

# THE SCOTT LETTER: CLOSED-END FUND REPORT

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*A Global View of the Closed-End Fund Industry*

April 2008

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](http://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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## *Special Edition: For Investment Advisors, Planners and Brokers*

# Strong Recovery by Cohen & Steers Funds: Their Managers Are Optimistic for 2008

Cohen & Steers is the manager of high income equity portfolios, specializing in U.S. REITs, international real estate securities, preferred securities, utilities, listed infrastructure securities and large cap stocks. Headquartered in New York City, with offices in Brussels, Hong Kong, London and Seattle, the company serves individual and institutional investors through open-end mutual funds, closed-end funds and institutional separate accounts.

Two Cohen & Steers funds are featured in this report: the Closed-End Opportunity Fund and the Worldwide Realty Fund.

### Cohen & Steers Closed-End Opportunity Fund

The Cohen & Steers Closed-End Opportunity Fund (FOF: NYSE) seeks to achieve its objective by investing in common stocks of closed-end funds selected by Cohen & Steers. FOF is managed by Doug Bond.

The Fund, launched on November 24, 2006 at \$20 per share, is unique – the first of its kind – and is designed to deliver high, current income while targeting shares of closed-end funds selling at discounts to their net asset value. It is a good fund for IRA's or for individuals who may have small amounts of money in the stock market, as it has exposure to the whole spectrum of the closed-end fund universe. Total assets of FOF on December 31, 2007 were \$458.7 million.

We spoke to Doug Bond on March 24, 2008.

**SL:** Please tell us about the Cohen & Steers Closed-End Opportunity Fund since inception.

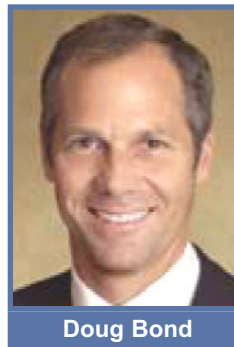
**Bond:** Much has changed since we spoke in March 2007. This includes the metamorphosis of what some thought would be a relatively contained subprime problem into a full-fledged credit crunch. Credit spreads have widened dramatically, and expectations for economic growth have changed. This has had a negative effect on the prices of many fixed income and equity securities, the bedrock of many closed-end fund portfolios.

**SL:** What is your perspective on the FOF portfolio and the closed-end fund industry?

**Bond:** Both FOF and closed-end funds offer investors a very significant and attractive value proposition. The average discount of closed-end funds today is about 6% across the entire universe of 659 closed-end funds. While that is lower than the wide discounts of about 10% in 2007, it is still well above the 3.8% 20-year average discount and is also significantly above what the discounts were when we last spoke – then around 1%.

The market is offering investors a wider selection opportunity for all types of funds in different sizes and shapes than ever before. It still has the characteristic of inefficiency, attracting us to the marketplace. Therefore, we launched the Closed-End Opportunity Fund in 2006. There has been very little outside research on closed-end funds and very few institutional participants in the closed-end fund industry.

As the investment environment has changed in the last 12 months, investor sentiment has also changed. This is reflected most dramatically in closed-end fund discounts. They have widened from 1%-1.50% to close to 9% at the end of 2007 and were about 11% at their worst point during that year.



Doug Bond

**SL:** Your highest allocation, 24%, is in covered call funds. How well have these funds protected you in down markets?

**Bond:** The covered call funds have taken out some of the equity market volatility – the option premiums collected have enabled them to outperform the equity funds that do not write calls. They now represent 24% of our portfolio due to their excellent relative value. We find them attractive, based not only upon the high distribution yields but also on the higher than average historical discounts.

In a continued choppy equity market, having a significant exposure in covered call funds makes a lot of sense. The covered call closed-end funds yield close to 11% and sell at an average discount of 8%. The distributions are strong, and there haven't been any dividend reductions.

**SL:** We have a similar philosophy as we have been converting many of our funds that pay annual distributions to funds that pay more frequently. Is it still true that you have increased distributions and have never cut them?

**Bond:** Yes. We have had a total of 32 dividend increases – and never a decrease among our 11 closed-end funds. That helps us stand out among closed-end fund issuers.

**SL:** How do you think *The Scott Letter* adds to available closed-end fund research?

**Bond:** *The Scott Letter* is a part of the closed-end fund market that is informed and educated. It adds to investors' understanding of closed-end fund investment opportunities. We need more publications like yours. A lot more has to be written, published, disseminated and communicated to investors before the closed-end market itself becomes efficient.

Hundreds of funds have been launched in the past few years without any research coverage. There is an enormous opportunity for investors who do their homework to find value in closed-end funds. We are, therefore, very optimistic about the investor promise and the value proposition that closed-end funds hold for investors.

**SL:** The Closed-End Fund Association also does a good job of informing investors. The experience I gained by

servicing on the board of a close-end fund, Bergstrom Capital, for 27 years has also been useful. In 1988, we launched *The Scott Letter*, followed by my co-authoring the book, *Investing in Closed-End Funds: Finding Value and Building Wealth*.

How has the leverage – up to 30% – impacted your performance and the discounts on these funds?

**Bond:** Leverage continues to be a risk factor in evaluating our closed-end funds. We continue to monitor this closely but, so far, it has not impacted shareholder distributions in FOF.

**SL:** What percentage of your funds use leverage?

**Bond:** About 48% of our current portfolios use leverage in their capital structures; 52% of them use no leverage. We paid out \$1.67 per share in total distributions for FOF in 2007. A very small percentage of that was a return of capital – a reflection of flow-through to shareholders of the tax characteristics of dividends we received from funds we owned.

**SL:** How much exposure do the funds in the FOF portfolio have to the auction rate markets?

**Bond:** About 39% of our holdings use auction market preferreds for leverage. There have been illiquidity problems in these markets, but so far the borrowing costs for our funds have been declining. We continue to monitor the borrowing practices of these funds.

**SL:** What's your outlook for closed-end funds for the rest of 2008?

**Bond:** We think they will do quite well, notwithstanding a tough first quarter. Over the last decade, closed-end funds have delivered strong double-digit returns in the year following a closed-end fund bear market like we had last year. Thus far this year, high quality bond funds have done better, but by the end of 2008, we think closed-end equity fund investors will have good returns. The U.S. stimulus package will make a difference later in 2008.

**SL:** What are concluding remarks do you have?

**Bond:** We continue to believe in investment opportunities in the secondary market for closed-end funds. Since we launched FOF in 2006, there have been

difficult market conditions and record levels of new issues, putting pressure on the secondary markets for closed-end funds. In the second half of 2007, the sweeping effects of the global credit crunch came from the subprime mortgage crisis.

It has been a very difficult and challenging period to navigate but in no way diminishes our long-term optimism toward the investment promise for the Closed-End Opportunity Fund investor.

### Cohen & Steers Worldwide Realty Fund



Tom Bohjalian

We also interviewed Tom Bohjalian, the portfolio manager for the Cohen & Steers Worldwide Realty Income Fund (RWF: NYSE), a fund which seeks high current income and capital appreciation by investing in global real estate securities. Tom spoke about the real estate markets.

**TB:** There has been a global recoupling of the world economies. If the U.S. is unhealthy, most of the rest of the world feels the effect. The U.S. should be the first to recover due to its aggressive monetary and fiscal policy.

We feel better about the U.S. than a year ago; it represents 24% of our portfolio. RWF has traded at a healthy discount to its net asset value despite the recent run-up in share prices. There is good value in the underlying securities that make up the REIT universe in the U.S. Some of our closed-end funds are trading at premiums to their net asset value.

**SL:** You may like funds trading at premiums, but the discounts leverage our clients' portfolios. Please tell us something about what real estate sectors you favor in the U.S. commercial real estate market.

**TB:** These are uncertain times so it is harder to make huge sector bets. We are more agnostic to the different property types, although we have taken sector positions. We are also more defensive in this

environment than normal, and there is more cyclicity in our portfolios.

We like the retail sectors because of the lease structure, despite the consumer recession. Retail sales have grown dramatically over the last five years, and leases are marked to market – meaning the rents are higher than when the leases were originally written. As the leases roll over, they will be able to capture that growth, despite more muted rental growth as retailers rationalize their space and retail sales growth slows or declines.

**SL:** What percentage do you have in retail investments for RWF?

**TB:** In the U.S., we have about 11% in retail, split between malls (7%) and shopping centers (4%).

You have to remember that the REITs own the best retail real estate in the United States. We are overweight in malls and bread-and-butter grocery-anchored shopping centers where there is little cyclicity, as you still need groceries, dry cleaning and Starbucks.

**SL:** Does this include community shopping centers like Kimco?

**TB:** Yes, Kimco, Federal Realty, Regency Centers and Developers Diversified are examples of names that we like. We also like Inland Real Estate which has most of its assets within a 50-mile radius of Chicago. These are dense, highly populated, high income markets with a good real estate potential, and we believe that they will continue to do well.

**SL:** We have seen good returns from the hotel sector. Do you have much exposure there?

**TB:** We have very little exposure to hotels which are the most cyclical type of property because they mark their portfolios to market every day. However, their valuations look very attractive, and hotel REITs trade at a 30%-40% discount to their net asset value and at cash flow multiples roughly half that of the REIT industry. We have owned Starwood Hotels in our open-end funds, which have a greater international exposure.

It's important to differentiate these real estate cycles with others that we've experienced in the past. Usually it's over-supply that ends a real estate cycle, not lack of

demand. Supply, in the last three or four years, has never gotten out of hand because replacement costs were moving up much faster than rents. This means that in order to build a new building, the rents needed to be higher to get an acceptable risk-adjusted return. It was, therefore, harder to build for commercial use as land was in tremendous demand for residential or other higher uses.

Construction has been below average for commercial real estate. There are pockets of supply in some markets that could affect REITs. We are not overly concerned about supply. Although demand may decline as there will be fewer jobs and less GDP growth, we still see high occupancy levels. Unless there is a long, deep recession, we feel pretty good about real estate fundamentals.

**[Editor's Note:** Investors have been dismissing the weakness in shopping malls, having previously driven up the shares of retail property 7.7%, though the sector fell 19.6% in 2007. Many malls have since shown weakness, and a few have sought bankruptcy protection. On the positive side, some retailers have plans to launch new store concepts, according to a recent report in *The Wall Street Journal*.]

**SL:** What about office sectors?

**TB:** We are more cautious. We try to stay focused on markets where there is job growth and some supply constraints.

**SL:** What cities or regions do you now prefer in the U.S.?

**TB:** We are weighted more towards the New York office market. Even assuming a 15% job loss in Manhattan, we believe the office companies there can continue to do well. It is different than 2001 or the late 1990's where companies were stockpiling space for growth. They have not taken space for future growth this time. I see less slack in the system and, therefore, less space that will come back to the market.

However, we have underwritten job losses in Manhattan and in space going back to landlords in our analysis there. New York is our biggest exposure for the RWF portfolio.

Companies have marked-to-market in their portfolios [as much as] 50%, meaning tenants pay \$40 per square foot today while market rates are \$60. There is a lot of

room for rents to decline. Still, these companies can generate respectable cash flow growth in a recessionary environment.

**SL:** What other sectors do you favor?

**TB:** We have a small exposure to multi-family units as the single-family housing market is being "challenged". Apartments are an alternative for housing. What we have done is to concentrate the portfolio in low-affordability/high-cost markets, so even if home prices come down a lot more it is still relatively expensive to own a home and thus multi-family [units] will continue to do well.

There is probably another 10% going into home price declines. In markets like South Florida and its west coast, declines of 25% or 40% are common as these markets compete with apartments. Here, the "rent versus own" equation still favors renting versus owning even when you consider the tax benefits of owning.

We like to own real estate in high cost markets like New York, Boston, Chicago, San Francisco, L.A. and San Diego. We are less comfortable with Las Vegas, Florida and perhaps Texas, where housing costs are low versus renting. That sums up the major property sectors in the U.S. We want to be in markets where the supply is constrained and where we expect demand to recover first.

**SL:** Looking at the overseas markets, when I spoke to Marty Cohen in 2007, he was excited about the Japanese office market. How is it now?

**TB:** Demand in the Tokyo office market is still strong. Mitsubishi Estates and Mitsui Fudosan have some of the best portfolios in Tokyo and the best capabilities in that region. We think Japan will follow the U.S. recovery.

**SL:** What about Hong Kong?

**TB:** We are a little more cautious on Hong Kong and China. If China slows, you could see a slowdown in the Hong Kong office market. Like in Japan, you want to be concentrated in the Hong Kong central business district. We lease space there. This district has renewed its rental rates for our office space at a 50% higher rate.

We are more cautious about the Hong Kong office outlook due to a potential

China slowdown and stress in their financial services industry.

**SL:** The slower growth in China doesn't bother us because of the recent increase in inflation there. Since I visited Hong Kong in 1997, there has been a huge boom in office towers. Do you see any oversupply in these properties?

**TB:** In Kowloon, there is a large property being developed by Sun Hung Kai Properties, which may steal demand from central Hong Kong. However, demand there is still very strong, in spite of more supply, so we think that Hong Kong will be all right barring a major global slowdown.

**SL:** What can you tell us about the U.K. real estate markets now?

**TB:** The U.K. funds have severely declined more so than those in continental

Europe. After the passing of REIT legislation in late 2006, the U.K. market had a material sell-off in 2007. However, we believe the U.K. market is over-sold and that there is good value there now. The economy is slowing, but the Bank of England is cutting interest rates to stimulate an economic recovery.

Moving to Australia, it feels a lot like the U.K. did 18 months ago. The economy was doing well, and the monetary authority is now raising interest rates to stem inflation. Their benchmark interest rate is 7.25%, and they continue to have a bias to raise rates. This will ultimately dampen economic growth and impact real estate in Australia.

The capitalization rates will have to increase as the cost of funding rises, trans-

lating into lower real estate values. Cashflow growth should slow with the slower economy. We have lowered our position in Australia and are looking for better values in the U.S. and the U.K. We think economic growth will return first to these two markets. ■

**Cohen & Steers Disclaimer:** All portfolio holdings discussed above are as of December 31, 2007, except Mitsui Fudosan, which is of March 31, 2008, and are included in our top 10 holdings for the quarter ended. The views and opinions herein are as of the date of publication and are subject to change at any time based upon market conditions. These views should not be relied on as investment advice and are not intended to predict or depict market performance on any investment. Please consider the investment objectives, risks, charges and expenses of the fund carefully before investing.

For more information on Cohen & Steers funds, including performance numbers, visit [www.cohenandsteers.com](http://www.cohenandsteers.com).

## Mobius Becomes More Active: Tries to Protect His Stock Holdings Templeton President Rallies Others to Demand Better Buyouts

Veteran investor, Dr. Mark Mobius, the Franklin Templeton emerging markets pioneer, has made a name for himself by finding unlocked values in the emerging markets. As private equity funds (such as hedge funds) are making their way into the scene, he's been honing his battle skills to protect his investments.

Trained by investment legend, Sir John Templeton, Dr. Mobius has employed fundamental analysis to seek opportunities in dozens of countries.

Dr. Mobius, well known to the readers of *The Scott Letter*, is president of Templeton Asset Management and oversees a \$47 billion portfolio (including four U.S. closed-end funds). Speaking publicly against takeover offers for companies in his portfolio, he has strongly urged fellow shareholders to demand higher prices and more disclosure.

The activist approach, rare among traditionally passive fund managers, isn't new to Dr. Mobius who has previously been vocal against inefficient management in companies in which he has invested.

Mobius is taking his activism to a new level by standing against buyout offers and rallying reluctant co-investors. As more companies in emerging markets wind up in

buyout deals, he is leveraging his resources and reputation to guard his hunting ground.

"We now have the size to influence," he says. "Most investors like us are passive and will not take action, but we're moving more and more in that direction – becoming more active."

In early March, Dr. Mobius was the first major investor in Singapore-listed drug maker, AsiaPharm Group Ltd., to announce his opposition to a 357 million Singapore dollars (USD \$256.8 million) management-buyout offer sponsored by private equity firm MBK Partners LP.

Templeton has also been trying to block a buyout of Taro Pharmaceutical Industries Ltd. of Israel by India's Sun Pharmaceutical Industries, Ltd., which agreed in 2007 to acquire management's stake in the company.

Dr. Mobius said the self-interest nature of investors makes cooperation difficult, but he recently has taken steps to unite shareholders against common opponents.

Dr. Mobius, whose fund owns 4% of AsiaPharm, said that two other substantial shareholders also plan to vote against MBK's offer. Together, the three investors own more than 10% of the company, enough to thwart the deal, conditional upon

90% shareholder acceptance unless the bidders waive the restriction. The offer was expected to close on March 31.

So far, Dr. Mobius has had mixed success in changing questionable management practices. In 2005, he sided with Dubai investor, Sovereign Global Investment, in a crusade to oust the chief executive of Korean oil refiner, SK Corp. He was unsuccessful.

In 2006, he convinced a Brazil-based company not to pay royalties to a family holding company by writing a letter to its chairman.

Dr. Mobius said that investors are handicapped in struggles against management because U.S. law prevents some mutual fund managers from signing agreements to coordinate actions.

"American Funds are afraid of getting involved in collusion," he said. "The other side has control of the company or at least has an inside position and can collude by using superior information, while minorities such as ourselves cannot."

Some of his funds' largest investments include Petroleo Brasileiro S.A., better known as Petrobras, the leading energy company in Brazil, Gazprom [a Russian

energy company] and Aluminum Corp. of China.

Dr. Mobius assigns each company he analyzes a score before making an investment and has learned to respond to managers who try to throw his investments off course.

"It always has to be a trade-off between risk and return," he said.

Stock exchanges can also put investors under pressure to accept buyout deals

because of rules that trigger mandatory delisting.

Mobius sees this as a "very strange situation where the regulatory authorities and the stock exchanges actually aid and abet the sellout of these companies at cheap prices."

"All of the shareholders are afraid they may eventually be sitting on an illiquid share which will be delisted," he said.

Recently, Dr. Mobius wrote, "Considering recent price corrections ... [it] could be a good opportunity to buy, especially if the economy is doing well." He favors China and Brazil but is aware that the Russian stock index is exposed to a correction in energy prices.

*The Scott Letter* interviews Dr. Mobius each year to update the emerging markets. ■

Source: *The Wall Street Journal*

## World Trade Decelerates Almost to a Standstill

Global trade slowed dramatically in 2008, threatening to shrink trade for the first time since the U.S. economy went into recession in 2001. The Bureau for Economic Policy Analysis, a Dutch research institute, showed that in the three months to January, world trade in goods rose at annualized rate of 0.2% over the previous three months. The equivalent growth rate in the three months to October was 6.9%.

"This is a substantial deceleration," the Bureau said. "World trade volume growth is on a downward trend."

Trade figures tend to be volatile, but even on a longer term basis, comparing the

3-month average with the same period a year earlier, the growth in goods is at its lowest since 2003.

This data appears to provide further evidence that global economic activity is slowing as growth in emerging markets has failed to compensate for weaker demand in the U.S. The last time annual growth went negative was in 2001 when the U.S. went into a recession, causing global commerce to contract.

Trade growth is consistently higher on average than overall economic growth, but it also tends to be more variable, dropping sharply during recessions.

Julian Jessop, chief economist of Capital Economics, said there were factors that might explain the weakness in world trade in recent months, e.g., disruptions to shipping and damage to Chinese trade caused by winter storms. He continued, "Global trade growth tends to do twice whatever global GDP is doing. With the world economy slowing, it doesn't surprise me that there is a slowdown in trade."

The Bureau said imports into both the U.S. and European Union fell in the three months to January, after year-on-year trade growth hit a record high of 9.7% in November 2006. ■

Source: *Financial Times*

## Financial Advisory Industry at Odds Over Rand Report: No Meeting of the Minds on How Far to Extend Fiduciary Duties

Representatives from the brokerage community and the investment advisory industry disagree about the need for all financial advisors to be regulated as fiduciaries. This was one of the findings of the annual *Investment News* roundtable, held in Washington on February 20, which centered on the financial advisory industry's reaction to a study commissioned by the SEC and conducted by the Rand Corp.

The preliminary report addressed the legal and regulatory environment faced by investment advisors and broker-dealers and whether investors understood the differences between the two channels and their obligations to investors.

A key issue was whether all providers of advice, including registered representatives or registered investment advisors,

should be held to the same fiduciary standard. Under such a standard, advisors must put a client's best interests above all else.

"Investors come in different shapes, sizes and needs," said Ira Hammerman, senior managing director and general counsel for the securities industry and Financial Markets Association. For example, investors who have concentrated stock positions in the companies for which they work may not want to diversify their holdings. He said, "That notion might be entirely inconsistent with the fiduciary duty standard, which would require diversification."

"The Securities and Exchange Commission should focus on developing disclosures that will give investors a clear understanding of what services they are

getting from all segments of the financial services industry," he continued.

While acting as a fiduciary entails more liability for financial advisors, Duane Thompson, managing director of the Financial Planning Association argued, "It is clearly a higher standard. It creates more liability for the firm and more protections for the customer. You just have to make that choice."

Ron Rhoades, chief compliance officer of Joseph Capital Management, LLC of Hernando, Florida, said, "Many clients who come to my firm from brokerage firms have been paying total fees of between 2.5% to 3.5%. We are able to reduce these costs significantly, often 30% to 70%. Investment advisors who adhere to

the fiduciary standard ought to be embraced," he said.

Most investors, when questioned in a focus group, did not understand the main differences between investment advisors and broker-dealers. About three-quarters of these investors "expressed high levels of satisfaction with their services".

"In reaction to the demand for investment advice, brokerage representatives have entered the advice business," Rhoades said. "That's a good thing, but what I don't like is the fact that they give advice without being held to the same standard of conduct [as investment advisors] .... They are allowed the use of titles like 'financial consultant' and 'financial advisor' as registered representatives do. They are not subject to the [Investment Advisor's Act [of 1940] requirements."

"Better disclosure is not enough to protect investors," said Rhoades, adding that there are differences in regulation between broker-dealers and investment advisors.

"The answer to protecting consumers is to apply the fiduciary standard (to always put the client's best interests first and foremost)," he said.

David Bellaire, general counsel for The Financial Institute said, "It is essential to maintain a distinction between broker-dealers and investment advisors in order to give investors a choice because brokers tend to be more willing to work with investors with lower account minimums."

"What I have observed is a lot of consumers just having apathy," said David Strege, chairman of the Certified Financial Planners Board of Standards, Inc.

"Part of that comes from confusion created by the complexity in financial services. We must have regulation in place that imposes action against professionals when they violate investor trust so that the consumer has confidence when they go to the professional," said Strege. "Without that, consumers will try to 'do it themselves', trying to learn through trial and error, which is a very expensive proposition."

According to the Rand report, the financial service industry is at a crossroads regarding its regulatory and legal status. The final version of the report has just been released. For more information, go to [www.InvestmentNews.com](http://www.InvestmentNews.com). ■

Source: *Investment News*

## Portfolio Manager's Review

The first quarter of 2007 gave us the weakest U.S. stock markets in 5½ years, including steep declines in the global stock markets, particularly in Hong Kong and China. Many of the foreign funds paid out large distributions early in 2008. Most of the markets we follow showed improvement by quarter-end as the positive effect of lower interest rates stabilized markets.

Strength is now particularly evident in the real estate sector, both domestically and abroad. This resulted in three of the nine Cohen & Steers funds trading at premiums at first quarter-end. However, with constant monitoring of these funds, we were able to buy shares of Cohen & Steers funds at discounts. Other real estate funds were selling at deeper discounts than these, but we would rather purchase the

Cohen & Steers funds at a narrower discount than other real estate funds because of the long experience (since 1986) Cohen & Steers has in these markets.

We sold most of our shares of The European Equity Fund and The Central Europe and Russia Fund in order to increase our cash and increase our exposure in Latin America and South Asia. We are taking a new look at the India funds as the Bombay Sensex index was the weakest of the foreign markets in the first quarter of 2008 after a huge rise in 2007. An interview with one of these funds is being considered for a future edition of *The Scott Letter*. ■

*George Cole Scott*

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