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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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Buffet Sees Recession and Gives Hints on Successors

The U.S. is in recession, billionaire investor and chairman of Berkshire Hathaway Warren Buffet told CNBC recently.

Buffett added that while the U.S. might not have met the formal tests of recession, "most people's situation, certainly their net worth, has been heading south for a while now."

Buffet also said that stocks were "not cheap" and that the financial markets were experiencing "waves of deliverance". Warning that the dollar would continue to decline, he said that it is nothing like 1973/1974 yet, but that the Fed has a difficult task balancing the risks to growth and inflation.

Berkshire Hathaway posted an 18% drop in fourth quarter 2007 net income on lower investment gains and a drop in insurance underwriting fees.

There is anticipation that Buffett might reveal the names of four candidates he has chosen to succeed him in the role of chief investment officer. He only said they were "young to middle aged, well-to-do rich, and all wish to work for Berkshire for reasons that go beyond compensation." He added that they all currently manage "substantial sums" elsewhere, and "all have indicated a strong interest in coming to Berkshire if called." ■

Editor's Note: Because we admire Warren Buffett and the shares have acted well, we have small positions in Berkshire Hathaway "B" shares.

Emerging Markets: The BRIC Countries

The four so-called BRIC countries (Brazil, Russia, India and China) are the largest of the emerging markets, where most of our clients' assets are invested overseas. The following is an update on the regions.

Brazil

With Brazilian legislators scrapping the country's financial transactions tax (CPMF) in December, the government says it must now plug a 40 billion real ($22 billion) gap in the 2008 budget. This amounts to 1.6% of GDP. The government plans to make up the shortfall, among other measures, by hiking tax rates and cutting spending.

Analysts are concerned that higher taxes on bank profits (to 15% from 9%) could lead to higher borrowing costs. This could dampen potential GDP growth.

However, Standard & Poor has affirmed all of its Brazil sovereign ratings "as long as the government carries through with its commitment to its fiscal targets and its broader economic program benefits the country's economic and external dynamics."

Petrobras, Brazil's state-controlled oil company, unveiled a $55 billion investment program for 2008, 29% above its 2007 investment. The company will invest 87% of the program domestically, and $26 billion is earmarked for exploration and production.

Russia

Vladimir Putin has installed his anointed successor, long-time protégé Dmitry Medvedev, 42, as Russia's next president. Analysts now wonder whether Medvedev will be allowed to rule. His opponents claimed ballot-rigging was more widespread that in parliamentary elections three months ago.

Medvedev is remembered for crushing the fragile shoots of democracy, but he has at least restored the economy, the state and his country's place in the world.

Between 1999 and 2007, the Russian economy expanded by 69%. Russia's oil and

gas exports jumped from $76 billion in 1999 to $350 billion in 2007.

Under Putin, little progress has been made on structural reforms, but rather, economic reform has gone backwards.

Corruption is rife, and there is no motivation for positive change, much less dynamic development. This is inevitable when so much unaccountable power is concentrated in one person's hands. By destroying independent institutions, the state has mutilated itself.

Yet Russia is also a nuclear-armed state with vast energy resources. That makes Russia's corruptive development worrying, as well as depressing.

Anders Aslund in 2007 wrote in his superb new book, *Russia's Capitalist Revolution,* that the biggest error Russia made was to focus on the ridiculously insignificant issue of post-Soviet debt, in late 1991 and early 1992, instead of meeting the challenges of political and economic transition.

Mr. Putin has not been a success and what he has created may not work. It is unlikely to provide sustained improvements in prosperity.

The West must resist efforts to divide Westerners against themselves. It must ensure itself against overdependence on Russian energy and must also repeat a powerful truth: The West is no enemy of the Russian people.

Nothing would be more desirable than for a vibrant and self-confident Russian democracy to take its place in the world of Western values ... and that must include NATO membership.

Russia offers no enticing new ideology; it is a cold peace. It is a tragedy but also a reality that the West must live with, probably for a long time to come.

Source: *Wall Street Journal, Financial Times*

[**Editor's Note:** Our only exposure to Russia is through the Central European & Russia Fund (CEE:NYSE) which was a big winner in 2007 but is now a smaller part of our emerging markets allocation.]

India

Thomas Friedman, in his book, *The World Is Flat,* wrote that he is "a starry-eyed advocate" of globalization but points out that globalization has its upsides and downsides. He sees China and India adopting a basically pro-globalization strategy, adopting political, social and economic conditions and reaping those benefits.

Friedman says there are costs of this growth as well – in terms of environment, social cohesion and economic equality. India, a top global innovator for high-tech products and services, underperforms relative to its innovation potential. However, its economy is now slowing rapidly for the first time in three years.

India's growth rate for the first quarter of 2008 is expected to be 8.7%, down from 9.6% in the previous year. The reasons given are the dual impact of the rupee appreciation and sharp monetary tightening. In spite of this, India is still one of the fastest growing countries in the world.

After its run of near double-digit GDP growth that triggered a politically dangerous bout of inflation in 2007, India looks to achieve a soft landing due to slowing export growth, slowdown in U.S. growth and less prolific domestic spending on consumer durables.

The world's electronics industry is poised to sharply increase the amount of work outsourced to companies, with India taking a much bigger share of the total, although it will remain well behind China.

By 2010, more than a quarter of all the manufacturing output of the world's electronic industry will be done by specialists.

[**Editor's Note:** Your editor visited India in 1968, while working for a London newspaper. The population was less than half of the 1.1 billion it is today, but he was overwhelmed by seeing so many people. After attending a United Nations conference on Trade and Development in New Delhi, George toured the city and visited the college that his sister had attended 12 years earlier, where he witnessed students working in villages to help their people. After 10 days, George flew to Hong Kong. He has wanted to return to India ever since.]

The number of overseas tourists visiting India in 2008 is expected to rise 13% – a substantial increase. But this is a relatively small number given the wealth of sites and activities that India boasts.

China

The World Bank has cut its forecast for Chinese economic growth to 9.6% for 2008 versus 11.4% in 2007. There is a growing opinion that the economy will slow because of decelerating exports and a worsening global outlook. Chinese economists have downgraded their forecasts due to weaker exports and a rising threat of a U.S. recession. More than 40% of Chinese exports go to the U.S. and Europe.

Indeed, a weak global economy might dovetail with Chinese policymakers' aims to relieve inflationary pressures and to help restrain the trade surplus.

The World Bank said, "The slowdown in the global economy should affect China's exports and investment in the trade sector. However, the momentum of domestic demand should remain robust, and a modest global slowdown could contribute to a rebalancing of the economy."

The trade surplus rose only 13% year-on-year in the final quarter of 2007, compared with 86% in that year. If the trend is maintained, trade surplus might begin to level out in 2008. The continued strength of the economy and positive news on trade could mean that Beijing has failed to correct the decline. Investment growth continues to be higher than consumption.

Industrial output also continues to outpace services. The measures taken to rebalance economic growth away from investment and industry to consumption and services have not yet had a noticeable impact.

China will maintain a tight grip on the value of its currency, requiring authorities to mop up most of the foreign exchange coming in which will continue to inhibit monetary policy. Beijing is also reluctant to raise its interest rates further for fear of attracting speculative capital inflows. This complicates managing domestic liquidity.

Inflation and the current account surplus add to the case for currency appreciation. Foreign reserves in China rose by $459 billion to $1,529 billion in 2007. ■

What Will Happen to China's Economy After the Olympics?

Many investors expect a post-Olympic economic slowdown in China, as infrastructure spending slows. A pre-Olympic slowdown could materialize sooner if the government is forced to act aggressively to reduce pollution.

Because the Olympics open on August 8, China is acutely aware of the problem. Various polluting industries have either been relocated or retrofitted with more energy-efficient technologies. Coal-burning plants have been converted to cleaner fuels, and more stringent vehicle emission standards have been instituted. As a result, the air quality has improved.

China remains one of the most polluted countries on earth. Against this backdrop, the UN has warned that high levels of pollution are a "legitimate concern" for anyone participating in the Games.

The success of the Games is too symbolic for China not to act aggressively, especially if air quality does not start to improve soon. China may have no choice but to slam on the industrial brakes in an economy that is slowing down.

If true, it could result in a deflationary shock to the global commodity markets, triggering an abrupt shutdown in commodity prices. In turn, real growth in many high-flying commodity nations such as Brazil, Australia and Canada could weaken. The upshot: weaker global growth and softer global earnings for China in 2008.

This is another way of saying that there is a great deal riding on China and its battle to clean the air before this August." ■

Source: Joe Quinlan, *The Financial Times*

Rewards Spur China Gold Rush

One Chinese mine has more than doubled its gold production in the past two years and forecasts a similar surge in 2008. Reasons for the rise include better knowledge about reserves, but above all, increases are being driven by higher global gold prices. At least one mine in Shanxi province is planning to quadruple output over the next two years.

China's mini-gold rush made it the world's biggest producer in 2007, the first time any nation has surpassed South Africa since the late 19th century.

Local production of iron ore, spurred by the higher prices of iron, increased by 40% year-on-year in 2006, as miners profited from the resources boom.

The production of gold and other resources comes primarily from small, semi-private mines, often producing low-grade ore in ventures that would have been unviable a few years ago. The lack of environmental scrutiny also keeps costs down.

China has more than 1,300 licensed gold mines and more than 1,000 gold mining companies, but none of the gold companies rank in the top five producers in the world. The big players have little incentive to invest in China. The Chinese market for jewelry is small compared to India, which is four times as large.

Gold output might begin to decline because China lacks the geology for large sustainable gold production. ■

Record Investments Pour into "Clean" Technology

The year 2008 will be another record-breaking year for venture capital investment in "clean" technologies, according to a new analysis of the market.

Nick Parker, chairman of Cleantech Group in the U.K., said: "There is no doubt this year will break records in terms of the amount invested, but 2008 will be notable for the amount of commercial take-up of clean technologies."

In 2007, more than $4 billion of venture capital was invested in environmental technologies such as renewable energy, water and carbon reduction technologies. This sector is now the biggest recipient of venture capital funds in the U.S., and in the first three quarters of 2007, about $3.8 billion of venture capital was invested, Mr. Parker said.

Such large flows of capital are now pouring into clean technology in response to record energy prices and governments' perceived willingness to regulate carbon. Total investment, not just for venture capitalists, in "clean" or low-carbon technology reached $74 billion in 2007. However, investment in clean technology is heavily dependent on politics.

"Policy is absolutely important in the clean-tech space. Traditional businesses have strong political forces in play. Somebody has to educate Washington," says the founder of a venture capital group.

Mr. Parker agrees: "Politically, the big shift is in recognizing that the market will respond if they send the right signals. There is a sense in the business world that there is no going back now. This is a one-way bet."

In most countries, renewable energy is not competitive with conventional sources such as coal-fired power without governmental support in the form of subsidies, fixed energy prices or regulations mandating a certain amount of electricity should come from renewable sources.

As conventional energy prices rise, however, clean technologies become more competitive as companies are financially driven to look for alternatives. Companies investing in clean technology have been strong supporters of carbon-restricting policies.

"We strongly advocate a price on carbon," said John Doerr, a venture capitalist and partner at KPCB. "Policy matters enormously. It's woven into every part of our worldwide energy economy for good reasons."

Recently the Intergovernmental Panel on Climate Change, a body of the world's climate experts convened by the UN, met in Valencia, Spain. The panel is working to distill its 30 most important findings over the last six years. This will be in time for them to digest the information before a crucial United Nations meeting on climate change in Bali in December. ■

Source: *Financial Times*

Investors Flock to Commodities

Commodities prices posted their largest monthly gains in February since the oil crisis of the 1970s and have enjoyed their strongest start of any year for half a century.

The gains were fueled by an explosion in popularity among investors seeking refuge from turmoil affecting equity and credit markets. They were supported by strong demands from emerging markets, widespread supply disruptions and a growing interest in commodities as a hedge against rising inflation and the weakness of the U.S. dollar.

However, record prices for energy and agricultural commodities are threatening inflation and are prompting fears of a return to the "stagflation" of the 1970s.

The Reuters/Jeffries CRB spot index, a benchmark that tracks commodities such as crude oil, shows that copper, corn and coffee jumped 12% in February, its biggest monthly rise since July 1974. The index gained 15.3% during January and February 2008, the strongest rise of any year since it was created in 1956.

In spite of rising raw materials prices, Fed chairman Bernanke said that he does not expect stagflation – the toxic combination of recession, high unemployment and rising inflation. He said, "I don't think we are anywhere near the situation that prevailed in the 1970's." Bernanke did, however, acknowledge that recent inflation figures, boosted by rising oil and food prices, were higher than expected.

Fears over inflation have led investors to pour record amounts of money into commodities. ■

Source: Financial Times

Portfolio Manager's Review

During February, we used some of our cash to invest in undervalued funds that have shown stability in the markets. For the domestic funds, when good opportunities were available, we purchased Adams Express, Central Securities, Ellsworth Fund and RMR Real Estate Fund. Foreign allocations added were First Trust Aberdeen Global Opportunity Fund, Latin America Equity Fund, RMR Asia Pacific Fund, Swiss Helvetia Fund and Templeton Emerging Markets Fund.

We sold shares of Alpine International Real Estate Fund, Asia Pacific Fund, Calamos Global Total Return Fund, Central European & Russia Fund, European Equity Fund, ING Clarion Global Real Estate Fund, Templeton Dragon Fund and several real estate funds. Templeton Global Income Fund, although it was a big winner, traded at a premium, so we also lightened up on this fund. Part of the strategy was to shift allocation out of Asia into a stronger presence in Latin America. We are keeping our investments in funds showing the most stability until we see better markets.

Going forward, there will be many opportunities to purchase funds, but we are keeping higher than usual cash levels. Despite the steady weakness in all markets, we are heartened that our portfolios have shown more stability than the volatile markets both in the U.S. and abroad.

We will be interviewing the portfolio managers of the Cohen & Steers funds for the April issue of *The Scott Letter.* ■

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