Published by
Closed-End Fund Advisors

THE SCOTT LETTER:
CLOSED-END FUND REPORT

Vol. V, No. 7 | *A Global View of the Closed-End Fund Industry* | August 2005

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

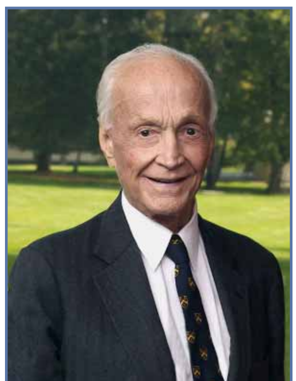
IN THIS ISSUE:

How Worldly Is Your Portfolio? Global Diversification: The Key to Long-Term Gains

It is so "20th century" to keep all your assets in U.S. stocks and bonds. 21st century investors must realize that their U.S. investments haven't kept up with higher returns available in the international markets. Therefore, investment success includes asset allocation into the world's stock markets and changing investment cycles.

We have been influenced by the investment philosophy of Sir John Templeton in many ways, especially in global investing.

Investors have many reasons to invest in foreign funds. We do our best to try to show you how to do it; in fact, some advisors recommend that up to half of your funds be invested abroad to achieve diversification and reduce risk. The CEFA-managed asset allocation portfolios invest up to 30% in foreign equity funds and up to 10% in foreign bond funds. Still, many of our domestic funds also perform well.



Sir John Templeton
Photo Courtesy of Ed Wheeler

To broaden our asset allocation, we use several types of real estate investments, including U.S. and foreign real estate trusts, real estate closed-end funds and foreign mutual funds (only when we can't find a closed-end at a discount). We also constantly look for new investment opportunities, such as the exchange traded funds ("ETFs") to further diversify and reduce investment risk. (See note at the end of this Letter regarding our views on ETFs.)

In this manner, CEFA tries to diversify into different asset classes that normally rise and fall during the various investment cycles. By spreading your money over one or two types of investments, you assume more risk than you would by diversifying it over a variety of assets that rise and fall over the cycles. This strategy has worked out well for our clients over the years.

"Simple common sense tells you that you will find more, and sometimes better investment opportunities if you search everywhere in the world rather than limiting yourself to only one nation," wrote Sir John Templeton in the foreword to *Global Investing: The Templeton Way.** Another of his favorite maxims is: "Find the best bargains, don't follow the crowd and use common sense". Your editor has been fortunate to have met with Sir John five times since 1989 as well as telephoning him over the years about investments and what he likes to call "spiritual matters". I became interested in the global investment marketplace while working for a London newspaper in the 1960s. After entering the investment business in 1969, my investment philosophy was strongly influenced by Sir John, a remarkable southern gentleman. I have, therefore, had the good fortune of being counted among those he likes to call one of his many "friends".

Here is a summary of Sir John's investment career.

John Marks Templeton, born in 1912, was raised in rural Tennessee, "next to a dog patch" he says. His education at Yale (during the Depression) was funded by scholarships, family loans, personal savings, working odd jobs and winnings at poker. He graduated second in his class in 1933 and was elected president of the Yale Chapter of Phi Beta Kappa. He promptly headed off to Oxford on a Rhodes Scholarship, where he earned a degree in law because no courses were offered in business or investments. While at Oxford, he became interested in investing and started buying stocks. Following his studies, he and a friend toured 27 countries throughout Europe, the Middle East and the Far East where they studied the people and cultures of those locales. Afterwards, he came home to Wall Street to start his investment career in 1937.

Always an innovator, Templeton was one of the first U.S. investment managers to invest abroad in the 1940s and 1950s. After working a few years at a brokerage firm, with $5,000 from savings, he bought an investment advisory firm in 1941 with two partners. The business grew steadily.

For Templeton, time has always been a thing to be treated as a gift. His close associate for many years, John Galbraith, said that "by nature he doesn't want to waste time. You always have a sense that he has more things to do than the time to do them. Regarding the time of others, whenever traveling around the world, he always set his watch 10 minutes fast to ensure his promptness." [I now do this as well and call it "Templeton time."]

Templeton created the Templeton Family of Mutual Funds when he saw this form of investment was best for his clients, not only to diversify portfolios but also because he decided that mutual funds are a very good business. He found that they are a way to help families at various income levels to save money, while acquiring wealth and security.

In 1963, he and his wife decided to look for a long-term base away from New York, where he felt he could excel in his investment career more easily. After a long search, they decided to settle at Lyford Cay in Nassau, partly attracted to the island by the deep religious spirit of the Bahamian people. They built a plantation-style house on one of the highest points on the island near the famed Lyford Cay Club, just 16 miles west of Nassau. This Club was my headquarters on three of my four visits to Nassau, the last in the year 2000 with my wife and 86-year-old mother who wanted to meet Sir John. The Club is unique: the 1,000+ members – many are the movers and shakers of the world (including notables such as Sean Connery) – represent at least 25 different nations. Here Templeton had exposure to people who could advise him on investments from all over the world, who gave him better insightful financial information than what he was able to get while located in New York. This resulted in an improvement in his stock picking performance.

John Templeton established his first reputation and material fortune by being a skillful investor. Yet, like any extraordinary person, there is another side to him:

"Having been raised in the Bible Belt, young John was influenced by his mother, a well-educated and active churchwoman, and during the Depression of the late 1930s, he began his practice of giving 10% of his income to charity," Norman Berryessa wrote in his 1988 book about Templeton. (Templeton personally told me that he now double tithes from his income).

Sir John became a naturalized British citizen in 1968 and was knighted by Queen Elizabeth II in 1987.

The Templeton global investment philosophy is summed up in his own words: *"A well-diversified portfolio produces less volatile returns than one made-up with investments that rise and fall together. It is by definition, less risky. As a result, your portfolio is likely to hold-up better during periods of poor overall stock market performance. By following this concept, we have been able to achieve superior investment results over the years."*

In 1992, he sold his mutual fund business (Templeton, Galbraith & Hansberger) to the Franklin Group, now known as Franklin Resources for $913 million. Sir John has since concentrated all his efforts on philanthropy, particularly on the study of science and religion. In 1973, he established the annual $1 million "Templeton Prize for Progress in Religion," which recognizes an individual's "progress toward research and discoveries about spiritual realities." The prize is awarded each year by Prince Philip at London's ancient Guildhall and is one of more than a dozen programs run by the John Templeton Foundation, which gives away more than $40 million a year. The Foundation also does research into the benefits of cooperation between science and religion as well as focuses on many related subjects such as the nature and relationship of altruism and freedom.

The Templeton Foundation Press has published 14 books written by Sir John. In 2004, they published a biography, *Supporting Scientific Research for Spiritual Discoveries,* by Robert Herman. We promptly ordered four copies. (To order your copy, visit www.TempletonPress.org or call 800-621-2736.)

Today, Sir John lives alone as both of his wives have died. He commutes daily five minutes to the Templeton International offices, just outside the Lyford gate in a Lincoln Continental. Templeton has one daughter and two sons. John Jr. is a retired pediatric surgeon in Philadelphia and is chairman of John Templeton Foundation.

I telephoned Sir John's office on July 25 of this year. His 28-year assistant, Mary Walker, said he doesn't grant many interviews "as he will be 93 in November." She confirmed, however, that he is in reasonably good health. Later, I spoke to him; he said he was doing pretty well for 92 and that only 10% of men have made it to 90.

The best known person associated with Sir John Templeton is Dr. Mark Mobius, the emerging markets guru, who joined Templeton International in 1987. Dr. Mobius, Director Emeritus of Templeton Asset Management (Hong Kong) Ltd., globally heads the Emerging Markets Division for the Franklin/Templeton Group. We interview Dr. Mobius each year for *The Scott Letter,* and feedback from our rapidly growing readership indicates that this is one of their favorites.

What we try to do each year is to learn more about the Templeton/Mobius investment style and how it differs from that of Sir John's. Dr. Mobius always gives us a clear and succinct review of economic developments in the countries he visits, as well as something of the schedule of his 16-hour workday, which includes a daily workout with the analysts and a review of the development of corporate governance in the companies he visits. The last Mobius interview was in March 2005. The next one may be sooner as the world of investing in emerging markets is changing at such a dramatic pace. ■

*See the 1988 book, *Global Investing: The Templeton Way,* as told to Norman Berryessa and Eric Kirzner (Dow Jones Irwin, 1988). The authors issued a revised, paperback edition in 1993, available at Amazon.com. The 2004 biography by Robert Herman is also available from the Templeton Foundation Press.

Making the Euro Zone Work

France and the Netherlands have rejected the constitutional treaty: it is dead. What does this mean?

According to Martin Wolf of *The Financial Times of London,* the rejection of the treaty by two of the original six members raises profound questions about the future of Europe and, above all, about the monetary union. A rising tide of integrationist ambition swept the single currency onto European shores in the 1990s. Now, it is in danger of becoming a beached whale.

Economists argue about the necessary and sufficient conditions for a successful currency, but the majority would agree that it helps if the area in question is subject to common stocks, markets for goods and services, capital and flexible labor; and not least, a shared identity embedded in common political institutions. Not one of these conditions is either necessary or sufficient, but the absence of all four creates a huge challenge. Yet, this is precisely where the euro zone now finds itself: economies have diverged, growth is disappointing, markets are proving dysfunctional and the movement towards further political integration is now in peril.

If all the members of the euro zone – above all, the big countries – are unwilling to promote reform, this project may yet flounder, however great the costs they would suffer. No currency union is likely to survive without either the economic or the political conditions of success. The struggle for a constitutional treaty is over. The battle for a successful currency union has begun.

In spite of this, the European stock markets continue to perform well. As a group, they rose solidly for the last three quarters. At the close of trading on July 29, 2005, the regional foreign indexes were: Europe, up +1.47%; Asia, up 0.19% and The Americas, up 0.10% versus declines for most of the U.S. indices. Individual markets have also prospered: Britain, +9.6%; France, +17.2%; Ireland, +5.0%; Italy, +8.8%; Switzerland, +15.8% and Spain, +11.3% – all in local currency gains.

Money managers attribute Europe's stock market run to attractive valuations, low interest rates, low bond yields and corporate profits buoyed by restructuring and cost-cutting. These factors with a stable or weak dollar will help returns on European stock markets going forward.

A leading investment manager in London says Europe remains an attractive area for (U.S.) equity investors. Low interest rates, sensible valuations and a currency tailwind should see these markets continue to go higher by year-end. ■

Editor's Note: CEFA's 2005 investment focus is Western Europe so we will continue to update our readers on developments in this area.

Harvard Loses An Ally in Fund Fight

Harvard Endowment Fund owns 29% of the $60 million Korea Equity Fund (KEF-NYSE). It is the largest shareholder, after a mutual fund group which owns a 7.5% stake. However, Harvard recently hit a snag in its attempt to liquidate the Fund. This is because the D3 Family of Funds of Camas, Washington has switched sides in the battle after initially backing Harvard's proposal. D3 now believes that shareholders would be better served by keeping the Fund going.

"The costs of liquidating the Fund, including brokerage commissions, legal and accounting could eat up at least half the difference between market price and what is its net asset value," said David Nierenberg, president of Nierenberg Investment Management, who runs the D3 funds. "It seems like an awful lot of work for a relatively small benefit. Nierenberg changed his position because the discount has narrowed substantially so there is limited upside to liquidation.

Harvard cites poor investment performance as its rationale, noting that the Fund has consistently underperformed the Korea Composite Stock Price Index and suggests that the equivalent exchange traded fund and American Depository receipts representing Korean stocks could be viable investment alternatives.

CEFA's view is that if the deal continues to weaken, existing shareholders will bail out quickly, leading to a substantial discount again. It is not all bad: there are many other choices for investing in Korea, including multi-country regional funds that cover the area.

Continuing discounts are a source of frustration, more for the funds themselves and for institutional investors like the college funds, who often pressure fund boards to liquidate or merge into traditional open-end mutual funds. We strongly disagree that discounts are bad for shareholders, unless they widen dramatically over time. On the other hand, if the fund managers do a good job with performance and distribute a decent dividend, they will find this attracts attention and the discount may narrow.

Closed-end fund investors like the leverage and the much lower expenses of closed-end funds that can often lead to higher returns. Mutual funds never have these advantages.

Nierenberg suggested KEF hold a secondary offering, allowing Harvard to sell all of its shares to the public. Such a plan would allow the fund to sell newly created shares to boost assets, while reducing its management costs per share. This could be "a win-win" proposal, allowing Harvard to exit and the remaining shareholders to enjoy lower costs, Nierenberg said.

CEFA has reservations about this recommendation because of dilution, which could depress the discount further. The discount to NAV on August 8, 2005 was -7.51%. ■

Source: *The Wall Street Journal*

Adams Express Declares Dividend and Reports Continued Outperformance

Baltimore, July 14, 2005 – The Board of Directors of The Adams Express Company today declared a dividend of $.05 per share, payable September 1, 2005, to shareholders of record as of August 16, 2005. For the six months ended June 30, 2005, the total return on Adams Express' net asset value, after adjusting for income and capital gains distributions paid, was 0.9%, outperforming its benchmarks. Comparable figures for the S&P 500 Index and the Dow Jones Industrial Average were -0.8% and -0.3%, respectively. For the 12 months ended June 30, 2005, the total return on Adams Express' net asset value, after adjusting for income and capital gains distributions paid, was 8%, also outperforming their benchmarks. ■

Note: CEFA clients, including the family of George Cole Scott, hold shares of Adams Express.

General American Investors Announces Action

On July 13, 2005, the Board of Directors of General American Investors Company (GAM:NYSE) acknowledged the retirement of Eugene L. DeStaebler, Jr., as Vice President, Administration, effective June 30, 2005 and expressed their deep appreciation for his 30 years of distinguished and dedicated service to the company.

DeStaebler, pursuant to a consulting agreement, will continue in his capacity as Chief Compliance Officer through the end of 2005, providing further support for the transition of administrative responsibilities to Eugene S. Stark, who was appointed Vice President. We spoke to Stark to welcome him to the firm, and we look forward to meeting him.

Repurchase of Common Stock

The Board of Directors also authorized the repurchase of an additional 500,000 shares of outstanding common stock when the shares are trading at a discount to the underlying net asset value is at least 8%. This continues a repurchase program which began in March 1995. Since that time, the company has repurchased over 11.6 million shares of common stock for $311.3 million at an average discount of 11.9%. Year-to-date through June 2005, the company has repurchased 636,000 shares for approximately $19.7 million at an average discount of 12.7%. ■

Editor's Note: We highly approve of share repurchases by closed-end funds and encourage other funds to do this. This has worked well for General American in improving investment performance and in narrowing of the discount. The discount of GAM on July 29, 2005 was –13.07%. The stock has been on the new high list many times this year. [CEFA clients, including the family of George Cole Scott, hold shares of General American.]

The German Fund Announces Name Change and Expansion

The Germany Fund, Inc (NYSE:GER) has announced that its board of directors has approved an expansion of the Fund's objective and fundamental policies to include equities in all European countries using the euro currency. The new focus will include at least 80% equities in all European countries using the euro. The Fund will include investments in Austria, Belgium, Finland, France, Germany, Italy, Greece, Ireland, Luxembourg, Portugal, the Netherlands and Spain. The Fund will change its benchmark to the European Economic and Monetary Union Index (MSCI/EMU), an unmanaged index which consists of approximately 320 stocks in these 12 countries. Shareholder approval will be sought later this year. We are pleased that there will soon be an alternative to The Europe Fund. ■

TCW Plans Efforts to Expand Shareholder Value

TCW Convertible Securities (CVT: NYSE) announced July 12, 2005 that, as part of its on-going efforts to enhance shareholder value and reduce the Fund's discount, it will propose amendments to its investment policies at the upcoming annual meeting of shareholders on September 29, 2005 in Los Angeles. The amendments are expected to provide greater flexibility for the Fund to generate investment income. This will include expanding the Fund's ability to employ leverage, expand the types of securities in which the Fund can invest as well as expand the Fund's ability to generate income through the use of call options.

"Lower interest rates and the emergence of hedge funds have dramatically impacted the convertible securities marketplace over the last several years. These initiatives give the Board additional tools and reflect their determination to increase the yield on the portfolio, reduce the return of capital and reduce the Fund's discount to net asset value," said Alvin R. Albe, Jr., CVTs President and Chief Executive Officer.

Since its inception in 1987, CVT has invested up to 80% of its total assets in convertible securities. ■

Note: CEFA clients, including the portfolio manager and his family, hold shares in CVT.

More ETF Options Coming, Global Assets Rise in 2005

The architects of exchange-traded funds have increased the supply at a rapid pace in 2005. The increase is powered by a continued rise in European demand for ETFs, where assets rose to $336 billion on June 30, 2005 from $319 billion at the end of 2004. Although growth in the ETF markets continues to be dominated by the U.S., investor appetite is growing in Europe, where assets under management grew by 19.2% from the end of 2004. Other new ETFs are planned in Sweden, China, India and Malaysia. Some of the new funds are leveraged.

Investors are being given exposure to everything from the euro to the performance of a group of commodities. Exchange-traded funds, like closed-end funds, trade all day on stock exchanges and started out resembling index-tracking mutual funds. The majority of such funds – which have about $240 billion in assets – still track indexes, including those on global geographical regions and styles.

Editor's Note: Although CEFA hasn't yet used ETFs for its portfolios, we continue to follow their growth and may be using them by year-end, if we are unable to find closed-end funds that fit a particular segment of our asset allocation in the domestic or international markets. ■

Portfolio Manager's Review

During July, we purchased some more Adams Express because of its 14% discount, but the focus of the month was to gain exposure to the booming biotech segment. We, therefore, spent most of the month buying H&Q Healthcare Fund (HQH-NYSE) and its sister fund, H&Q Health Science Investors (HQL:NYSE).

As August began, we continued purchasing these two funds so all of our clients would have exposure to this exciting industry. The only other major purchases during the month were to increase our holdings in TCW Convertible Securities Fund (CVT:NYSE) because of their announcement that they are making efforts to narrow the discount and increase distributions. ■

George Cole Scott

There is no limit on how far a man can go as long as he doesn't care who gets credit.

- CNBC, December 4, 2004

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The Scott Letter Online is published by

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