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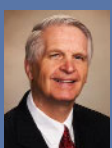

– George Cole Scott
Editor-in-Chief

IN THIS ISSUE:

Global Economies Growing Faster Than Expected

"Global economic output is growing faster than was expected just a few months ago, fueled particularly by demand in China, India and other developing countries," said International Monetary Fund in late July.

Later in this report, we will give an analysis of these countries where growth is so strong that it could prevent a recession in the slowing U.S. economy.

China alone will account for about a quarter of global growth in 2007. For the first time, China, whose economy is expected to expand 11.2% in 2007 and another 10.5% in 2008, has become the largest contributor to global growth. China's consumption is evidenced by double-digit increases in retail sales this year. Progress is being made in rebalancing the Chinese economy as their economic growth has been almost totally dependent on exports and investment.

The International Monetary Fund ("IMF") has slightly lowered its 2007 forecast for the U.S. economy to 2% this year and 2.8% in 2008. Through slower growth, the downside risks to demand have receded, it said.

The slumping U.S. housing market continues to be a drag on U.S. growth but to a lesser degree than in 2006. Meanwhile, business investment and inventories have picked up as much as 3% in annual growth, according to recent data.

Globally, booming demand has contributed more pressure on prices, the Fund said. "With continued strong growth, supply constraints are tightening and inflation risks have edged up ... increasing the likelihood that central banks will need to further tighten monetary policy."

IMF predicted a sharp jump in commodity prices in 2007, including increases in food prices due to weather-related production issues and greater use of fuels derived from crops. Oil prices have also been higher than expected since April, and the risks of energy price spikes remains a threat to economic growth, it said. ■

Source: *The Wall Street Journal*

Global Real Estate Review

The first half of 2007 was extremely volatile for real estate investment trust investors. The first six months saw performance in the U.S. driven by two starkly different trends: the bullish overtones created by Blackstone's acquisition of Equity Office Properties, followed by the implosion of subprime residential mortgages which reintroduced credit risk into the capital markets.

Taking the long-term view, during the more than 15 years of the modern REIT era, REIT total returns have averaged 15.6% per year, approximately 45% higher than the S&P 500 index. There are now encouraging signs of an increase of consolidation among REITs, a positive factor, despite the recent turbulence in the debt markets, according to a recent report by A.G. Edwards.

The report continues: "This implies that there will be an approximate 11% increase in the second half of the year, which [is viewed] as highly dependent on the near-term direction of interest rates and overall investment sentiment towards fixed income investments. However, stabilizing interest rates, continued economic growth without the concerns of excessive inflation and positive suppy/demand real estate fundamentals represent an accommodative environment for REITs to produce capital gains."

A very positive development is the establishment of German REIT legislation in June, retroactive to January 1, 2007. Most of the major (European) economies now have REITs, with Italy soon to follow.

Significantly, institutional holdings of REITs have expanded with increased real estate allocations every year since 2000. More than 40% of pension funds intend to increase their allocation to real estate over the next few years, according to a recent report.

In the U.S., loan delinquencies have climbed in the commercial real estate sector, rising in the second quarter for the first time since 2003. However, loan volume in 2006 was much higher than in previous years, while the delinquency rate is still historically low.

Mortgage-backed bonds have dropped sharply, but the delinquency rate is low. Commercial real estate fundamentals, such as vacancies and rents, are still solid. Lending practices in the commercial sector became aggressive in the last two years and in the first few months of 2007. This could lead to problems due to relaxed loan underwriting.

Loan underwriters have been optimistic about the ability of borrowers to repay their loans. Investors are concerned that increasingly high levels of debt have been grafted into commercial properties, a figure that has risen significantly by the second quarter of 2007. Many borrowers assumed that prices would keep rising and took on more debt than their properties were worth. This doesn't appear to be so.

Hotel Construction Booms

After several years of dormancy, hotel construction is ramping up again as developers hope to benefit from rising room rates. Private construction, especially overseas, is running ahead of last year. U.S. spending in lodging construction is growing at a much higher rate than other commercial sectors, which were up to a seasonably adjusted annual rate of $161.4 billion, according to the U.S. census.

If construction spending continues at current levels, 2007 will smash the record set in 2000, when it totaled an inflation-adjusted $19.5 billion on higher priced land and materials.

The pick-up in U.S. hotel construction specifically reflects a desire to meet growing demand from travelers at a time that room rates have been rising between 6% and 8% annually for the past four years. Room completions are also rising and are expected to hit 100,924 in 2007, according to Lodging Econometrics, a real-estate research firm.

In Asia, the hotel boom is even stronger, where there is a shortage of luxury hotels. China and India are leading this construction boom. Hilton Hotels announced that it will invest as much as $143 million in a joint venture to help meet India's surging demand for hotel and hospitality space.

Sources: *The Wall Street Journal,*
A.G. Edwards Real Estate Portfolio

BRIC Countries Lead Global Growth

Brazil, Russia, India and China are the world's largest economies, outside of the U.S. Our investments in the international markets are primarily concentrated in these four economies. An update on these countries' economic progress indicates that the economic strength of the BRIC countries should keep the U.S. economy from a recession.

Brazil Enjoys Sugar Power's Sweet Success

Brazil's president, Lula Inacio Lula da Silva, rarely misses an opportunity to advertise the power of his country's ethanol industry in his bid to wield greater influence in the world. A number of leaders in the Americas have begun to share his enthusiasm, arguing that cooperation between the energy-hungry north and the resource-and-technology rich south form the basis for greater integration and healthier relations across the hemispheres. Brazil has been self-sufficient in its energy needs for several years now.

Brazil's economy is large and well developed in its agricultural, mining, manufacturing and service sectors. Its president has restated his commitment to fiscal responsibility by maintaining the country's surplus during the 2006 election. He has announced further economic reforms to reduce taxes and increase public investment. A major challenge will be to maintain sufficient growth to generate employment and reduce the government debt burden. As far as we can see, he has succeeded.

There is plenty more to do so that Brazil can consolidate its recent progress, compete more effectively with rival emerging market giants such as China and India and make its transition toward developed country status. Brazil's growth rate is still a modest 3%-4% a year, but price increases will average less than 4% this year, down from a +20% level not so many years ago.

Brazil also has an enormous scope for expansion of its sugar crop. Producing about 4.6 billion gallons of ethanol from the current harvest, Brazil is using only about half of its available land for sugar cane, while land in the U.S. for sugar cane production is scarce.

Many analysts also say a biofuel alliance with Brazil's neighbors could help counterbalance the growing influence of Venezuela's oil-rich government under President Hugo Chavez. A lot of what Chavez does in the region depends on energy and his links with Brazil. Imports could be increased by further development of biofuels and the reduction/elimination of the expensive tariffs for U.S. imports of ethanol from Brazil.

Brazil's home market promises steady demand as locally developed "flex fuel" technology means more than 90% of its new cars run on ethanol, gasoline or a mixture of the two. The flexible-fuel vehicle can typically alternate between two sources of fuel with separate tanks and fuel systems. Some of the cars even switch from gasoline to natural gas.

Brazil has a unique window of opportunity to encourage its political elites to abandon vested interests and encourage Mr. Lula da Silva to forge a more ambitious economic strategy.

Source: *Financial Times, Daily News*

Investors Still Drawn to Russia

Despite some continued political and economic risks for foreign companies, Russia presents a tricky dilemma. On one hand, there is a perception that investment risks in Russia are getting worse, not better. On the other hand, Russia has had eight years of strong economic growth, a consumer boom and a rising middle class. With vast natural resource reserves, Russia may be becoming a growth market as attractive as China and India.

Lifted by high oil prices and the wave of foreign investment, the once humble ruble has been showing its muscle and fueling a consumer boom. After gaining 20% against the dollar in the last few years, the ruble is even starting to displace the greenback as Russia's currency of choice for both saving and spending. This means that imported goods are becoming cheaper for Russian consumers.

The Foreign Investment Advisors Council, a Moscow forum that fosters dialogue between government and businesses (highlighting Russia's growth potential), found that 40% of foreign investors reported sales are growing more than 30% since 2005, while nearly a third said profits increased even faster.

In spite of some problem cases, government figures show that foreign investment in Russia jumped dramatically in 2006. The biggest political risks are in natural resources, with Russia pushing to control its strategic assets such as oil, gas, metals and mining. At the same time, Russian authorities are systematically reviewing licenses granted toward the exploitation of natural resource assets and penalizing companies that don't stick to agreed development time tables. Authorities say that it is possible to do business, if you go about it the right way.

Outside natural resources, the biggest difficulties faced by Russia businesses are red tape and corruption. Permit requirements provide plenty of opportunities for officials to demand bribes, and the trend is increasing. Some foreign companies say that once they refuse to pay bribes from the outset, demand for payment often dries up. Third party contractors can sometimes be hired to obtain the permits.

There are also some tax disputes, but lawyers say that the companies that follow the rules by the letter often can easily settle disputes.

Source: *Financial Times, The New York Times*

Indian Stocks Reward Investors

A few clouds hovered over corporate India in the run-up to the reporting of second quarter earnings. Still, results so far have been sufficiently strong to temper some of the doubts and to bolster one view that there still is room for long-term gains in India's stock market. India has been high on the list for foreign investors because its growth is second only to that of China. Recently, there have been reasons for caution.

Indian companies have been buffeted by the sharply appreciating rupee, hurting currency translations for exporters. Higher interest rates, inflation worries and labor costs have added to the pain. As a result, other markets are considered cheaper. Growth is slowing due to inflation and higher interest rates. (See interview with Kheim Do.) Regardless, foreign investors are still flooding into the market. Net foreign investment inflows totaled $8.4 billion in the first half of this year, compared with $7.9 billion for all of 2006. Strategists warn that many companies' earnings growth could be volatile in the next 6-12 months, while the strengthening rupee continues to be a particular problem for exporters.

Source: The Wall Street Journal

China Raises Interest Rates Again to Curb Inflation

China's central bank raised interest rates again on July 20, 2007 for the fifth time in 15 months, but analysts said more tightening will be needed to curb the rampant growth in the world's fastest growing economy.

Growth this year has been consistently faster than expected. Investment in factories and infrastructure has accelerated, increasing 25.9% in the first half, the fastest annual growth since 1994 when GDP grew 13.1%.

A day after economic growth and inflation data blew past expectations, the People's Bank of China ("PBOC") said it was raising its one-year benchmark deposit and lending rates by +0.27% each. "This rate adjustment will help guide the reasonable growth of credit and investment .... It will help adjust and maintain basic stability of prices," the PBOC said in a statement. It is unlikely to be Beijing's last tightening. Authorities also slashed a tax on interest income from bank deposits, effectively pushing deposit rates even higher.

The unexpected acceleration of China's economy, which is on pace for the fastest annual growth in more than a decade, is raising the risk of overheating at a time when the nation's lenders are occupied with a major political shuffle.

China's gross domestic product, the broadest measure of economic output, expanded 11.9% in the second quarter from a year earlier.

China's top priority has long been maintaining economic growth in order to boost incomes and employ a rapidly urbanizing population. Its leaders, fearful of risking that growth, have preferred cautious, gradual changes in policy – a tendency accentuated by the political maneuvering before a key Communist Party meeting later in 2007.

The Party Congress, held every five years, will soon elevate a new generation of cadres to senior posts and set the government's direction for coming years. China's State Council, or cabinet, said in a statement in June that any policy changes should "encourage the steady and fast development of the economy, in order to create a positive environment and conditions" for the party meeting.

China has three main economic problems: a widening trade surplus that has strained China's relations with the U.S. and Europe, soaring food prices that are pinching consumers and heavy energy use resulting in pollution. This list reinforces indications that the government's main focus is on additional issues in specific sectors, not curbing overall expansion.

Increasing water and air pollution is something that sometimes concerns individuals more than the government in

China. A recent story in the *Financial Times* tells of an activist, who tried to save a lake from pollution, being arrested by the authorities. This shows China has a "confused attitude" about solving its environmental problems. Beijing attempts to make reducing pollution a priority, despite discomfort about individual activists.

Source: The Wall Street Journal

Update on the Asian Markets

To update on the Asian markets, we telephoned Khiem Do, the portfolio manager of the Asia Pacific Fund in Hong Kong. Khiem sees parallels in the recent correction and the one that occurred last February, when the Shanghai index fell 9.2% (also due to subprime fears) and then the rebound to 28% to-date.

"All the markets around the world have corrected, including the currency and commodity markets and the European and Asian markets. The correction is a reflection of a risk reduction/aversion for the traders to protect their profits, so they won't lose money elsewhere. Hedge funds using derivatives are losing left, right and center, as they must sell to cover their losses."

Khiem has taken advantage of the weakness to buy Asian equities as the fundamentals haven't changed. He sees these short-term corrections having nothing to do with the continuing bull market in Hong Kong, Korea, Singapore, Malaysia and other countries in his region.

This is because the three fastest growing economies are now China (11.5%), India (7.5%-8.0%) and Singapore (7%). Khiem has long been cautious on India where he now has reduced his exposure to less than 2%, due to current account deficits, higher inflation and higher valuations, favoring China because of its faster growth and massive surpluses. ■

Note: Clients of Closed-End Fund Advisors hold shares of The Latin American Discovery Fund, the Latin American Equity Fund, The Central European and Russia Fund, The India Fund, the Asia Pacific Fund and The Templeton Dragon Fund.

We will interview the Latin American Equity Fund for the next *Scott Letter.*

Portfolio Manager's Review

During the first part of July, we took advantage of high stock prices to raise a substantial amount of cash to complete the semi-annual rebalancing of our asset allocations. The first task was to reduce our concentration in U.S. and global real estate funds, due to concerns about U.S. subprime mortgages and the brokerage firms that invest in them.

Sales were made in both the domestic and global real estate funds, and we added to some of the U.S. funds that were acting well. By August first, we had reinvested most of our assets at much lower prices as the markets appeared to be oversold, and the global markets have little exposure to credit problems in the U.S.

Asian and European banks can weather the downturn in the U.S. credit markets, according to the *Financial Times.* This is because of their limited exposure to the subprime mortgage market.

Some areas, however, are affected. There were big losses at two Australian domestic hedge funds and two high yield funds because of exposure to the U.S. corporate loans. Japan's largest banks had exposure to this market. There have also been some problems in Europe.

We note recent higher unemployment numbers as more evidence of a slower U.S. economy which indicates that a cut in interest rates may be sooner rather than later. The futures market now forecasts the Fed may cut its interest rates by the end of the year. This possibility would have a very positive effect on stock markets, both here and abroad, well before the event takes place. ■

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