

# THE SCOTT LETTER: CLOSED-END FUND REPORT

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

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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](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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## Focus on Latin America: Their Governments Attempt to Gain More Control

A decade after winning the presidency of Venezuela for the first time, Hugo Chávez continues his “Bolivarian Revolution” based on what he calls “new 21st century socialism”.

The victory of the “bishop of the poor” in Paraguay’s presidential election expands a wave of leftist leadership across Latin America. The few remaining conservative governments – Columbia, El Salvador and Mexico – may be growing more isolated. With his country awash in petrodollars, President Chávez has little trouble supporting Latin America’s push to the political left, leading to the establishment of a new business and regulatory environment throughout the region.

“There are considerable differences between the populist left of Hugo Chávez and the pragmatic left of [Chilean president] Michelle Bachelet or [Brazilian president] Lula da Silva,” says Terry McCoy, director of Latin American Business Environment Program at the University of Florida.

“Argentina has a foot in both the pragmatic and populist arenas because the rhetoric is populist,” says McCoy. “You look carefully at the government’s policies; they’re not as reckless as the rhetoric would suggest.”

While both camps emphasize social welfare programs, McCoy says Latin America’s pragmatic left has pursued orthodox economic policies and done nothing to upset the region’s macroeconomics.

“The pragmatic left has followed the holy trinity of macroeconomic responsibility ... a floating exchange rate, fiscal discipline and inflation targeting,” McCoy notes.

He feels that while companies can still turn a hefty profit in markets with populist regimes, investors are more likely to make long-term commitments in those with pragmatic policies where the rules of the game are clearer and more business-friendly.

McCoy illustrates his point by reviewing the foreign direct investment (FDI) data for the

region, which grew from \$28 billion in 2006 to \$77 billion in 2007.

When broken down by country, those with pragmatic regimes, such as Chile and Brazil, posted a rise in FDI from \$5 billion in 2006 to \$8.5 billion in 2007.

On the other hand, Venezuela posted the region’s fastest GDP growth in 2007, but the country has reported net outflows of FDI in the past two years, while close ally Ecuador has seen its FDI dwindle from \$1.3 billion in 2001 to 2007’s scant \$400 million.

“The leaders of Venezuela, Argentina and Bolivia have adopted a populism that has inspired an extremist anti-market and anti-private property stance,” says Lawrence Kogen, president and CEO of the Institute for Trade, Standards and Sustainable Development in Princeton, New Jersey.

Venezuela, the epicenter of the region’s new left, is the most challenging business environment. It has nationalized previously privatized companies and introduced new taxes in 2007. This includes expansion of its ban on firing workers.

In a World Bank survey of nations with fewer obstacles to doing business in 2006-2007, Venezuela ranked 172 among 175 countries included in the ranking. Its currency is believed to be 50% overvalued.

“A resurgence of populism in Latin America is stirring concern among international investors,” writes Michael Patsalos-Fox, chairman of the Americas at Consultant McKinsey.

“Yet these developments should hardly be surprising, for the fruits of recent regulatory reforms, trade liberalization and economic growth have failed to reach many of the region’s people. When given the choice, they sometimes vote for politicians who promise populist solutions.”

Patsalos-Fox sees the situation as frustrating for businesses. “In our work in the region,

we see that governments frustrate business leaders,” he says. “Many of them wonder if their countries will ever grow as fast as China or India. They are tired of the excuses and lack of progress on important reforms, particularly on the macroeconomic level.”

On the positive side, he recommends companies in the region take advantage of recent economic growth and deepening capital markets to create value “by moving up the value chain in commodities or consolidating and restructuring fragmented industries.” He points out that, despite this complex environment, many companies are making lots of money.

While Citicorp reported net losses of \$9.83 billion in the fourth quarter of 2007, its Latin American and Mexican division posted net profits of \$3.6 billion. Avon Products reported a 30% year-on-year drop in net income during the same quarter, though Latin American sales were up 28% with sales in Brazil and Columbia each soaring 40%. Whirlpool’s fourth quarter earnings soared 72% in the region, with another 8% rise forecasted in appliance shipments to Latin America in 2008. Microsoft says the region remains one of the software giant’s fastest growing markets in the world, with 2007 being its best year in at least a decade.

Merrill Lynch remains bullish on Latin American equities and estimates a 26% return in local currency terms in 2008. The quality of earnings growth, according to Merrill’s analysis, will be supported by an improvement in earnings growth dispersion as credit penetration remains strong, and domestic demand and investments outpace regional GDP expansion. The firm sees a continued high price outlook for Latin American commodities and strong corporate balance sheets. It also added that the region’s economy should grow 4.67% in 2008 and 4.2% in 2009, despite a U.S. slowdown.

The International Monetary Fund (IMF) predicts 4.3% growth, while the World Bank and the United Nations Economic Commission for Latin America and the Caribbean forecast 4.5% and 4.9% regional GDP expansion, respectively.

Brazil, the largest nation in the region, had a 2007 growth rate of 4.5%, while 31% of its population was below the poverty line and there was 9.8% unemployment.

The Brazilian stock market hit a record high after Standard & Poor’s recently lifted the country’s credit rating to investment grade, citing its economic expansion and declining foreign debt.

This move was seen by President Lula da Silva as a “magic moment”. Brazil’s markets seem to agree, but amid the euphoria, everybody needs to keep a sense of perspective. An investment grade makes a country’s debt more attractive to the big funds and insurers, but it’s not a badge of development.

The Brazilian upgrade marks a wider trend among emerging market borrowers. Brazil now enjoys similar status to India, Russia and China (the BRICs) whose growth is transforming the world economy. Brazil still has a lot of work to do, if it is to join the ranks of the “first world”. This is also significant as it opens the country to a wider range of large institutional investors and could stimulate faster growth.

The future of banking in Brazil is bright as well. Banco Bradesco, the country’s largest lender, and Banco Itaú Holding Financiera, the No. 2 player, each represent the future of Brazilian banking. Bradesco ranks 17th among the world’s banks, and Itaú 20th.

At a time when share prices of global banks have been hammered by concerns about the worsening credit crisis, the Brazilians have benefited from strong performance at home and continuing appetite from international investors. Both Bradesco’s and Itaú’s shares have climbed sharply over the past 12 months, while Citigroup’s shares have plummeted.

The patrician of Banco Itaú, Roberto Setúbal, the scion of Brazil’s preeminent banking family, is the third generation to run the bank. Setúbal is seeking to build Itaú into Latin America’s universal banking champion, offering increasingly sophisticated banking and investment products to Brazil’s upper and middle classes. This consists of loans and investment services to the country’s fast growing ranks of global-minded companies.

Thus far, the Brazilian banks have come out of the global financial crisis unscathed. Unlike U.S. and European financial institutions, the “Brazilian banks haven’t been affected at all by the banking crisis – we have no assets in that business,” said Setúbal. Moreover, they enjoy high liquidity, a good funding profile (with less than 10% of funding coming from abroad) and the prospect of high lending growth.

“We believe we can expand as a retail bank in Latin America and become the leading regional bank,” the CEO tells *Institutional Investor*.

“What we are seeing in Brazil is a transformation that has turned its banking sector from a poorly capitalized, crisis-prone backwater into one of the world’s most dynamic and profitable financial sectors among the world’s emerging-markets economies,” he adds.

This rosy scenario could change if global prices for Brazilian minerals and agricultural commodities – key factors in the country’s recent GDP growth – fall because of a worldwide recession. For now, Brazil’s banks are strong on all fronts. The two leading banks have BBB ratings from Standard & Poor’s – higher than the BB+ rating it gives to Brazil.

For the entire Latin America region, domestic consumption will be the main economic engine in 2008, with private consumption expected to rise 6.5% in Argentina, 5.3% in Brazil, 6% in Chile and 4.1% in Mexico, according to Merrill. This forecast has prompted our focus on Latin American regional funds which emphasize the largest economy, Brazil.

While many of the region’s governments have increased taxes to fund social programs, the threat of further increases looms large. Furthermore, one in four Latin Americans believes tax revenues are being well spent, saying funds should be better invested to reduce poverty and maintain citizens’ trust in democratic systems.

The IMF agrees: “Increased fiscal transparency in Latin America will strengthen the investment environment and address weaknesses in fiscal management. The Fund further recommends priority be given to promoting a transparent business environment by simplifying the tax system,

reducing discretion in dealing with the private sector and reinforcing to promote investment.

“Simplified tax regimes would not only be more transparent, but it would also raise revenue collection while reducing costs. The regulations affecting business operations need to be streamlined with minimal discretion to promote fairness, permit easy entry/exit of firms and reduce uncertainty faced by businesses.”

### Washington Pumps in Cash

While U.S. companies continue to thrive under the new environment, Washington hopes money will help convince some Latin Americans to ease their mounting anti-U.S. rhetoric. U.S. president George W. Bush’s proposed budget for fiscal year 2009 includes \$2.7 billion in aid to Latin America, a 25% jump from the previous year. Most of the additional aid, however, is earmarked for mili-

tary and police activities, not for economic development.

For that, Chávez got some of his closest allies to launch the Banco del Sur (Bank of the South) last December as a multilateral regional development bank to compete with the Washington-based IMF, World Bank and the Inter-American Development Bank. In December 2005, Argentina and Brazil announced plans to prepay \$9.8 billion and \$15.5 billion, respectively, to the IMF.

“Developing nations must create their own finance mechanisms instead of suffering under those of the IMF and the World Bank,” Brazilian president Luiz da Silva said during the Banco del Sur’s launch. U.S.-led multilaterals reacted cautiously.

“As far as the World Bank is concerned, this new initiative is not perceived as a competitor,” said Augusto de la Torre, World Bank’s vice president for Latin America.

As increasingly effective banking strategies develop in Brazil, the local bankers are not intimidated by global giants such as Citicorp, which first opened a branch there in 1915 and now ranks 10th in global assets. Spanish-owned Santander is taking a more active role in buying Banespa, a major state-owned bank focused on the Sao Paulo region [of Brazil], and in October 2007, it acquired Banco Real.

The new entity should flourish in the current golden age of growth under the center-left government of President Lula, which has continued the conservative macroeconomic policies of his center-right predecessor. He has seen economic expansion accelerate to 5.4% in 2007 from 3.8% in 2006.

“The business environment is still good, even with the move to the left, but uncertainties may continue to hold back investments,” says McCoy. ■

Sources: *Global Finance*, *Institutional Investor*

## CEFA Launches Closed-End Fund Universe Data Service

Closed-End Fund Advisors recently launched its Closed-End Fund Universe data service. The comprehensive, technically-focused service was developed to provide valuable insight for investors seeking to better manage their investment portfolios. (Download sample report from [www.CEFAadvisors.com/universe.html](http://www.CEFAadvisors.com/universe.html).)

The Universe data service provides information that is either missing or hard to access in the CEF industry. It presents 24 data points covering 658 funds with 77 unique sub-groups.

CEFA recognizes that some of its readers may not be familiar with all of the data points contained in its weekly service. Therefore, in the next few issues of *The Scott Letter*, we will explain the purpose and use of the various data points. This month we cover *undistributed net investment income (UNII)* and *Relative UNII*.

**UNII** represents a fund’s net investment income, that is, the fund’s income after deduction of interest and expenses. This balance sheet item may be used to fund future payments to shareholders and is expressed on a per-share basis.

UNII can be a valuable figure for determining investment risk for income-producing funds and is typically updated quarterly on a fund’s report to shareholders. On an absolute basis, it could indicate if there is sufficient income-generation within the fund to pay out distributions.

A positive UNII figure on a fund’s balance sheet could indicate that there is investment income available for future distribution to shareholders, whereas a negative UNII could indicate a deficit in a fund’s revenue-generation to meet its distribution obligations. A negative UNII figure could potentially indicate a dividend cut or return of capital to shareholders.

The **Relative UNII** (updated weekly) is often considered a more powerful data point than the UNII in that it allows for peer-to-peer risk management comparisons. The Relative UNII considers the amount of UNII on a per-share basis and divides it by the amount of the trailing year’s income-only distribution.

For example, suppose Fund A trades at a market price of \$5 per share, and the fund currently shows a trailing 6% income-only

distribution yield of \$0.30 per share. If the same fund shows a UNII figure of \$0.10 per share, then its Relative UNII is 33.3% (\$0.10 per share divided by \$0.30 trailing income-only dividend). Fund A then has a 33.3% cushion for future income payments to shareholders.

Fund B, on the other hand, trades at a market price of \$40 per share and currently shows a trailing 11% income-only distribution yield (\$4.40 per share). If the same fund shows a UNII figure of \$0.10 per share, then its Relative UNII is 2.3% (\$0.10 per share divided by \$4.40 trailing income-only dividend).

Relative UNII is a data point useful in peer analysis. If all other information were equivalent, an investor could reduce their investment risk by purchasing income-oriented funds with the highest Relative UNII available.

In the previous example, the investor would need to consider whether an investment in Fund A with a 33.3% cushion on future income payments, as compared to Fund B with only a 2.3% cushion for future income payments, would better meet his



investment objectives. Of course, investors should not make any investment decisions based on only one data point.

With the help of analysts at Fund Data, this data has been gathered in an accurate

and reliable manner, affording CEFA's Universe subscribers easy access to the information. Next month we plan to explain in detail the 52-week and 50-day moving average relative price figures.

For more information about the use of UNII and Relative UNII in the evaluation of CEF funds, please contact [John Cole Scott](mailto:John.Cole.Scott@cefa.com) at (800) 356-3508 or visit CEFA at [www.CEFAdvisors.com/universe.html](http://www.CEFAdvisors.com/universe.html). ■

## T. Rowe Price Sees the Worst of the Credit Crunch Over

The chief executive of T. Rowe Price Group, Inc. said markets have worked through the worst of the credit crunch.

"We are out of the crisis stage," wrote CEO Jim Kennedy on April 24. He added that "government efforts and emergency measures by the Federal Reserve have helped prevent a total collapse of the global financial system.

"The rescue of Bear Stearns acquired by J.P. Morgan Chase stopped the contagion from spreading to other banks. It will take a while to work through," the CEO said, "and the economy will be slow for some time.

"We had a near-disaster on our hands, but the credit crisis has eased a bit, and we're no longer staring into the abyss.

"Although the firm's total assets were hit by 'bad markets'", the CEO said, "retail investors have continued to plow money into retirement accounts."

T. Rowe Price saw net inflows of almost \$3 billion into its target-date funds, designed to automatically manage workers portfolio allocations. ■

Source: Dow Jones Newswires

## Book Review

*Superclass: The Global Power Elite and the World They Are Making* by David Rothkopf

Each of them is one in a million. They number 6,000 on a planet of six billion. They run our governments and our largest corporations and are the powerhouses of international finance, the media and the world's religions from the shadows. They include the world's most dangerous criminal and terrorist organizations. This group of people are the global superclass, shaping the history of our time.

Today's superclass has achieved unprecedented levels of wealth and power and has globalized more rapidly than any other group. But do they have more in common with one another than with their own countrymen, as critics have argued?

They control globalization (one of the themes of *The Scott Letter*) more than

anyone else. Has their influence fed the growing economic and social inequities that divide the world? What happens behind closed doors in meetings in Davos, Switzerland or aboard corporate jets at 41,000 feet? Is it conspiracy or collaboration? Is it deal-making or idle self-indulgence? What does the rise of Asia and Latin America mean for the conventional wisdom that shapes our destinies? Who sets the rules for a group that (may) operate beyond national laws? Drawn from scores of exclusive interviews and extensive original reporting, *Superclass* answers all of these questions and more.

Taking us from the corporate boardrooms of America's most powerful companies to a dinner meeting with Russia's most notorious oligarch, from the secretive meetings of The Trilateral Commission, the Bohemian Grove to China's upstart

Boao Forum, Rothkopf clearly shows us how it really works. He is a trusted consultant who is invited to many of their meetings. His description of the annual economic forum held each January at a fashionable Swiss ski resort shows the extent of the networking of this superclass.

Rothkopf draws back the curtain on a privileged society that most of us know little about, even though it profoundly affects our everyday lives. This book is the first indepth examination of the connections among the global communities of leaders who are at the helm of every major enterprise on the planet and who control its greatest wealth. It is an unprecedented examination of the trends within the superclass, that is altering our politics, our institutions and shaping of the world in which we live. ■

## Berkshire Hathaway Publishes Annual Report, Holds Annual Meeting

Berkshire Hathaway, Inc. has published its 2007 Annual Report prior to its May 3 annual meeting in Omaha, NE. Chairman Warren Buffett gave a report about his companies, answered questions and urged his visitors to "go shopping" for some of his companies' products.

The 77-page annual report contains much of the Chairman's wisdom and has many comments about his portfolio

companies. The holding company, structured like a closed-end fund, pays no distributions to shareholders. Rather than paying dividends, Mr. Buffett solely makes acquisitions that "we believe will raise the per share intrinsic value of Berkshire's stock." This includes investments in property and casualty, insurance and reinsurance, utilities and energy, finance, manufacturing, services and retailing.

As Berkshire holds some foreign companies, we classify it as a global investment company and expect its foreign presence to increase.

"Most of our managers are independently wealthy," Mr. Buffett writes, "and it's therefore up to us to create a climate that encourages them to choose working with Berkshire over golfing or fishing. That leaves us needing to treat them fairly and in

the manner that we would wish to be treated if our positions were reversed.”

Now 84, Buffett says that he and his partner Charlie Munger, 76, “have selected four successors to manage the portfolio after my death,” adding that he has abandoned his hope to give new meaning to “thinking outside the box”.

Buffet also stated, “I also want to assure you that I have never felt better. I

love running Berkshire, and if enjoying life promotes longevity, Methuselah’s record is in jeopardy.”

Mr. Buffett is a true “value” investor. We use the Berkshire B shares as another way to utilize the philosophy behind how Mr. Buffett manages money and the principles behind it.

More information is available at [www.berkshirehathaway.com](http://www.berkshirehathaway.com). ■

## Investors Leery of Funds But Trust Advisors

Investors are not satisfied with information from (mutual) fund firms but trust their advisors, according to a survey by a division of Barclay’s Global Advisors.

The survey polled 1,004 investors with \$500,000+ in investable assets between January 24, 2008 and February 1, 2008. While 71% said they lacked trust or were uncertain about whether to trust the fund industry, 87% reported a high level of trust in their advisor, comparable to their level of trust in their physician.

The issue of satisfaction focused on whether they believed fund firms did a good job articulating details about fees, risks and tax implications.

Of those surveyed, 54% were not satisfied with the fund industry in term of articulating fees, 45% were not satisfied with

the information about risk and 61% were not satisfied with the tax implications.

Seventy percent of those surveyed had financial advisors, while only 9% of those surveyed said they were likely to change their advisor in the next year. ■

**Editor’s Note:** CEFA invests around 5% of its assets in mutual funds but only when we cannot fill the allocation with a closed-end fund. We fully disclose our fees and survey prospective clients regarding risk tolerance and tax implications. The management fees and expenses for most closed-end funds are usually much lower than for mutual funds. Based on SEC rules, they cannot charge shareholders to advertise these funds, and most investment advisors want their expenses to be as low as possible to try to achieve the highest investment performance for their clients.

## Portfolio Manager’s Review

On April 15, the markets were so oversold that we decided to put much of our cash to work. Fortunately, our timing was good: the markets worldwide rallied, and their tone improved dramatically.

Shares were purchased in the Cohen & Steers Opportunity Fund to take advantage of their exposure to the entire closed-end fund universe. We also purchased shares of Ellsworth Fund, which had lagged recently but sported the deepest discount in a long time. We started buying shares of The India Fund, but it moved up so swiftly that, in this volatile environment, we are waiting for better prices. The June *Scott Letter* will have a full report on the Indian economy.

The Latin America Equity Fund illustrates our focused region for 2008. The RMR Real Estate Fund will replace the REIT, Diamond Hospitality Co., because of its lower earnings and our desire to try to eliminate REITs from the portfolio in favor of diversified closed-end funds.

We eliminated the Central European and Russia Fund as we have concerns about this region.

Although this activity was higher than usual, we feel that our client portfolios are now in very good positions to take advantage of market trends. ■

*George Cole Scott*

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