Published by
Closed-End Fund Advisors

THE SCOTT LETTER:
CLOSED-END FUND REPORT

Vol. V, No. 8 | *A Global View of the Closed-End Fund Industry* | September 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:

Interview with Donald Cassidy, Lipper, Inc.

Don Cassidy joined Lipper, Inc. in 1990 and is responsible for the firm's closed-end funds research group. This includes writing, media contact and consulting assignments. For years, Don directly supervised the firm's closed-end funds research group where, even today, he maintains a significant role.

Prior to joining Lipper, Don served as a sell-side analyst with the regional retail brokerage firm, Boettcher & Co. Early in his career he worked for the Fidelity Funds organization.

Don has written five books for individual investors, the latest of which is *Trading on Volume* (November 2001). Previous popular titles included *When the Dow Breaks* (July 1999) and *It's When You Sell that Counts!* (1997). In 1993, McGraw-Hill published his *Plugging Into Utilities*. Don is frequently quoted by major financial newspapers and magazines, and has appeared on CNBC, CNN and local TV stations. For the past nine years, he has served as guest mutual funds commentator on Denver's "Business for Breakfast" radio program, now carried across Colorado on KRCN, AM-1060.


Donald Cassidy

Don has twice served on the faculty of Harvard University's Annual Congress on the Psychology of Investing, is a member of the Denver Society of Securities Analysts, has been on the CFA Institute's international speaker list since 2003 and gives guest lectures at several local colleges in Colorado. He also serves as an advisor to the Finance Club and the Finance Faculty at Metropolitan State College of Denver. He is Colorado Program Director for the American Association of Individual Investors (AAII), a non-profit national educational group. Don has made over 150 presentations to AAII chapters since 1996 and has spoken to its national convention three times. He serves on the 401(k) committee at Reuters America, Lipper's parent since 1998. In 2004 he joined the advisory board of the Foundation for Investor Education. Education: BS in Economics, cum laude, Wharton School, 1967, minors in journalism and sociology.

We interviewed Don Cassidy on August 9, 2005.

SL: In preparation for the CEFA Dallas closed-end fund conference, where you are the keynote speaker, could you tell us what topics will be covered?

Cassidy: The important topics are self-evident. The competitive inroads of exchange traded funds are an issue, as ETFs are serious competition for investor dollars. Secondly, we are currently in a down cycle in new underwritings, a concern for the industry. The media gets excited about every wiggle and asks, "Is this the end for CEFs?" Our industry and investment advisors need to be careful about this as it is always easy to sell people on what is already "hot" and what makes a dollar in the industry. This doesn't make you friends long-term. I don't know how to solve it, but this is an issue we need to study.

We are also seeing the downside of new leveraged funds. At the conference, I will discuss what is being created in these funds, what is in "fashion," … in vogue such as the "buy and write" option write funds. What is selling easily may not work out well for shareholders. The closed-end fund industry also has to face the serious lack of brokerage coverage in the aftermarket. This is a problem.

SL: That's interesting. Would you also address what concerns individual investors?

Cassidy: Yes, for example, ETFs now have about $240 billion vs. $230 billion in closed-end funds which have been around a lot longer and are the original form of mutual funds. They are serious competition now and are already pinching parts of the closed-end fund world. It is a poison that is not going to be fatal by any means: ETFs are a challenge and competitive so there may be added pressures to liquidate some CEFs, creating opportunities for investors.

SL: People like to have choices for investment, don't you think?

Cassidy: That's true. Some say that ETFs are so much better that they will drive closed-end funds out, but I don't think so. We have seen since 1996 (when "iShare" country funds came in) that there have been almost no new issuance of country funds. Russia and Eastern Europe funds were part of a cycle, but since then you have seen nothing. Creating new closed-end funds has been difficult. The U.K. Fund, France Fund, Italy Fund and others have, one by one, disappeared, either by open-ending or liquidation.

These are the more advanced stock markets where you don't have the premium/discount risks. As a result, many investors have switched to ETFs, a challenge to closed-ends, but that doesn't mean that closed-end funds will go away. If anything, where there is competition, they will go to significant discounts which will probably pinch parts of the closed–end world. This will not be fatal by any means.

SL: So, investors do like to have investment options?

Cassidy: Right. Some say that these new entities will drive closed-ends out, but this is not true.

[However, there has been a recent decline in press coverage of the weekly reporting of the net asset values of closed-end funds. The New York Times Sunday listings were dropped on August 21. They are still listed in *Barron's* and the Monday editions of *The Wall Street Journal*? – Editor]

SL: We constantly emphasize the big differences and advantages of closed-ends over ETFs to our readers, especially emphasizing the advantages of buying at a discount to net asset value. Do you see premium/discounts as a "risk"?

Cassidy: I think that most investors are risk-averse. Experienced investors and others who love closed-ends see discounts as an interesting aspect, a challenge and a possible way to improve returns. The average unsophisticated investor says: "This fund has a 10% discount, isn't that wonderful? Yes, but may it go to twenty?" People are risk-averse and that doesn't help [bring them to closed-end funds].

SL: On the other hand, with closed-ends, you can get a so called "managed distribution" that doesn't exist with ETFs. In this way, they can get more income out of the fund.

Cassidy: That's right. But there is a danger with a managed distribution. Over time it is likely the fund will dissipate some of its capital which means that the net asset value will drop as the fund pays out part of the principal back. We see many cycles like this, depending on the kind of fund it is and how the market is doing.

One example is TCW Convertible. They had paid a very high dividend for a number of years, and they didn't earn it most of the time. As a result, you have to ask: "Where is the extra money going to come from, except from the NAV?" In late 2002, they reduced their distributions substantially.

SL: You may be aware that they have a vote coming-up at their September 29th annual meeting to increase their investment options, to include allowing the Fund to leverage.

Cassidy: Yes. If you overpay what you are earning, you are reducing your remaining asset base, whether it is return of capital for tax purposes or not. It is like a person in retirement: If you are spending your principal, you will hurt your future return since, if you overpay what you are earning, you are reducing your remaining asset base. If a retired person spends their principal, there will be less left to earn a return for the future.

SL: Of course. That is why the SEC is cracking down by not allowing any more funds to join the crowd in managed distributions until there has been further study.

Cassidy: The philosophy of the SEC for a long time was "disclose it and you are covered." The problem is that people don't read. If they do read, they may not understand. For disclosure alone, the philosophy seems to be changing but not enough to protect people.

SL: What about sector funds?

Cassidy: About 20 real estate closed-end funds were issued in 2002 and 2003, including a one new healthcare fund, Blackrock Healthcare Trust (BME). However, they raised just under $200 million. I think that fund was fairly courageous with all the competition out there. I don't think you will see many new sector funds created in the near future.

A large percentage of the closed-end population is yield-oriented; the real estate ones are easy because they generate a lot of income. About 70% of CEFs are bond funds. When you include all the real estate and utility funds, over 80 per cent of the population are yield–oriented.

[Don went on to describe other matters of interest to closed-end funds investors, including rising interest rates and other economic issues. He pointed out that discounts have narrowed lately, in spite of the new issuance of funds, especially of municipal bond funds, which have now slowed down lately.

In the international arena, there are some new international funds, paying good dividends, some new energy funds, and more and more funds trying to create capital gains. He added that there has been a lot of excitement about the issuance of the new so-called "buy and write" funds which purchase stocks and immediately write call options on the stocks. This is nothing new for the stock markets but is for closed-end funds. He also pointed out that in a sideways (U.S.) market, these funds can create extra large income, but in a bull market, there will be under-performance.]

SL: What are your thoughts on the global funds. This is where we are getting the highest returns for our clients.

Cassidy: They have beaten U.S. domestic funds three years running. Earlier, they were getting a tailwind as the U.S. dollar was declining; a return of 5%-7% higher than in the U.S., while the underlying markets went sideways. It became an obvious play. The dollar has now reversed, so it has taken the nice wind out of some of these funds. Once everybody caught onto that game, it didn't work as well. We think people have to be invested in the international markets over the long term.

SL: We agree. This is the philosophy we learned from Sir John Templeton when he said: "If you seek progress, always remain open-minded, read widely, travel extensively, continually ask questions, and be alert to new methods in your work. Think of new ways to select investments and test them rigorously to see which ones work."

Have your studies coordinated your views on the importance of international investing with the widening of the discount on closed-end funds?

Cassidy: The numbers show that you do get correlation between the flows and the discounts. Currently, the median discount on world equity funds is 9.3% (August 1, 2005). On May 27, it was up to 11.5%; last February, the discount narrowed to 5.4%. In July of 2004, it was in the 13% range. The longer term numbers show discounts of 20% or more.

On the world income side, where the discounts tend to be narrower, we recently saw a 5% discount on all world bond funds versus a premium on these funds earlier this year. So you see that everything goes in cycles. The discounts will increase if the dollar becomes strong on a sustained basis. The recycling of the China/Japan dollars is also a factor here.

SL: As you know, our thrust is global investing. John Templeton was way ahead of his time by saying that you have to be investing outside the U.S. He also got out of Japan in the early 1990s and, once he said that in print, he was the subject of ridicule, but he was dead right.

For more information about his work on closed-end funds, contact Don at Don.Cassidy@Lipper.Reuters.com. ■

WALL STREET WISDOM

To stay ahead of the other security analysts, Templeton reads widely and seeks to try new methods that are not yet popular with others. "It is important to examine your field in a world context because your mind will grow more open and flexible, if you understand what has happened under different circumstances in other cultures," he said.

We try to emulate this philosophy and pass it along to our readers. This is what I have learned over my years as an investment counselor. The biggest influence on my investment success has been to study the life of Sir John Templeton. Details about his life may be found in the August 2005 issue of The Scott Letter.

The following is an excerpt from the book, *Spiritual Investments: Wall Street Wisdom from the Career of Sir John Templeton* by Gary Moore (available from Templeton Foundation Press, $12.95, tfp@templetonpress.org, (484) 531-8380.

Financial Principles:

1. Invest for maximum total return.
2. Invest – don't trade or speculate.
3. Remain flexible and open-minded about types of investments.
4. Buy low – at the point of maximum pessimism.
5. Search for quality when buying.
6. Buy value, not market trends or economic outlook.
7. Diversify.
8. Do your homework or hire reliable experts to help you.
9. Monitor your investments.
10. Don't panic.
11. Learn from your mistakes.
12. Use prayer to gain perspective and quiet your mind.
13. Recognize the difficulty of outperforming the market.
14. An investor who has all the answers doesn't even understand the questions.
15. There is no free lunch.
16. Do not be overly fearful or negative.
17. Those who do good do well.

Wise investors recognize that success is a process of continually seeking answers to new questions.

Editor's Note: More in line with the spiritual nature of Sir John, each chapter is followed by a spiritual principle which gives the book a unique quality. We know of no other investment book that does it this way.

AMEX Courts Closed-End Funds

The American Stock Exchange is looking to lure closed-end funds away from rival exchanges by proposing a waiver on its initial listing fees for such investment vehicles. The offer, which the exchange hopes to implement in about a month, is part of an attempt by the Amex to gain a competitive edge in the closed-end fund sector, where the New York Stock Exchange has the biggest market share.

"It's obvious to everyone in the industry that fund complexes are under cost pressures, " says Tom Rzepski, vice president of AMEX's closed-end fund business, noting that rising costs associated with expanded compliance requirements. "We hope to offer (funds) a solution to help them achieve cost savings," he says.

To encourage funds to make the move, the Amex has requested clearance from the SEC to give closed-end funds a waiver, deferral or rebate of its $5,000 initial listing fee if they transfer to the Amex from another exchange. The waiver will be offered on a case-by-case basis.

Mr. Rzepski notes that during the past seven years, five closed-end funds voluntary de-listed from the NYSE and two from the Pacific to re-list on the Amex. There are about 650 closed-end funds, with a market capitalization of around $200 billion. Some 148 closed-end funds trade on the AMEX, while 480 trade on the NYSE.

A NYSE spokesman said that the AMEX move won't prompt similar measures by the NYSE, where the standard minimum listing fee is $20,000, subject to adjustments. He also said that Big Board officials aren't concerned that the AMEX's proposed fee policy will inspire a raft of closed-end fund de-listings.

As for the American exchange, a spokesman said, "the AMEX offers its issuers an efficient, liquid marketplace without burdensome and unnecessary costs." ■

Source: Exchange Proposes Waiver of Listing Fees by Angela Pruitt, Dow Jones News Wires

General American Investors Report Higher Earnings

For the six months ended June 30, 2005, the investment return for General American Investors (GAM:NYSE) was 3.1% (assuming reinvestment of all dividends). The net asset value per common share increased 5.9% versus a decline of 0.8% for the Standard & Poor's 500 stock Index.

For the twelve months ended June 30, 2005, the return to stockholders was 10.2%, and the return on the net asset value per common share was 14.6% compared to +6.2% for the S&P 500.

During the six months, 636,204 shares of the company's common stock were repurchased for $19,701,744 at an average discount from net asset value of 12.7%. The relatively robust returns generated thus far this year come, in large measure, from exposure to securities related to the oil and gas industry (26.7%).

The full semi-annual report is at www.generalamericaninvestors.com. ■

Portfolio Manager's Review

During the month of August, we stressed enlarging our exposure to Western Europe with purchases of The Germany Fund, which will soon enlarge its geographical regions to 11 countries. Because our recent winners included both H&Q Health Care Fund and H&Q Health Sciences Investors, we added to both of these funds on weakness. In order to pay for the new purchases, the majority of sales were Swiss Helvetia Fund, which has been lagging the other European markets, largely because of its low dividend payout.

Overall, we were gratified to see that our focus region – Western Europe – has been the top performing region in the world. The DJ Euro STOXX 50 rose 13.67% on September 12, 2005 in dollar terms, followed closely by the Latin American markets. Going forward, we plan to continue looking for undervalued funds that fit the objective of our clients.

George Cole Scott

> *Live for something.*
> *Do good, and leave behind*
> *you a monument of virtue*
> *that the storms of time can*
> *never destroy.*
>
> **– Thomas Chalmers (1780-1847)**
> **Theologian and Philanthropist**

George Cole Scott
Founder and Editor-in-Chief
Portfolio Manager

Leslie J. Daniels
Copy Editor

Mamie Woo McNeal
Production Editor

John Cole Scott
Marketing Consultant

The Scott Letter Online is published by

Closed-End Fund Advisors
Global Investment Counsel
707 East Main Street, 20th Floor
Richmond, Virginia 23219
(800) 356-3508
www.CEFAdvisors.com