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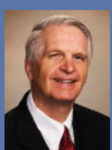
THE SCOTT LETTER is intended to educate global investors about closed-end funds. Closed-end funds can be a valuable and profitable investment tool. To learn about closed-end funds, visit our web site, www.CEFAdvisors.com, and in particular, read our article, *What Are Closed-End Funds*. Feel free to 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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The Effects of Globalization:
As more countries mature and enter the global market, the balance of economic and political power is changing

Globalization in the 21st Century

Globalization is first defined as "the compression of the world and the intensification of the consciousness of the world as a whole." Financial globalization is the emergence of worldwide financial markets and better access to external financing for corporate, national and sub-national borrowers. Covering a wide range of distinct political, economic and cultural trends, the term "globalization" has quickly become one of the most fashionable buzzwords of contemporary political and academic debate. Some forms of it are controversial.

"After undergoing a decade of dramatic change, the world's economy looks very different than it did throughout the 1990s," states *Global Finance* (November 2006).

The magazine says a host of countries that were just finding their economic feet and beginning to play on the global stage now have economic and political power to spare. The titans of the West also see their roles change as they have discovered they can no longer expand with impunity into the farthest flung corners of the earth.

"This is the inevitable result of globalization. By another definition, it is 'a process of greater integration within the world economy through movements of goods and services, capital, technology and (to a lesser extent) labor, which has led increasingly to economic decisions being influenced by global conditions'.

"That definition is as apposite as ever – perhaps even more so, given the acceleration of economic integration both globally and regionally. As many formerly emerging markets mature and more countries enter the global market, the balance of economic power is changing. Businesses and economies that prosper will be playing by a whole new set of rules.

"One of the symptoms of change is that yield-hungry investors are looking farther a field as their traditional stomping grounds are beginning to look less like emerging markets. The extremely favorable conditions in global capital markets for emerging markets over the past few years encouraged more stable types of investors, such as pension funds from the U.S., to invest in emerging markets assets.

"That has really benefited large developing countries such as Brazil, Mexico, Turkey and some of the Asian countries," says Lauren Phillips, a research fellow at London's Overseas Development Institute. As a result, the yield on these markets has fallen. "Investors have been looking at the smaller emerging markets, which can now access international capital much more easily," she adds. "The changes taking place are not driven only by investors dipping their toes in new markets; the very workings of the globalization machine are now turning differently."

"No longer does globalization just describe the process of western multinationals moving into new markets: it is more about convergence, with companies around the world having the same access to sophisticated technology and banking services.

"In many ways, the changes are being led by the global banks. As they work to grow their businesses and develop new markets and products, these banks are facilitating rapid growth in cross border trade— of goods, services and currencies.

"Technology is a great facilitator. Companies no longer have to establish a physical presence in multiple countries because, in many cases, they are simply linking up with local businesses. They are outsourcing or offshoring their production and administrative functions.

"As such services become more commoditized and universal, poorer countries can enjoy the greatest transformative impact: The benefits for a newly emerging economy able to tap into these sophisticated and highly efficient processes from day one are barely overstated. In an unexpected spin-off, the sharp rise in the availability of information, primarily through the internet, has enabled the world's central bankers to raise their game to a whole new level. [With] a wealth of information about how best to run a modern economy and by the detail available on what their peers are doing and how they are faring, the world's central bankers are exhibiting a dramatic rise in competence and effectiveness.

According to the Bank for International Settlements (BIS), central bankers have been able to hone their craft as their access to information "and the general level of transparency around central bank's operations" has increased.

Imbalanced Output

"While the effects of globalization are evident on every continent, some regions and nations are faring less well than some of their erstwhile peers. The contrasts between Latin America and East Asia, (China, Hong Kong, Japan, South Korea and Taiwan) provide a perfect example. Nowhere has the transformation wrought by globalization been more dramatic than in East Asia, much of which suffered economic meltdown during the financial crisis of 1998.

"The fallout from that crisis showed the region was riddled with many of the problems that seem to be endemic to developing economies – corruption, cronyism and nepotism. Observers predicted it would be many years before the regions formerly dynamic economies regained their luster.

"This is symptomatic of the dramatic changes that have taken place in globalization. Far from descending into economic chaos, many of the countries in the region worked hard to root out their problems and to rebuild their economies on a much more sustainable basis. The region's countries have been able to stage this rapid recovery because they abandoned the traditional model of providing large, low income workforces from the developed world.

"The new Asia is more innovative and networked. It's characterized by a very competitive business environment that encourages new products/processes and a labor force able to absorb new ideas," according to an economist at the World Bank.

"Growth and development in Asia have been so rapid that some are concerned that a number of other major emerging markets, particularly in Latin America, are getting left behind.

"Latin America's economies have failed to diversify into technology-oriented products and high-end manufacturing, and they continue to be driven by commodities and raw materials," says London's research fellow Phillips. "To some extent its growth is driven by that because it is providing the source materials Asia needs to continue developing."

There are also clear losers from globalization within individual nations. "While more countries have become more economically interdependent, requir[ing] us to work together collectively, economic globalization has not kept pace with democratic institutions." said Joseph E. Stiglitz, a Nobel Prize-winning economist.

Stiglitz also notes that there are losers in developing countries too, particularly those whose jobs are shipped to foreign markets. In his latest book, *Making Globalization Work,* Stiglitz, takes a similar position as U.S. Federal Reserve Chairman Ben Bernanke, pointing out that a government's failure to ensure cushioning of its workers from the harsh realities of globalization, will prompt these people to become increasingly opposed to trade and favor economic protectionism.

"The first thing is to realize that there are losers as a result of trade liberalization," Bernanke comments. In a speech at the Fed's annual meeting this year, he urged policymakers to ensure that the benefits of globalization would be felt at all levels and not just by the rich.

"China's voracious appetite for raw materials, which has produced a boom in commodity prices, has helped many developing countries, as a well as commodity-rich industrial countries like Australia," said Stanley Fischer, the head of Israel's central bank and a former first deputy managing director of the IMF. He added that while there may be economic casualties, they are merely symptomatic of the shift in economic power that is underway. He agrees that the gains from globalization appear to be concentrated in just a handful of countries – China and India being the most prominent – but the countries that trade with them also benefit.

"China and India's energy needs helped push oil and other energy prices to their highest sustained levels and contributed to the prosperity of energy producers in the Middle East, Russia and central Asia, as well as Africa, where there are many oil exporters," Fischer said.

According to Phillips, the two countries are also bringing finance to places that have been passed over in previous waves of globalization: "China and India are investing in Africa or in Latin America, taking risks in countries where western firms have tended not to invest, such as Sudan," she says. "India has put a large amount of money into Bolivia, and China has large investments in Latin America."

A Double-Edged Sword

"The rapid growth of still developing countries such as Russia, China and India means that they wield enormous economic and political power, but it also presents something of a double-edged sword.

"China, for example, which despite its gargantuan size is still very much a developing market, is already practicing some of the economic adventurism that the European powers were so fond of in the 19th century. Conscious of its seemingly insatiable hunger for energy and raw materials, it is frantically building relationships with resource-rich nations, particularly in Latin America, Africa and central Asia. Unfortunately, it is prone to some heavy-handed political manipulation in its attempt to secure future resource supplies.

"Russia, too, has been flexing its muscles in the past year, clearly demonstrating that it has growing political and economic power. Few would argue, however, that abruptly turning off the energy supplied to its neighbors was a responsible use of that power.

Brave New World

"There is no disputing the numbers. Trade is growing at a tremendous rate, while countries across the emerging world are seeing their GDP per head growing rapidly. Many millions of people have been lifted from poverty in the past decade. At the same time, more than 40% of the world's population still lives in poverty.

"The benefits of free trade come more from imports than from exports," says a recent issue of *The Economist*. "Trade talks always seem to break down before they succeed. Old hands need to look with new eyes ...."

"Imports of cheaper or better goods give consumers more for their money, and through competition, raise domestic productivity. Multilateral liberalization is a sort of jujitsu that uses exporters' determination to get into foreign markets to overwhelm domestic lobbies that would sooner keep home markets closed.

"The trade diplomat's incantation that to open this market is a 'concession' granted in exchange for an opening somewhere else is economic nonsense spouted for domestic political purposes. But, it is remarkably fruitful nonsense because within the World Trade Organization any concession to one trade partner is automatically extended to all members. This trick has helped the world enjoy decades of prosperity.

"Inequality remains within countries and between them," Global Finance continues. "In many nations, both developed and developing, the gulf between the rich and the poor is growing ever wider. Some analysts suggest that this is the result of changing corporate behavior: Companies are reaping huge financial benefits from globalization but are passing on their swelling profits not to their workers but to their shareholders and, in the U.S. at least, their senior managers. Ben Bernanke has already brought this to light, while in China officials are trying to find ways to ensure the benefits from that country's explosive growth are shared more evenly.

If both those economic giants are successful in creating more equitable economies, we could be witnessing the dawn of yet another new phase in which multi-nationals become more acutely aware of the debt they owe their own employees. ■

Source: *Global Finance*, www.gfmag.com

Editor's Note: Globalization is controversial and not everybody thinks it is a good idea. We do because it is the reality of what is happening around the world. It is beneficial to raise the living standards of millions of people. CEFA tries to educate our readers about how globalization will affect their investments, and we will pursue this subject in future issues.

Are the Emerging Markets Re-Emerging?

After a wave of selling and mutual fund redemptions from May to August, investors were showing renewed interest in emerging markets funds. Mutual funds dedicated to emerging markets attracted $705.5 million in net inflow as of November 10, 2006. Since August 1, emerging market stock (mutual) funds have recorded $1.4 billion in new money, compared to inflow of $7.8 billion for global funds. For the week ending October 11, 2006, emerging markets funds have taken in $2.5 billion or 20% above the average weekly average for the year. Some 70% of the assets are institutional funds. Their valuations have returned to reasonable levels, earnings are still strong, and these markets are increasingly rallying on internal demand, making their economies less vulnerable to outside distractions.

Investors are now focusing on funds investing in China and Latin America. However, many mutual funds investing in the emerging markets are still subject to sudden redemptions as happened in the last correction. They do not have the protection of the discount offered by closed-end funds. We cannot make this point clearer: If one chooses to invest in the often thinly-traded emerging markets using mutual funds, you need to be aware that there are higher risks in them than in using closed-end funds, as they have built-in discount protection. During difficult periods, mutual fund managers have no choice but to sell at any price to meet redemption obligations. Enough said. ■

Source: *The Wall Street Journal*

Hong Kong's Bull Run Shows No Signs of Seasonal Slowdown

It's beginning to feel a lot like Christmas in Hong Kong, and not only because local property developers are already decking their malls with yuletide trinkets. Adding to the festive mood, the benchmark Hang Seng Index is trading at record levels, yet investors show no signs of vertigo. Recently, the Index rose above the 19,000 level and then leveled off some after the sharp rise.

Many are crediting China for the early offset of Christmas cheer – particularly the feel-good factor still lingering from the Industrial and Commerce Bank of China's (ICBC's) initial public offering on October 6, the world's largest. The Hong Kong-listed H shares have risen more than 25% since its debut to November 21, 2006.

"All the underlying reasons have been there: the anticipation of a revaluation of the renmimbi, rapid economic growth in China and high liquidity," says Eric Yuen, head of research at Dao Heng Securities in Hong Kong. "Because of ICBC, fund managers who have not been investing in Hong Kong were forced to look at the market. Reflecting the fever for all things Chinese, the Hang Seng China Enterprises Index, which tracks mainland companies listed in Hong Kong, also set a recent record close. ICBC joins another state-owned commercial bank, China Construction Bank, which was welcomed into the Hang Seng this year along with Asia's largest oil refiner, Sinopec.

"The Hang Seng is a different index now," says Mr. Yuen says. For the first time, it has included some H shares, which are direct beneficiaries of the growth in China. They have been supporting the strong rally in the Hang Seng.

Strong as the sentiment has been in Hong Kong, however, the markets have still lagged behind many of its regional peers. Nine other Asian ex-Japan markets, from New Zealand to Pakistan, have outperformed Hong Kong in the past 3½ years. During this period, India has led the pack, rising almost five times in dollar terms while Hong Kong, whose currency is pegged to the greenback, is up 2.3 times.

"The emerging markets rally has been underway for three years already," says John Tang, of J.P. Morgan in Hong Kong "China is playing catch-up."

Hong Kong's relative underperformance, coupled with attractive valuations in the territory, has convinced investors that the bull market has not yet run its course. The result has been large capital inflows.

"We're seeing a huge liquidity boom in both China and India", says Jing Ulrich, managing director at J.P. Morgan. "I, for one, do not see an end to the liquidity anytime soon."

Ms. Ulrich notes that MSCI China Index constituents are trading at a 2006 price/earnings ratio of 14.5 compared with 20.9 for their MSCI India peers. (Interest rates may also increase for a fourth time in a year). However, she also points out that Indian companies have earned their higher valuations. Their 2006 return on equity is forecast at 22.8%, against 17.7% for the MSCI China constituents.

Mr. Yuen makes a similar point about the Hang Seng. Even as it trades at record highs, its constituents are priced at 15-16 times earnings: "It still has a long way to go. I don't think it has reached a turning point yet."

Like all good things, Christmas and bull markets must come to an end. But with the U.S. interest rate outlook still stable, the end appears some ways off. Hong Kong investors often carry a strong year-end rally into the Chinese New Year, which this year falls in late February. ■

Source: *Financial Times*

Is the Time Still Right for Emerging Markets Bond Funds?

U.S. investors have become quite enamored with foreign equity funds in recent years, but they haven't fallen nearly as hard for funds investing in foreign bonds.

Neglecting bond funds may be shortsighted as many bond experts say that some foreign diversification can be good for the fixed income side of a portfolio and can help smooth out returns if there is a decline in the dollar. Some experts, however, say that this may not be the best time to put new money into foreign bonds.

As bond prices fall when interest rates rise, Treasuries will fare better in 2007 than foreign bonds, if the Federal Reserve cuts interest rates. But, if the dollar continues to fall against other currencies, Americans who hold foreign bonds (or bond funds) will benefit.

U.S. dollar-denominated emerging market bonds generated strong positive performance in 2006 for the $692.4 million Templeton Emerging Markets Income Fund (TEI-NYSE). CEFA has been using TEI in place of Templeton Global Income Fund (GIM-NYSE), which has been selling at a premium.

Since the early summer of 2005, long-term U.S. rates have risen relative to long-term rates in the U.K., euro zone and Japan. This rise in bond yields has been a global phenomenon, suggesting that growing confidence in the economic cycle is entering a new phase, defined by broader-based growth, a vanishing output gap and pre-emptive action against inflation risks.

The net asset value of TEI increased from $13.75 for the fiscal year ended August 31, 2005 to $14.63 on August 31, 2006. Its largest holdings are invested in sovereign bonds in Indonesia, Brazil, Argentina and Russia.

For the 12-month period ending August 31, 2006, TEI performed well, despite the rise in U.S. Treasury yields. Sovereign (government) interest rate spreads (a valuation measure) narrowed in the 12-month period over the U.S. Treasury market, with particularly strong returns of +11.64% in Latin America and +10.00 in Asia. Strong global demand boosted production, and high prices for regional exports allowed some countries to improve external balances and debt structures, particularly Peru, Argentina and Venezuela, which generated a positive net asset value return for the fund in the first half of the year.

Credit quality in Russia has continued to strengthen during the year because Russia is a major oil producer. High oil prices earlier enabled Russia to enjoy external liquidity, pay down debt and increase its foreign reserves. This resulted in an upgrade in its bond ratings by Standard & Poors in 2005 and a further credit improvement in 2006. Inflation in Russia fell to 7.9% in October from 12.4% in the previous month, thanks to a recent decline in the price of oil.

As interest rates are tightening in Asia, TEI has maintained short duration bonds, with the exception of Indonesia whose bond markets boomed as its interest rates declined. Interest rates tightened most aggressively in Thailand and South Korea, where there were significantly higher returns as well.

The outlook for foreign interest rates is only one part of the picture. Foreign currency markets can have a much stronger impact on foreign bond funds, which are either hedged – eliminating the risk of foreign currency markets – or not hedged. A hedged fund only has to worry about the relative interest rates in the countries where it invests. There is now a stronger case for unhedged foreign bond funds, because of a weaker outlook for the dollar.

Both GIM and TEI are unhedged. ■

Source: 2006 Annual Reports, GIM, TEI and *The Wall Street Journal*

As one goes through life one learns that if you don't paddle your own canoe, you don't move.

– Katharine Hepburn (1907-2003)

Thomas Herzfeld Applies to Open Second Cuba Closed-End Fund

Thomas J. Herzfeld, a Miami-based closed-end funds specialist, is best known for a tiny Caribbean Basin Fund (CUBA-NASDAQ) organized in 1992. CUBA mostly has private investments but also has invested 19% of its assets in Florida East Coast Industries which runs a freight railroad between Jacksonville and Miami, on the expectation that any boom in trade after the Cuba embargo is lifted will be carried on the line. However, there is no immediate expectation that much change will occur any time soon, in spite of the apparent demise of Fidel Castro.

Herzfeld has raised the stakes in his Cuba bet by filing a registration statement with U.S. regulators to open a second Cuba find that would allow investing in Cuba itself. This fund could be launched when the embargo seems likely to end. He expects the shareholders of the new fund will benefit if U.S.-Cuban trade opens up after Castro makes his final exit.

Herzfeld wants to be involved in rebuilding Cuba, a free Cuba, he told *Cuba Business.* "As he prepares to swoop down on Cuba and profit from the demise of Castro's regime," the soft-spoken Herzfeld said he might be described as the friendly face of "vulture capitalism." Herzfeld said he preferred to think in terms of the "American Eagle," however.

When Cuba does open up, U.S. cruise lines and other members of the U.S. travel industry could be huge beneficiaries. The cruise industry hopes that they can bring their hordes of free-spending American tourists into Cuba, and inevitably they will, our research has found.

Herzfeld is the largest shareholder of the Caribbean Basin Fund, owning 3% of the shares. The shares closed at $8.72 on December 1, 2006, with a NAV of $12.07 and were trading at a premium of 38.4% on that date. ■

Source: Cuba Business News as reported by Reuters

Editor's Note: Because of my friendship with Tom Herzfeld, I visited Havana in 1992 and 1995 out of curiosity, traveling there from Mexico and Nassau. To those looking for a quick change, it is important to note that only three years in its history has Cuba had a democratic government. Could it be another China or Vietnam? We have no answers but strongly support the U.S. Chamber of Commerce's position to remove the U.S. trade embargo against Cuba to benefit U.S. exporters.

Two New Books Indicate Emerging Markets' Time Has Arrived

Reviewed by James M. Bogin

We live in the age of emerging markets. Not only have China and India made monumental strides, but Brazil, Korea, Mexico, South Africa and other countries are now home to huge world-class companies. In another 50 years, the economies of today's emerging market will eclipse those of the developed world in size. Two new books clearly illustrate the emerging markets' remarkable gains and bright prospects.

As Antoine van Agtmael suggests in his new book, *The Emerging Markets Century: How a New Breed of World-Class Companies Is Overtaking the World,* you only need to board a plane in the modern, well-ordered airports of Seoul, Shanghai or Singapore and land in the chaos of confusion and intrusive construction of New York's JFK to recognize what challenges these dynamic new economies pose for established powers.

David Riedel, a one-time equity analyst for Smith Barney, has written *Finding the Hot Spots: 10 Strategies for Global Investing.* Riedel advises investors to develop ideas and to assemble a portfolio that reflects the new global economy.

Source: *Barron's,* December 4, 2006

A Fund of Closed-End Funds: A New Innovation

Cohen & Steers launched the Cohen & Steers Closed-End Opportunity Fund on November 21, 2006, a first for the industry. The investment objective is total return through an asset allocation strategy. The new fund has an investment objective of total return through an asset allocation strategy. The original offer of 23,750,000 shares was priced at $20 per share and raised approximately $475 million. Proceeds are to be invested in other closed-end funds that trade at a discount.

The fund will be looking for a broad range of closed-end funds paying relatively high current income and managed by funds with "well regarded outfits with strong track records." It will concentrate on buying other funds that are $200 million or larger, which have a high trading volume to limit the problem of illiquidity, according to the prospectus. It will limit its stake to no more than 3% of a particular fund and will not buy other Cohen & Steers funds.

The shares are trading under the NYSE symbol "FOF" (NAV ticker: XFOFX). On December 1, 2006, FOF closed at $20.40, at a premium over its NAV of $19.44, or +4.70%. ■

ETF Filings Give Pause

by David Hoffman

Enough, already. That is what some experts and financial advisers are saying in the wake of filings in November by Rydex Investments of Maryland and Wisdom Tree Investments Inc. of New York to bring to market 96 and 31 new exchange traded funds, respectively.

If they receive approval from the SEC – and there is no reason to think they won't – the proposed ETFs will be added to the 329 that were in existence at the end of October 2006. But that doesn't sit well with some in the industry. ■

Source: Investment News

International REITs Enticing Investors

Investors will find compelling opportunities in international markets, particularly in Asia and in global real estate, according to State Street Global Advisors. The global real estate market is outperforming the U.S. real estate market; year to date through the third quarter, U.S. REITS have gained 25% while international had gained 26%.

The global market capitalization of REITs is more than $608 billion and growing, according to a report released by Ernst & Young, which covered 13 countries across four regions. Rapidly expanding REIT markets in Australia, France, Japan, Canada, the Netherlands, Singapore and Hong Kong are driving the new growth.

Source: Investment News

Portfolio Manager's Review

During November, we found that we had not filled our asset allocation for the bond fund sector. We had been using Templeton Global Income Fund until it traded at a premium. We then switched to the Templeton Emerging Income Fund, because of its discount and higher yield. We found that, in the December sell-off, this fund behaved very well versus the rest of the markets. We like the stability and strong diversification of both of these funds. We also continued to sell some shares of Cohen & Steers Worldwide Realty Fund (RWF-NYSE) when it sells at a premium. It has been a wonderful investment, but we are value investors and seldom hold onto funds that are overpriced. They inevitably come back to a discount at at a later date.

As we close the 2006 year, we have been grateful for the support of our loyal clients. Our new Hybrid Income Portfolio, managed by our associate, Jon Chatfield, has done very well so far. Investors interested in the Hybrid Income Portfolio should keep in mind that we think of it as a total return vehicle.

In the January 2007 *Scott Letter,* we will have an in-depth review of both the domestic and global real estate markets. ■

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