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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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Outlook for Global Growth Dominates Investor Concern

Purchasing managers' surveys for manufacturing and services across the U.S., U.K. and Europe will be closely watched for signs of a further loss of economic momentum in the second quarter, according to a report in *The Financial Times.*

Growth in Japan, Asia and Europe weakened, but crucially, the U.S. experienced a limited slowdown. The U.S. economy expanded at an annualized rate of 3.1% in the first quarter, down from 3.8% in the final quarter of 2004.

High oil and raw material prices, as well as rising inflationary pressures, have investors worried that the Federal Reserve might be forced to increase the pace and magnitude of monetary tightening.

The latest disappointing economic data means that markets have swung to questioning whether the Fed will choose to pause or slow the pace of interest rate increases.

"The chances are rising that the Fed will need to change course and stop rising rates," said Paul Ashworth, senior international economist at Capital Economics, who still expects the Fed will stick to its policy of raising interest rates at a measured pace at the next couple of meetings.

However, the sharp slowdown in U.S. investment growth and the much-larger-than-expected increase in inventories are pointing to a potential slowdown in demand (in the U.S.).

European Stocks Still Shine

Given Europe's problems, a prospective investor might ask: Why bother? After all, Europe is being buffeted by high oil prices, a strong Euro, rising U.S. interest rates, low growth, weak domestic demand, a slowing U.S. economy and possibly a slowing Chinese one.

Yet, European stocks are outperforming other major markets and most likely will continue to do so, although the ride will be rough, say money managers. The Dow Jones Stoxx 50 Index, which tracks Europe's largest publicly traded companies, has rallied 5.92% this year versus a drop of the Dow Jones industrial average of -2.16% as of June 1, 2005.

"The current environment is certainly bumpy," says Franz Wenzel, an investment strategist at AXA Investment Management in Paris. "But once the monetary tightening in the U.S. has mostly run its course, European equities have room for another leg up." Additional capital gains plus dividend payments could give investors a total return of 6% to 8% by year-end," he says.

To-date, European stocks owe their superior returns to a combination of stable and low interest rates in Europe, low valuations and the boost in earnings from corporate restructuring and companies transferring production to lower-cost eastern and central European facilities, says Robert Parker, vice chairman of Credit Suisse Asset Management in London.

Gary Clarke, manager in London of Gartmore Investment Management's European Focus Fund, says European stocks "offer low valuations, strong yields and provide ideal hunting grounds for stock pickers."

For instance, Morgan Stanley Capital International's Europe ex-United Kingdom Index is selling at 13.8 times 12-month projected earnings, compared with 15.7 times for the Standard & Poor's 500-stock index, he says. Even so, Europe's economy doesn't make for enjoyable reading.

Mr. Clarke acknowledges that, in the short term, European equities are unlikely to trade much higher. Still, he says, "A weak domestic European environment doesn't necessarily sound the death knell for European equities, because a large number of European companies generate a large proportion of revenue from overseas economies – such as Asia and the U.S. – which are powering ahead."

He also argues that European stocks long-term prospects are much stronger "with the benefits of economic and labor reform, restructuring and a simulative monetary policy feeding through." In addition, merger deals and takeover speculation should help buoy share prices.

Mr. Parker at Credit Suisse Asset Management says that, after weakening for the next two or three months, "equity markets should start to improve during the second half of 2005."

The Fund Group's "central case" calls for equities to deliver a total return of 7%-8% in 2005. ■

Note: As our 2005 focus is Western Europe, Closed-End Fund Advisors is using The Europe Fund (EF-NYSE) and Swiss Helvetia Fund (SWZ-NYSE) in our portfolios.

For more information about the Swiss Helvetia Fund, read our [January/February 2005 *Scott Letter*](http:/www.cefadvisors.com/ScottLetter/2005-01-02.pdf) (http:/www.cefadvisors.com/ScottLetter/2005-01-02.pdf).

SEC Examines Fund Payout Policies

By *Angela Pruitt, Dow Jones Newswires*

New closed-end funds won't be making monthly or quarterly payments ... at least for a while. The Securities and Exchange Commission has suspended approving so-called exemptive orders that allow funds with what are known as managed-distribution policies to make more than an annual distribution to shareholders, a person familiar with the matter said. Funds that already have permission to make frequent distributions can continue to do so.

The suspension comes amid concerns that funds are merely giving investors back their principal and not profits derived from capital gains. Closed-End Cornerstone Total Return Fund, Inc., for instance, reported in a regulatory filing in June 2004 that 98% of its distribution was a return of capital.

"The SEC is reviewing whether this is an 'appropriate' strategy," the person said, noting that issuers have been informed that the pay-outs are on hold. A spokesman for the SEC declined to comment.

Managed distributions have become increasingly popular among closed-end funds, which have a finite number of shares and trade all day on exchanges, just like stocks. Both traditional mutual funds and closed-end funds make an annual capital gains distribution to investors from profits earned on securities sales during the year.

Closed-end funds often add monthly or quarterly cash payouts, usually based on a percentage of the fund's assets. Such policies aim to make shares of the funds more attractive to investors. [They also tend to reduce discounts to net asset value, improving returns. – Editor]

It is unclear what triggered the SEC move, market observers said. No new exemptive orders have been granted since mid-2004. Mariana Bush, a closed-end fund analyst for Wachovia Securities, said the SEC probably wants to guard against funds promising investors a certain amount in yield when, in fact, it could be a return of principal. "They don't want funds promising much more than they what they are really earning," she said.

Already, some funds are telling shareholders not to expect managed payouts.

In a recent supplement to its prospectus, the NJF Dividend, Interest & Premium Strategy Fund, which was launched in late February 2005, said the SEC "has indicated that it has suspended the processing of exertive applications ... pending review by the staff of the results of an industry-wide SEC inspection focusing on the dividend practices of closed-end investment companies."

"As a result of this development, the fund has no current expectation that it will be in a position to include long-term capital gains in ... distributions more frequently than it is permitted under the Investment Company Act of 1940," NJF said in the filing. The fund added that it would postpone submitting an application until the SEC resumes processing them.

[We are watching these developments carefully as we have used many funds that have managed distribution plans. It is a little tricky for the new funds, which haven't had time to build-up capital gains but has worked well for the older funds which have the gains and want to make periodic distributions. – Editor]

Real Estate Funds: A Look at the International Arena

Hot Real Estate Funds Cool Off

Real estate funds in 2004 are finding it difficult to stage another encore in 2005, according to a report in the *New York Times*. These funds returned roughly 32% in 2004 and have had a 19.3% annualized gain over the last five years through March 2005. By contrast, the Standard & Poor's 500 stock index returned 10.8% last year and lost 3.2%, annualized over five years.

"It's not unusual to have some kind of pullback after an extraordinary run," said Martin Cohen, co-chairman of and co-chief-executive of Cohen & Steers, which specializes in real estate investments like the Cohen & Steers Realty Shares, (CSRSX), a mutual fund well known to readers of *The Scott Letter*. This fund has about $2 billion in assets, down for the first quarter. "They couldn't have gone on like this," he said.

But he and others were quick to dismiss speculation that the shifting performance might be an ominous sign for real estate overall, even though some economists have expressed concerns about the run-up in housing prices.

"There is a lot of talk about a bubble; it doesn't feel like the tech bubble to me, in the sense the tech bubble did in 2000," said Daniel McNeela, a senior analyst who follows the real estate industry for Morningstar. He characterizes the decline as "a cooling–off period, a correction."

Donald Cassidy, a senior analyst at Lipper, another mutual fund research firm, said that many investors waited until the first quarter to lock-in profits, especially as the stock market became volatile. "When a market decides to take a correction," he said, "people tend to sell things that have done relatively well."

Mr. Cassidy cautioned that some housing markets were showing signs of overheating ... especially if interest rates continue to rise. Higher rates could also hurt the stocks of publicly–traded home-builders. "I think we are in a slight bubble with some high-end single family homes ... but that is not the stuff that REITs buy," he added, referring to real estate investment trusts which make up the bulk of many funds' holdings.

Most real estate funds, in fact, owe their success to the strength of REITs (publicly traded companies with portfolios of real estate – from shopping centers to hotels to apartment buildings) that payout most of their income in dividends. After the NAREIT composite index soared 30.4% in 2004 and was up 20.1% annualized over the five years ending March 31, 2005, the index lost 7.6%.

The National Association of Investment Trusts, a trade group, predicted that REITs would turn around in 2005, though it doesn't expect anything like last year's total return. Not surprisingly, real estate with a limited exposure to REITs managed to buck the downward trend in the last quarter, according to Morningstar. Among them were Alpine U.S. Real Estate Realty, up 3.2%; Alpine International Real Estate, up 2.2%; and Third Avenue Real Estate Value, up 1.2%.

Sam A. Leiber, the chief executive of Alpine Management and Research and the fund manager for Alpine U.S. Real Estate Equity Fund and Alpine International Real Estate Fund, said that REIT holdings made up just 15% of his domestic fund. "I think (U.S.) REITs will be a little boring this year," he said.

Mr. Cohen, too, says he thinks that many REITs remain fundamentally strong. His top holdings include Boston Properties, Avalon Bay Communities, Host Marriott and Vornado. Mr. Cohen's enthusiasm is tempered by what he calls economic "headwinds," namely the Federal Reserve's determination to keep inflation in check by raising interest rates. "Higher rates will hurt some REIT companies that borrow to finance their projects," he said, "and tighter credit could significantly cool off the economy."

The values of office and apartment buildings continued to rise in the first quarter of 2005, but at a slower pace than they did in the fourth quarter, according to a report mentioned in *The Wall Street Journal.* "But investors, largely ignoring the underlying value of the building, paid big premiums for properties," the report added. The value of office buildings increased 1.7% in the first quarter, down from a rise of 3.3% whereas the value of apartment buildings rose only 0.8%, down from an increase of 1.4% in the fourth quarter.

International REIT Funds

The top holdings of Alpine International Real Estate Fund, which has assets of around $200 million, include JM, the Swedish commercial and residential developer; Gecina of France, which develops high-end office and apartment buildings in Paris and the Midland Realty Group, a big real estate broker in Hong Kong. These companies have had strong earnings or increases in their stock prices.

Source: New York Times

Axis Hopes Malaysia Is REIT-Ripe

Kuala Lumpur – Axis Group plans an offering of Malaysia's first real-estate investment trust in 14 years, becoming a test case for the country's efforts to rejuvenate the sector under new, more transparent rules. The sale may be held as early as May, coming just six months after the government introduced the latest regulations for the industry. The REIT, from the closely held industrial property owner, will also attempt to tap demand for a financial instrument that has won many supporters elsewhere in Asia.

A REIT from China, valued at more than $2 billion, or about U.S. $256 million, is expected to list in Hong Kong or Singapore by June 2005, while Singapore already has five REITs listed and more to come. Hong Kong's first such sale was derailed last year by legal issues.

Malaysia's previous experiences with REITs – there are three property trusts listed on Bursa Malaysia, all thinly traded – was marred by questions about standards, a lack of focus on the business, asset valuation issues and relatively low yields, as well as capital gains, analysts say.

Regulators hope the new guidelines, including capping non-property investments by REITs and a green light to include overseas properties, will help Malaysian REITs grow. Malaysian REITs, like those in Singapore, also won't pay a 28% tax on dividends.

Apart from Axis, which has regulatory approval for its REIT, other property owners that have voiced interest to launch REITs include Sunway City Bhd. and the YTL Group. Both companies own hotels and shopping malls.

Closed-End Fund Advisors has previously used Cohen & Steers Total Return Fund (RFI-NYSE) for its clients, but this closed-end fund now trades at a premium. We have therefore been using the open-end fund, Cohen & Steers Realty Shares. For international allocations, we have been buying the Alpine International Real Estate Fund. The Cohen & Steers World Wide Realty Fund is a new closed-end fund which was trading at a premium at press time. ■

Source: Carolyn Lim, Dow Jones Newswires

CEFA continues to watch developments in the International REIT area as part of our research into using global asset allocation in real estate. CEFA clients now hold 15% of their portfolios in real estate investments, and we plan on increasing it to fit our 20% allocation model.

Lazard Global Total Return Fund, Inc. Annual Report (December 31, 2004)

The annual report of Lazard Global Total Fund (LGI) for the period ending December 31, 2004, states:

As of December 31, 2004, the Fund's performance, as measured by the 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 an 11.9% rise for the Index. Similarly, since inception, the Fund's NAV has increased by 17.7% versus an 11.9% increase by the Index. Shares of LGI ended the fourth quarter with a closing market 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, representing a 30.4% leverage.

We believe that LGI's investment thesis remains sound and are encouraged by the significant outperformance of the NAV return relative to the MSCI World Index. While the global equity segment was a moderate contributor to this value added, the smaller, short-duration emerging markets currency and debt portion of the portfolio was responsible for most of this out-performance.

As of December 31, 2004, 65% 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.

Pursuant to LGI's level distribution policy, the Fund's Board of Directors declared a monthly dividend distribution of $0.1042 per share on the Fund's outstanding stock. 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 the distributions that have been paid out in 2004 were composed of dividends and short-term capital gains, with no return of capital. [We will be interviewing the portfolio manager of LGI for the July 2005 edition of *The Scott Letter*. – Editor]

Be bold in what you stand for and careful what you fall for – RUTH BOORSTIN, Writer and Editor

Portfolio Manager's Review

During the month of May 2005, we realized the liquidation of Brazilian Equity Fund, which generated large gains for clients holding this fund. We also completed our sale of the remaining shares of Ellsworth Convertible Growth & Income Fund, which has been lagging the markets. We switched most of our Templeton Developing Markets Trust, a mutual fund into the closed-end Templeton Emerging Markets Fund (EMF) also managed by Dr. Mark Mobius, because EMF was trading at a discount of over 5%.

CEFA also purchased additional Adams Express and created a new position in Alpine International Real Estate Fund at no cost to our clients in order to hold positions in the international real estate markets. We also added to Templeton Dragon Fund (TDF), because of increased confidence in the Asia markets.

Top Ten Holdings (May, 31, 2005)

1. General American Investors (GAM)
2. Allied Capital Corporation (ALD)
3. Adams Express Co. (ADX)
4. Lazard Global Total Return & Income Fund (LGI)
5. Swiss Helvetia Fund (SWZ)
6. Asia Pacific Fund (APB)
7. Templeton Dragon Fund (TDF)
8. Cohen & Steers Total Return Realty Fund (RFI)
9. Cohen & Steers Realty Shares (CSRSX)
10. Central Securities (CET)

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