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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

IN THIS ISSUE:

A Special Report After Market Turmoil:
Shares in the Emerging Markets Post Biggest Gains

With stocks in the emerging markets soaring, individuals might wonder how much of their portfolio is strapped to this rocket. Now that the fallout from the housing-loan market downturn has prompted the Federal Reserve to cut interest rates, the race is on to find the next bubble. Emerging markets are a popular answer.

As stock markets around the world rallied in response to the Fed's 50 basis point cut, shares in the emerging markets, generally defined as countries with modest income that are growing fast, posted the biggest gains. Immediately, following the cut (September 18, 2007), Mexico's IPC index rose 2.8%, and Brazil's Bovespa rose 4.3%. Asian markets, led by the Bombay Sensex index, climbed 4.2% to cross 16,000 for the first time. All of these trumped the Dow Jones Industrial Average's 2.5% gain.

During bouts of financial turbulence, emerging markets have typically been the first to suffer. Sharp currency moves, interest rate spikes or liquidity crises usually spark a flight to quality, benefiting the U.S. dollar and U.S. treasuries. But, this time a curious thing happened. Investors, for the most part, kept their nerve – and their positions – in the emerging markets.

A decade ago these countries were loaded with debt and low foreign reserves that were vulnerable to interest rate swings. Now they have low inflation and strong economic growth. They have also learned to take advantage of high commodity prices.

The most dramatic example is China with a torrid 11.5% growth rate in the first half of 2007. It has also heavily insulated itself from global capital flows by limitations on direct foreign investment to just $10 billion.

Emerging markets have weaknesses as well. Inflation pressures are building in China and India which could force authorities to tighten monetary policy. In fact, The People's Bank of China hiked its one-year lending rate to 7.02% in August 2007, a modest hike but also the fourth in 2007.

The subdued response of emerging markets bonds was telling. The yield spread widened in mid-August 2007, but this spread remains historically low.

There is some direct exposure to the subprime crisis in emerging markets but not enough to worry most investors. The major banks have ample cash to cover possible losses, making these concerns moot. The IMF predicts that 2007 will see China as the biggest contributor to global growth.

A U.S. economic slowdown could even help China if trade demand lightens a bit, resulting in a decrease in China's large trade surplus and thereby easing tensions in U.S.-China relations. It could also help authorities in Beijing seeking to cool the economy and prevent the risk of a surge in inflation.

The long-term outlook for emerging markets is positive for a number of reasons, not the least of which is the dramatic improvement in economic fundamentals, particularly in Asia and Latin America. Many countries have slashed debt and increased reserves to reduce their vulnerability to crises. Brazil and other Latin American countries are enjoying unprecedented currency stability as a result of the booming commodity exports and record reserve accumulations.

In India, consumer lending has grown almost 30% a year for the past five years as the country's emerging middle class uses credit to buy everything from washing machines and cars to houses. And just wait until Tata Motors brings out its $2,500 car for domestic consumption in 2008!

Excluding Japan, Asians are buying as many personal computers each year as Americans. Chinese consumers bought seven million cars in 2006, up from only two million in 2002. And all of this is happening in a low inflation environment. Not only are emerging markets stronger than they were a decade ago, but there is also the new element of domestic demand.

Fed policymakers do see a welcome change in tone and sentiment since their rate cut, with investors starting to differentiate much more between assets and investment vehicles. The effects of this have been most noted in the asset-backed commercial paper market where stress is now more tightly confined to paper that is backed by problem mortgages and investment vehicles that are not backed by strong banks. The market for leveraged buy-outs has reopened, and mortgage spreads have tightened a little. These are positive signs.

Although the Fed cut does not necessarily cure the ills of the liquidity crisis, they are optimistic that day-to-day relative stability takes the markets closer to recovery. The macroeconomic data is still cloudy, however. There are still some weak figures on housing, soft durable goods orders and lower confidence set against a resilient consumer spending report. Either the economic data will point upwards, in which case the market healing process should speed up, or they will point downwards. Then markets are likely to take another turn for the worse.

Consumer spending was strong in August 2007 in a continuing credit squeeze and market turmoil while inflation fell. This was a hopeful sign for the U.S. economy's ability to avoid a recession. ■

Source: The Wall Street Journal, Financial Times, Institutional Investor.

Editor's Note: Closed-End Fund Advisors has recently purchased shares of Templeton Emerging Markets Fund for its clients.

Global Real Estate Review

New real estate markets in Asia and Europe offer expanded access to global commercial real estate securities. More than ever, investors can diversify portfolios with exposure to markets at different stages of maturity in their real estate cycles if, that is, they have the right investment manager.

Since 2000, seven countries in Asia, including Japan, Hong Kong and Singapore, have introduced REIT-like structures. In 2007 alone, the United Kingdom, Germany and Italy have enacted REIT legislation.

Investors in search of income potential and global diversification are faced with an interesting array of choices.

Scott Crowe, senior vice president of Cohen & Steers and member of the firm's global investment committee, says "Asia offers some of the most compelling opportunities in the real estate securities markets. Growth in China and the economic turnaround in Japan are attracting a large amount of direct foreign investment to Asia Pacific markets, including real estate."

When asked why Singapore and Hong Kong have performed well recently, Derek Cheung, senior vice president and head of Cohen & Steers' Asia Pacific real estate research, responded, "China."

Hong Kong is a clear beneficiary of China's economic expansion and trend toward urbanization. The number of people living in cities has increased by 140 million since 2000.

"This has been a big plus for Hong Kong property companies with operations on the mainland," said Cheung, who also notes that there are risks associated with investing in Asia's real estate securities, such as the potential for high short-term volatility.

Japan's real estate market has entered a sustained recovery after a long period of deflation. Property fundamentals, especially in Tokyo, are accelerating, and vacancy rates in the city's main wards have fallen below 3%.

Europe Tackles Structural Change

"With REIT models in place, we believe European markets have embarked on long-term structural changes," Crowe said. "Real estate companies are gaining access to capital markets and investor bases that didn't exist before. The potential for investors is significant."

The value of total European real estate outstrips that of both Asia Pacific and North America. Yet a scant 2.8% was listed on the public markets as of December 31, 2006, according to Citigroup investment research. The sheer size of German private real estate holdings is extraordinary; a significant amount of these holdings could enter Germany's public real estate market by 2010. While no German properties have converted to REIT status, Cohen & Steers expects this may change in 2008, when the tax environment for REIT conversion will be more favorable.

By contrast, nine of the largest U.K. real estate companies have immediately converted to REITs when they took effect on January 1, 2007, after a large anticipatory run-up in 2006 prices. A sharp price decline followed. Investors took profits, despite strong fundamentals.

"At current valuations, we believe the U.K. offers some of the best values in the global REIT markets," Crowe said.

Crowe also sees opportunities in eastern Europe. "There is a shortage of supply in countries with young populations and growing demand for real estate. From retail to residential space, western European companies that we own could provide much of the needed development."

For several years now, knowledgeable investors have embraced international real estate securities as an asset class with potential for diversification, attractive total returns and current income. They recognize the benefits of increasingly broad, liquid and growing opportunities available in the public real estate markets. Differences in valuations provide opportunities to capitalize on disparities in economic, capitalization and real estate cycles.

At Cohen & Steers, an experienced investment manager's research team analyzes each country's and region's real estate cycles to identify opportunities. Thus far, 2007 has been an eventful year for global real estate securities while many closed-end funds are adding new country REITs to their portfolios.

The United Kingdom, Germany and Italy all introduced REIT-like structures, giving 75% of Europe's GDP access to publicly traded real estate securities. At the same time, private equity firms snapped up some of the largest U.S. REITs at considerable premiums.

More recently, the broad global equity markets have been unusually volatile. What's going on, and what does it mean?

Martin Cohen, Cohen & Steers co-chairman and co-chief executive officer gave insights to his investors.

Q: REITs reached their all-time highs in price in February 2007 and then reversed course. What happened?

A: While fundamentals for commercial real estate have remained strong, several developments combined to put pressure on REITs. First, defaults in the subprime mortgage market caused investors to re-evaluate the risks of the securities and mortgages collaterized in interest rates between higher quality debt and lower quality debt securities [that] had been very low. With these defaults, spreads began to widen. That is, investors demanded higher returns to match higher risk.

Second, there was a heavy accumulation of debt used to finance leveraged buy-outs ("LBO"). The banks and brokerage firms that backed those deals took on too many obligations and had trouble selling the loans in the aftermarket – something they do to limit their exposure to any one borrower. As they couldn't sell LBO loans, banks stopped making them. Because much of the recent activity had been concentrated in real estate companies, the reduced possibility of further privatizations removed a positive catalyst from the REIT market.

Finally, there seemed to be more expectations of a slowing economy due to weakness in the housing market. Investors, in turn, have lowered their expectations for returns, profits and real estate values.

Q: Is this a good time to buy real estate?

A: This has been the most severe decline in many years, and REITs have now reached very attractive prices, even taking into account reduced NAV calculations. It's impossible to predict, of course, but we may be closer to a bottom in REIT stock prices than a top. It may take a little while to see how widespread the mortgage problems are, and I think the markets will be nervous until they feel that they've heard all the bad news.

We believe that REITs will trough even while uncertainty hangs over the market. Typically you can find the best values before that nervousness fades. We believe that there are some very attractively valued real estate securities, and we are buying selectively. As bottom-up investors, we look at individual stocks. We evaluate their fundamentals – their business model, balance sheet and management team. ■

Robust Growth Forecast for Asia

Booming domestic consumption in China and India will lead to robust economic growth in Asia in 2007 and 2008 in spite of turmoil in global credit markets and a U.S. slowdown, forecast the Asian Development Bank ("ADB").

On September 17, 2007, the ADB just sharply increased its growth forecast for Asia, excluding Japan, to 8.3% from the 7.6% that it predicted just six months ago. For 2008, the forecast was raised to 8.2% from 7.7%.

"Developing Asia's defenses against external shocks are solid, and it can weather a slowdown in the U.S.," said an ADB chief economist. "Asia has stout financial defenses. Even a serious U.S. slowdown could be good news for some Asian countries that were showing signs of overheating," he said.

The Bank said it was working on the assumption that the credit squeeze would lead to a slowdown in U.S. growth rather than a recession. Paradoxically, Asian central banks might have a sigh of relief, if capital inflows turn from a torrent to a trickle because that makes monetary management simpler.

Excluding China and India, which represent 55% of developing Asia's gross domestic product, ADP forecasts Asian growth to be 5.7% in 2007 and 5.6% in 2008, indicating significant progress in countries like Indonesia and Vietnam.

Asia's ability to weather a U.S. downturn stems from its booming domestic consumption, build-up of $2.6 billion in reserves and mature, healthy financial institutions and markets. Asian stock markets – with the exception of China – had so far resisted "exuberance" with price-to-earnings expectations remaining in line with corporate performance. China needs a stronger currency appreciation to stem inflation, which could not be achieved through "a glacial pace of interest rate increases."

The report added that there were "many signals of overheating" in China, ranging from soaring food prices to the booming real estate market and record stock market valuations. China recently reported that inflation was running at 6.5%, the highest in almost 11 years. However, Beijing is likely to stick to "a gradualist approach" to currency appreciation, noting that it could partly offset the impact of a U.S. recession by stimulating the domestic economy, most notably through higher infrastructure spending.

A really meaningful slowdown in the U.S. economy with extensions into Europe and Japan could have a pretty direct impact on Chinese growth.

Source: Bloomberg from Beijing and reported in the Financial Times

Editor's Note: Some closed-end funds covering the Asian region include Asia Pacific Fund (APB), Asia Tigers Fund (GRR), China Fund (CHN), Greater China Fund (GCH), India Fund (IF), Indonesia Fund (IF), ING Asia Pacific Dividend Equity Fund (IAE), Japan Equity Fund (JEQ), Japan Small Cap Fund (JOF), Korea Fund (KF), Malaysia Fund (MF), MS Asia Fund (APF), MS China Share Fund (CAF), MS India Fund (IIF), RMR Asia Pacific Real Estate Fund (RAP), Singapore Fund (SGF), Taiwan Fund (TWN), TaiGreat China Fund (TFC), Templeton Dragon Fund (TDF), Templeton Emerging Markets Fund (EMF), Thai Cap Fund (TF), and Thai Fund (TTF).

Climate Change Affects All Economies

Conservationists argue that human health and well-being should be central to conservation efforts. "Ecosystems such as wetlands and mangrove stands protect people from lethal storms; forests and coral reefs provide food and income. Damage to one ecosystem can harm another half a world away as individuals rely on it for resources or tourist revenue," according to a well-researched report in the August 2007 issue of *Scientific American.*

Conserving the resources of the planet has finally come into the mainstream press as investors now realize that a cleaner, conservation-minded planet affects economic growth in all countries.

Preserving biodiversity for its own sake is not working as a conservation strategy. More and more people are realizing that protection of ecosystems for better health and well-being makes more sense. Such ecosystems include forests and wetlands that maintain clean water, mangroves that shield against storms and reefs that maintain fisheries. Saving these sites can preserve biodiversity and ensure that people are a priority.

Recent high profile meetings on global warming are now heating up as an economic issue. One question is: "Should the industrialized world subject itself to tighter greenhouse gas regulations?" This debate is being eclipsed by a more practical question: "How can we create incentives to encourage carbon emission cuts in the developing as well as the emerging world?" We also wonder how all of this will affect the global investor?

Source: The Wall Street Journal; Scientific American.

Editor's Note: From time to time, we will address conservation issues as we think they can directly affect investors interested in not only world economic growth but also in the well-being of its people. Reader comments are welcome.

Portfolio Manager's Review

After rapid changes in the world's stock markets brought about by the subprime debacle, we examined carefully which of our holdings were most vulnerable to the decline and which were the most stable. As a result, we have sold our entire position in Calamos Strategic Total Return Fund, substituting it with the more stable Ellsworth Fund, which has a deeper discount and behaved well during the recent market weakness. We also purchased The Alpine International Real Estate Fund (EGLRX), a no-load mutual fund, to keep as much of our assets as possible working for our clients.

As the real estate markets improve, we have added to Cohen & Steers Worldwide Realty in the foreign markets and to Diamond Hospitality Co., Starwood Hotels and a few other Cohen & Steers funds on the domestic side. We are emphasizing the global real estate funds heavier in this sector as they have been leading the charge in the real estate recovery.

We then added to Templeton Emerging Markets Fund as well as the Templeton Emerging Markets Income Fund, both of which have been top performers. Our Global Hybrid Income Portfolio, which has been under some pressure during the credit crunch, has just completed its first year.

This portfolio has provided good performance for clients and has now been adjusted to take advantage of strengths in the income markets, with an emphasis on global and real estate portfolios with steady monthly income distributions. We reviewed every account and found each of them was in good condition after the summer turmoil.

The next issue of *The Scott Letter* will feature an interview with the portfolio manager of the Asian Pacific Fund. ■

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