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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

Closed-End Fund Investor Challenges the SEC

Buying closed-end funds at discount is "investment for dummies," says Phil Goldstein, a hedge fund manager. Mr. Goldstein, well-known to closed-end fund professionals, now heads Bulldog Investors which specializes in trying to open-end closed-end funds.

Goldstein has also recently challenged the Securities and Exchange Commission's attempt to require hedge funds to register with the agency and won. What he really wants is publicity as he manages assets. We do this in a different way.

The Wall Street Journal suggests that the 8,500 hedge funds out there should be forced to register by Congress. We think they often take advantage of unsophisticated investors and therefore should be registered like mutual funds.

One of the hallmarks of a hedge fund is the performance fee. Along with a 1%-2% management fee levied on assets, hedge funds typically keep 20% of the profits generated each year as payment.

Registration could still become law, but the hedge fund lobby is strong. ■

Global Real Estate Funds Proliferate

The appetite for global real estate is not a new phenomenon. The first global fund was introduced in 1989. However, the real growth in the number and size of global funds has occurred in the last couple of years. At the end of the last decade, only ten global real estate mutual funds existed.

By the end of 2005, however, the number had doubled to 20. In 2004, they more than doubled again (to 41); and in 2005, the momentum continued so by the end of 2005, a further 26 funds were added, making the total 68 (holding close to $14.5 billion in assets).

The grandfather of the global real estate fund family is Alpine International Real Estate Equity Fund, which was introduced in 1989. Sam Lieber, its founder, said that when he was pioneering real estate funds, many of the world's most dynamic real estate companies were abroad. He, therefore, started the Evergreen Global Real Estate Fund, a mutual fund, in 1989. It changed its name to The Alpine International Real Estate Fund in 1998.

A year later, the United Bank of Switzerland (UBS) launched their Investment Foundation Foreign Real Estate Fund. Five years passed before further real estate funds hit the market. In 1995, two Netherlands-based funds launched global funds. The largest demand came from Japan, followed by Australia, Luxembourg, the Netherlands, Singapore, Ireland, South Africa, Belgium, Canada, Hong Kong and a number of smaller countries. The main driver is Japan, where interest rates are extremely low and the yield on the 10-year bond is less than 1.5% whereas the net yield on a global property security fund is between 3.5% and 4% with added growth as a possibility.

In 2005, Cohen & Steers launched the first global closed-end real estate fund, Cohen & Steers Worldwide Realty Income Fund (RWF-NYSE).

The reason for U.S.-based investors to go global is two-fold: (1) a global approach offers a much expanded universe of potential investments and diversification benefits, and (2) a higher, more total return potential.

Many countries, particularly in the Asia-Pacific region, are experiencing higher levels of economic growth. This raises demand for real estate and a vital rent growth potential.

In another dynamic area – Europe – there are opportunities driven in part by the underdeveloped public market for real estate companies. Germany and the U.K. represent

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two large economies, and real estate markets there are actively considering REIT-enabling legislation. The same is happening in Australia, another hot area for REITs.

The drive for expansion into real estate is also due to U.S. institutional investors increasing their target real estate allocations in recent years. They are finding it difficult to reach these new targets in direct property investments. As a result, many institutions have added U.S. REIT portfolios to their real estate allocations as a way to get their capital invested in a timely manner.

These fundamental forces driving the growth in real estate securities are expected to remain in place for decades as property is an enormous asset class with only a 7% penetration rate in public companies versus the size of the market. In the last two years, the growth in the number of property securities has been phenomenal. Total assets under management of the current 68 funds analyzed reached almost $14.5 billion in January 2006. From a U.S. standpoint, the addition of Europe and Asia to your investment universe doubles the size of your investment pool. In addition, current REIT developments in Europe and Asia offer investors a new level of opportunity. The size of the institutional quality global listed real estate is estimated to hit $1 trillion within the next five years.

Closed-End Fund Advisors has been increasing holdings in global real estate funds and are looking for more of them. ■

China's Trapped Transition

Book Review: *The Limits of Developmental Autocracy* by Chris Patten

The prime issue of this book is not whether Hong Kong will remain a champion of democracy, but can China buck the trend of history and avoid/prevent a political transition to pluralism and democracy?

Chris Patten, the last British governor of Hong Kong, writes that this issue is of particular interest to those who are contemplating the rise of China and India, and those who are wondering on which country they should place their bets.

Maxim Pei, a China specialist, questions whether China could manage without democracy. He sees this issue on a more serious level than other commentators.

Pei does not have time for the optimistic assumption that democracy in China is just around the corner. He sees little chance of dethroning the Communist Party behemoth in spite of heroic efforts of the dissidents and democracy campaigners. The party-state remains "adaptable and ferocious," in Sinologist Jonathan Mirsky's phrase, "giving little chance of a political transition to freedom and participative government."

Pei goes on to say: "The debate on the future of China is that serious change to transform the state is stuck along with any political change. China is saddled with the worst of capitalism ... incapable of becoming more progressive."

This is why: People have long pointed to the fact that China's leaders have to juggle a dizzying array of problems. Social inequality, corruption and pollution top the list. Just how long will it be for the positive factors about China – the "feel good" factors – to offset the "feel bad" factors? This is difficult to gauge.

Patten also believes that there is something in Confucianism that is inherently antipathetic to democracy. Baroness Margaret Thatcher argued that it did not matter whether you started with political freedom or economic freedom, you would end-up with both. He writes that you cannot allow people a lengthening menu of economic choices and yet deny them political choices. He may be right.

Technology today liberates people by providing them with access to ever more information. The Chinese cannot now cover up the truth indefinitely about a health scare such as Sars or a toxic spill. Finally, the political climate affects its creativity and ability to innovate. China can and is doing what it can to buy its way up the technology ladder. Pei points out that it is more sustainable to create a culture of innovation and openness, such as is flourishing in the software houses of Bangalore and other Indian cities.

That is one reason why, at least for now, there is bound to be a qualitative difference in our relationship with India, a great democracy that shares our values. Lord Patten hopes that this will be true of China as well. ■

Swiss Helvetia Fund Reports
(Condensed from "Letter to Stockholders," March 31, 2006)

Equity markets across the world continued to perform strongly. This was true in Switzerland where the industrial sector showed strong performance, largely due to the boom in the Chinese economy and other emerging markets. Buyout activity in the private equity sector had a strong positive impact on the valuation of small and mid-cap sectors. The size of large companies has been a deterrent to buyouts. Thus far, private equity funds have been raising larger amounts of cash and adding leverage to the mix. Large-cap companies could become attractive buyout targets. The mergers and acquisitions frenzy taking place in Europe has been, in fact, one of the main drivers for the markets despite the headwind represented by higher interest rates.

Swiss Helvetia Fund (SWZ-NYSE) has earned the Lipper Inc. 2005 award for ranking No. 1 among Western European closed-end funds in one-year performance. Based on U.S dollars, updated perform-

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ance numbers show that SWZ's one-year performance based on net asset value was +31.83% to May 31, 2006 and +36.64% based on market price. The five largest holdings, as of June 30, were Roche Holdings, Nestle SA, Novartis AG, UBS AG, and Swiss Life Holding.

Swiss asset managers had strong showings in the first quarter of 2006. The strength of this sector was due to higher than expected money inflows, very favorable capital markets and strong revenues from alternative products. High net worth individuals and institutional investors continue to allocate money to this asset class.

There has also been takeover speculation that Serono SA, the largest Swiss biotech company, will be bought. It still generates a sizeable cash flow from its strong market position and royalty streams. There is also a merger for the company being discussed between Zurich Financial and St. Paul Travelers.

The Swiss economic upswing continued with an increase in real GDP of 2.1% for the fourth quarter of 2005, compared with the previous period. The Swiss Institute for Business Cycle Research has forecasted an increase in GDP of 2.1% in 2006 and 1.9% in 2007 on the back of sustained private consumption, fueled by disposable income growth and investments in machinery and equipment. In the past quarter, economic indicators in Germany, one of Switzerland's main trading partners, have also risen strongly.

After an impressive run in 2005, the U.S. dollar started the year under pressure. It decreased by 0.8% against the Swiss franc and by 2.27% against the euro in the first quarter. It is likely that the U.S. currency will continue to depreciate overall, as its risk premium may not be large enough to satisfy investors and as global tensions tend to rise. ■

Editor's Note: SWZ is held by clients of Closed-End Fund Advisors, its portfolio manager and his family.

Asia Pacific Fund Update: A Report from the Investment Manager

During the fiscal year ended March 31, 2006, Asia Pacific Fund (APB-NYSE) net asset value (NAV) per share rose 28.1% after adjustment for a distribution of $0.68. This compares with the Fund's referenced benchmark with total returns of 29.5%. The top three performing markets, as measured by the MSCI country indices in U.S. Dollar-terms over the period, included India (+70.9%, 2.3% of the portfolio), South Korea (+47.8%, 31.5% of the portfolio) and Hong Kong (+45.9%, 35.9% of the portfolio).

The strong returns achieved by Asian equities were aided by the relatively strong Asian currencies compared to the U.S. dollar during the period. For comparative purposes, over the period, the MSCI U.S. and the world indices gross returns were +12.4% and +18.6%, respectively.

The first period was influenced by a number of global and regional uncertainties. Global concerns included the strong rise of the oil price from the low 50s USD to the high 60s USD and the continuing implementation of the monetary tightening policy by the U.S. Federal Reserve. Within Asia, investors were uncertain about the impact of the rumoured revaluation of the Chinese currency, the Renmimbi ("RMB"). This did occur in July, but the RMB revaluation of 2.1% was smaller than expected. The regional Asian reference benchmark index was also negatively impacted by the sell-off in Taiwan, as local investors abandoned hopes for a rapprochement between Taiwan and China.

The second quarter of 2006, the bull market phase, started in November 2005. Economic and corporate earnings data in this period surprised investors on the upside. Interest rates eased in China following the RMB revaluation, oil prices corrected somewhat, and valuations of Asian equities were perceived to be cheap again. Reports of significant inflows into Asian equities, as well as in those sourced from direct portfolio or private equity investors, lent credence to the attractive valuation view. Of note was sharp the rally in the Korean market in this period, boosted by the unexpectedly large participation of local investors in the Korean equity market.

The Fund's overall strategy over the fiscal year was to focus on those markets which were expected to show upside earnings surprises and which were relatively cheap. These include Taiwan, Korea and China. The manager increased exposure to Korea in a substantial manner in December 2005. After achieving solid gains in this market, he locked-in profits and switched the proceeds to China in the early part of 2006, where the market valuation was deemed cheaper than in Korea.

This timely switch helped the Fund to participate fully in the big rally in the Chinese market. The overweight exposure to Taiwan did not pay off as much as expected, due to the poor sentiment of local investors. Exposure to Taiwan was reduced at fiscal year-end.

For our detailed report on The Asia Pacific Fund, go to the May 2006 issue of *The Scott Letter* (www.cefadvisors.com/scottletter.html). ■

Editor's Note: APB is one of the largest holdings for clients of Closed-End Fund Advisors and is held by the portfolio manager and his family.

As much as we need a prosperous economy, we also need prosperity of kindness and decency.
– Carolyn Kennedy Schlossberg
Attorney

A wise man should have money in his head, not in his heart.
– Jonathan Swift (1667-1745)
Cleric and Writer

The truth is that you can spend your life any way you want, but you can spend it only once.
– John C. Maxwell
Leadership Expert

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Personal Portfolio Management

Here is some good advice for investors, courtesy of Schwab.

Investment Expenses: What You Can Deduct?

Deductible investment-related items include:

1. Fees for investment counsel and advice, including subscriptions to financial publications
2. Software or on-line services used to manage investments
3. Safe deposit rent, if used for certificates or investment-related documents
4. Transportation to a broker's or investment advisors office
5. Attorney, accounting or clerical costs necessary to produce or collect taxable income

Non-deductible items include:

1. Trading commissions (those are capitalizable costs that increase basis or reduce proceeds)
2. Travel costs to attend a shareholders meeting (professional investors are excepted)
3. Investment advisory fees related to tax-exempt income
4. Borrowing costs associated with life insurance

Investment interest expenses also are deductible if the borrowed money is used to purchase taxable investments. For example, investors can deduct the interest on a margin loan that was used to buy stock. However, the interest would not be deductible if the margin loan was used to buy a car.

Source: Schwab Center for Investment Research

AAII Survival Guide for Investors

When perusing any top-performers list, make sure you understand how a fund managed to survive over the long-term. If it did so by taking a riskier approach, then you are paying a steep price for the possibility of greater returns.

Calmer Approach to Survival

1. Low expense ratios
2. High tax efficiency
3. Consistently good performance year-to-year relative to similar funds
4. Well-diversified

Stressful Approach to Survival

1. Big variations in year-to-year returns
2. Bull marker star, bear market dog
3. High category risk
4. Small number of holdings, industry concentrations

Source: AAII Journal

Portfolio Manager's Review

Since May, we have been more and more defensive with our clients' portfolios. Recent changes have included less emphasis on the emerging markets, despite the fact that some bargains can be found there.

We have increased our holdings in Allied Capital, a business development company structured as a closed-end fund. It now yields over 8%, giving its shareholders strong downside protection. We have also been eliminating H&Q Healthcare as it has been the weakest of our funds. Other defensive moves have included some purchases of Berkshire Hathaway "B" shares. We have also increased our holdings in the real estate funds we follow.

Going forward, we are looking into re-entering the emerging markets where the downside has been severe, creating bargains. ■

None of the information contained herein should be construed as an offer to buy or sell securities or as recommendations. Performance results shown should, under no circumstances, be construed as an indication of future performance. Data, while obtained from sources we believe to be reliable, cannot be guaranteed.

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