this year?

Do: No, as I said earlier, Asian markets are flat year- to-date. From a long-term historical perspective, Asian markets have been re-rated after the 1997-98 Asian crisis. Before that, in fact, they tended to trade at the same or higher valuation than their OECD (U.S. and European) peers. Our house view is that Asian markets are likely to continue to be re-rated in the next few years. Investors will come to realize that they are buying value for money when they are investing in Asian equities now.

SL: I like your analysis of this, but there must be other factors at work here. In your reports, you speak of re-rating of

companies. What do you mean by that term?

Do: Before the 1997-98 crisis, Asia traded at a premium to the world. But, after the crisis, Asia started to trade at a discount to the world P/E multiples and price-to-book. We think that Asia has improved substantially since then, and, while their stock markets have outperformed the world in the last four to five years, there is more to come.

At the minimum, we think Asia will be re-rated close to where the world is trading in terms of earnings multiples. We can't see why we should be trading at such a big discount [to world markets]. The growth rate in Asia is more sustainable.

Another factor that has changed is that since the 1997 Asia crisis, Asia is a net lender for the world, whereas before we were net borrowers. Asia's interest rates are lower than the U.S. Thus, our "equity risk premium" should be equal to or lower than Europe and the U.S., but it is not. That is an argument that Asia should continue to be re-rated. This "Asian discount" still gives long-term investors an opportunity to invest in Asia at an abnormally cheap price.

Another factor is our dividend yields are higher in Asia than in Europe and the U.S.

SL: Really, that surprises me.

Do: Yes, indeed! For instance, in Taiwan, the dividend yield is close to 4% and, on average, the weighted Asian universe's average is currently about 2.9%, while the S&P 500 is only paying 2.2%.

SL: Is that because the Taiwan market is so depressed? Are there the same high dividend yields throughout the region because of low markets?

Do: There's truth in both. A rising number of companies are paying out more, and share prices of Taiwanese companies are the same as they were three years ago. Other Asian companies have also decided to raise their dividend pay-out ratio, rather than wasting excess cash on unproductive investments, as they did in the past.

SL: Your philosophy is to look for stocks that pay good dividends? Is there any possibility that dividend cuts can change the scenario?

Do: If a stock pays 3%-4% dividend with good earnings growth, it makes a lot of sense to own it. But we don't just own a stock for a high dividend yield because we are not a "deep value" house. If we can buy some reasonable growth companies with a fair valuation and a good dividend yield, that certainly would get them onto our radar screen.

SL: Rather than having a discussion about specific companies, unless they are dominant as Samsung has been in Korea, we are more interested in what type of companies and sectors you choose to invest in this year versus last year. For instance, banking and industrial stocks comprised 34.7% of the portfolio at the end of 2004. Have there been changes in your allocation of last year?

"At the minimum, we think Asia will be re-rated close to where the world is trading in terms of earnings multiples."

Do: A number of banking and industrial stocks offer solid growth at a reasonable price. That's why we owned them. But, this year we have been accumulating cheap technology stocks; the sector is like an "orphan" because Nasdaq stocks have been falling. Technology news has not been positive. This gives us an opportunity to buy cheap stocks in Taiwan, especially because local sentiment has been weak.

We have been analyzing stocks along the whole technology curve from components manufacturers to the distributors. We find that there are a lot of cheap companies along the whole chain of the technology link in Taiwan. This is also true in Hong Kong. We like to buy stocks when the sentiment is poor.

SL: Tell us more about the Hong Kong market. How have you played the China growth story?

Do: We have always liked to play the China growth through Hong Kong. This is the best way, as Hong Kong companies tend to be very well-managed. We are encouraged by the fact that when we look further into the red chips [Chinese companies listed in Hong Kong] and the "H" and "B" shares trading in Hong Kong, we have found a number of companies that are also well-managed and have good earnings stories at a reasonably cheap price.

For, example, we have found a diesel truck manufacturer, Weichai Power, that is benefiting from the bottleneck problems in the train system in mainland China. In the China boom, the railroads haven't been able to keep pace. They are run by the government rather than the private sector so there is a shortage of railroad cars.

Transport of heavy goods is filled-in by trucks, and the government says that there have to be lighter loads, which means more trucks, and, therefore, more engines for the diesel manufacturers.

This is a really fabulous story for a company such as Weichai Power which makes diesel engines and trades at a low P/E multiple of 12x 2005 earnings. Weichai is growing at about 20% per annum, making it a great "growth at a reasonable price" stock.

SL: We hope you will continue to find other winners like Weichai Power. We are always concerned about corporate transparency in the emerging markets. What are your comments on progress in this area in China?

Do: We never rely on the GDP numbers. We prefer to analyze partial economic indicators such as electricity consumption, import growth, retail sales and industrial production. We make frequent company visits to Shanghai and Beijing to check-out their sales growth trends. And, we can see if the traffic jams are getting better or worse!

To give you an example, we have had difficulty in meeting with four companies in Shanghai recently, whereas we could easily see six a few years ago. Traffic jams in China's main cities are becoming a big issue. The economies in Shanghai and Guangdong have been growing at 15%,

rather than 9%-10%, as many of the people are moving to the urban sector where wages are about five times higher (than in the rural sector).

Regarding the reliability of reports, Chinese companies listed on the "H" share exchange in Hong Kong allegedly have to be approved by the government first. One can't underestimate the issue of "saving face" so they will not list "rubbish" on the Hong Kong Exchange. A number of this type of company ended up on the "A" share exchanges in Shenzhen and Shanghai markets, which have been in a Bear Market for the past five years.

SL: I didn't realize that. There is a lot of talk here about China revaluing the currency and that the government may be giving into outside pressure. What are your views on that issue?

Do: We have been waiting for that move for a long time. It appears that the People's Bank of China is quite happy to see the Renminbi revalued upward, but the government is not ready to pull the trigger because they do not want bow to the pressures put on them by the U.S. or Europe, for fear of "losing face" to 1.3 billion people. The more pressure from the Western world, the less likely they will do it. If the West keeps quiet, they will revalue.

SL: I wonder why the West doesn't realize that their views are counterproductive regarding revaluation.

Do: The West has their way of doing things, which is to put everything on the table. The East, however, prefers to do things in a more measured and quieter manner.

[This issue is predominant in the world press. For example, the World Bank on April 27, 2005 said China should revalue the Renminbi and abandon the dollar peg in favor of a link to a basket of currencies. It warned that without revaluation, speculative capital flows could destabilize economies in the region. The chief economist for the region said that there was no imminent risk of a financial crisis caused by currency speculators, like that in the late 1990s, but "very large volumes of money" flowing into the region threatened to cause economic distortions. – Editor]

SL: In Korea, if you look at the cash flow achieved by the companies and the return on investment capital they have, cash flow has risen, yet the markets there have not been rewarded in the price/earnings multiples. The Korean market is still trading at eight times earnings. If you look at the cash flows and the return on capital, it has risen from about 4% seven years ago to about 14%-15% this year. When you have a return on capital of about 14% to 15%, the stocks should not be trading about 1.4 to 1.5 but closer to two times book value.

SL: Last year, Samsung was the dominant performer. How is that market doing now?

Do: Samsung is a fabulous technology company, but we are underweighting the

"The Korean market is the cheapest one in Asia at present, and it is very undervalued."

stock at present because the company will have problems generating profits in a falling technology commodity environment this year. They are expected to see an earnings decline of 10%-20% in 2005. There has also been added selling pressure because the Nasdaq and Philadelphia Semiconductor Index markets have been weak.

SL: You still have 31% of the portfolio in Korea?

Do: We do. The Korean market is the cheapest one in Asia at present, and it is very undervalued. We have a diversified portfolio, spreading from technology to materials, banks and telecoms. We are underweighted in the consumer sector there because it doesn't fit our GARP criteria.

SL: I now want to look at the SE Asia economies as you have as much as 20% in that region. Which countries do you like best, and which sectors do you favor?

Do: In the ASEAN region, we like Thailand because the market is very cheap. The local sentiment is very poor because of the bird flu, tsunami and so forth. There is also concern over local terrorism in the south of Thailand. Tourism hasn't come back to normal yet as well. For instance, a number of my friends still refuse to go back to Thailand on holiday, so this sector is suffering. However, the fundamentals of the companies look great, as against the sentiment, which is poor. That is the kind of market we like to buy into.

SL: You sound like Mark Mobius of Franklin/Templeton. How long do you think it will be before the sentiment will change so the stock markets will act better?

Do: Give it another three months or so.

SL: What about the other countries in the region?

Do: We think the macro-risks in Indonesia are not properly discounted in the market. These include rising interest rates as the real rate is still zero. They will have to rise a further 2%-3% before we would be interested in buying there at lower prices.

There has been a lack of Foreign Direct Investment (FDI) coming into Indonesia. Despite the common perception that Indonesia is a net oil exporter, they actually have had to import oil because there has been no new investment in this sector over the past five years.

The Malaysian economy is doing well. We have a neutral rating on it because the market is at fair value. We would like to add a bit more in steady companies such as banks and telecoms. In Singapore, we are underweighted because what is lacking are earnings growth surprises. The market is not cheap either.

SL: APB paid a dividend of \$0.15 this year. You made reference to high dividends coming from some of your stocks. This is an important issue as dividend pay-outs help to narrow the discount on the Fund, which helps your performance. I know that this is a Board decision, but we were intrigued that you have stressed buying stocks that pay-out higher yields than those in the U.S. and Europe. Comments?

Do: Companies paying a high dividend yield combined with moderate earnings

growth are definitely on our radar screen. But, as we said before, we are not just piling in high dividend payers for the sake of it, particularly if they offer no earnings growth.

SL: Has the Fund any plans to buy back your shares as you did last year? We realize that this may be difficult as you have enlarged your portfolio with borrowed assets. However, your discount is now over 13%. We are also uncertain if the Fund is allowed to repurchase shares if the portfolio is leveraged using borrowed money.

Do: This is a decision for the Board to make. On the discount, it is very much correlated with investors' sentiment towards Asia. If global investors become risk-averse and do not want to over-weight Asia, the discount tends to widen. As Asian markets have been dragged down by the U.S. market in the past few weeks, the discount has widened. As soon as the U.S. market stabilizes, we expect the discount to narrow again. The Board and the Fund management has actively taken steps to continue to promote APB to a larger audience, with the aim to spark more interest in the Fund in Asia. APB has consistently outperformed its benchmark over the longer term.

SL: To conclude, please give us an assessment of how you see the future of investment in the region, both positive and negative, and how you think you can continue your good long-term record?

Do: The current negatives have more to do with sentiment and perhaps the expected slowdown in the U.S. Despite the

short-term negative sentiment, I am very bullish on the Asian region because we see the Chinese economy growing reasonably well, not as fast as last year, but 8.5% is still good growth. We also see the Hong Kong (and China) economies still doing quite well. The Korean economy is bottoming out and turning up.

In Taiwan, the domestic economy is doing quite well. In the ASEAN nations, the only two economies we have some slight concern about are Indonesia and the Philippines, where the debt profile hasn't improved much. We think that the valuations in Asian markets are cheap, and the earnings expectations are so low at the moment that there is a scope for upward surprises.

What can go horribly wrong in Asia? The risk factors are external in nature, such as a recession in the U.S. or the oil price rising to \$70 or \$80 a barrel. We do not see major risks within the Asian region.

If anything, there could be more positive surprises: a Renminbi re-valuation, a possible reconciliation between China and Taiwan, as well as a compromise between North Korea and U.S./Japan/China/South Korea relations.

SL: You certainly have prepared your remarks well and showed us that you have a deep understanding of your region. You also show a caution necessary in the often volatile and risky markets you are following which we appreciate. ■

For more information about The Asia Pacific Fund, call 888-4-ASIA-PAC or 212-400-2604, or visit their web site (www.asiapacificfund.com).

Portfolio Manager's Review

In April, the biggest event for CEFA clients was the liquidation of Brazil Equity Fund, a nice gain for many of our clients. We spent much of the month redeploying the assets, as well as cash from new accounts into other funds. We added to Adams Express, Europe Fund, General American Investors, TCW Convertible Securities Fund and Templeton Dragon Fund in the domestic and foreign sectors.

Many clients were low in the real estate sector, so we added to Cohen & Steers Realty Shares Fund, a mutual fund. We used this fund because the equivalent closed-end fund, Cohen & Steers Total Return Fund (RFI), has been selling at a premium. We continue to hold RFI in spite of its small premium. Prices were low in April, so the May rally improved the total value of our portfolios. ■

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