

THE SCOTT LETTER: CLOSED-END FUND REPORT

Vol. VIII, No. 10

A Global View of the Closed-End Fund Industry

November-December 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, 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:

- Latin America Equity Fund 1
- Closed-End Funds Begin to Cut Payouts ... 5
- CEFA Universe Report: Unrealized Capital Gains, Expressed as a Percentage of NAV ... 6
- Portfolio Manager' Review 7

The Latin America Equity Fund, Inc. Reality Reaches Latin America

The Latin America Equity Fund, Inc. (AMEX: LAQ) is a closed-end investment management company launched on October 30, 1991 by Credit Suisse Asset Management, LLC (“CSAM”). CSAM also manages seven other closed-end funds, including The Chile Fund, Inc (AMEX: CH).

LAQ seeks long-term capital appreciation and invests at least 80% of its net assets in Latin American equity securities (primarily in listed securities in Argentina, Brazil, Chile and Mexico). It may also invest up to 20% of its net assets in unlisted Latin American equity securities and up to 20% of its net assets in corporate or government debt of Latin American issuers. LAQ’s largest holding is Petroleo Brasileiro S.A. which was 20.29% of total assets on June 30, 2008.

CSAM is part of the institutional and mutual fund asset management arm of Credit Suisse, one of the world’s largest financial firms. Its asset management business had \$612 billion in worldwide assets under management as of June 30, 2008.

Matthew J.K. Hickman, Director, is the lead portfolio manager for the LAQ’s assets. He joined Credit Suisse in 2003 from Compass Group Investment Advisors and was based in Santiago, Chile. Previously, Hickman was an equity analyst focusing on Latin American telecommunications companies in several Latin American country markets and an equity analyst and member of the management team for the Five Arrows Chile Fund at Rothschild Asset Management.

We interviewed Matthew Hickman on October 29-30, 2008.

Argentina

SL: The Argentine leftist government plans to “crack open the piggy bank of the pension system” because of pressures brought

on by the global financial and commodities bust. They would then have the cash needed to avoid default for the second time this decade. What are your comments?

Hickman: This is the worst signal to send. It speaks volumes about their attitudes towards the free market and private property as these accounts are individually capitalized, portable pension plans. If you were living in Argentina, you would have a pension plan and be forced by law to deduct a percentage of your salary into a 401(k) account. If you didn’t like the manager, you could move your money to



Matthew Hickman

another one. Through its plan, the government has just put their hands in your pocket and stolen the money and will be able to use it to force pensioners to buy government bonds at prices that no one else would want to pay.

SL: A travel brochure describes a beautiful picture of the capital of Argentina: “A sprawling metropolis in perpetual motion, Buenos Aires pulsates with a passionate

Latin spirit and creative energy. Known as the Paris of South America, its broad boulevards, lined with upscale boutiques, café plazas and quaint museums will remind you of Europe’s stylish capitals.”

What are the inflation and unemployment rates for Argentina?

Hickman: This is a “made up” number because inflation is controlled partly by dictate, by ringing up providers of goods and services in the CPI basket, bullying them into agreement to not raise prices, and partly by manipulating the data, firing the head of the national statistics agency and putting in place somebody they could push around.

SL: No wonder you are down on Argentina.

[**Editor’s Note:** Argentina’s government has presented its controversial proposal of

nationalizing private pension funds to the lower house of its congress. President Kirchner defends seizing of the private funds with nearly \$30 billion in assets, as the government will protect Argentina's savers amid global stock market turbulence. Economists see the takeover as a way of getting the government out of a cash squeeze and to avoid another default like in 2001.]

SL: Is this now very common in Latin American countries?

Hickman: No, Latin America today really is a totally bifurcated world. Most countries in the region – notably Brazil, Chile, Mexico and Colombia – are following a basic free market approach to managing their economies in what we have come to expect and consider as “normal” in the democratic world. Argentina, Venezuela, Bolivia and Ecuador have followed the traditional Latin American “populist” route which is neither democratic nor market-oriented.

The only countries which count, from an investment point of view, are: Brazil, (60% of the MSCI Latin America), Mexico (25% of the MSCI) and Chile (about 7%-8% of the MSCI), followed by Colombia, Peru and Argentina.

I am extremely bearish on Argentina and have been for many years. Our only holding in Argentina (Tenaris) is about 1% of our portfolio and has been reclassified as an Italian company. This means Argentina will disappear from the benchmark index. Tenaris is a market leader supplying seamless steel pipes to the oil business around the world and accounts for 70% of Argentina's weighting in the MSCI index.

Brazil

With its 190 million people, Brazil is the 8th largest world economy and is politically stable. About half of the South American territory, it has a moderately free market and export-oriented economy. Its gross domestic product surpasses a trillion dollars, the 10th largest in the world and the second in the Americas.

The Latin American Equity Fund, Inc. The Chile Fund, Inc. (As of September 30, 2008)							
	2005	2006	2007	1Q08	2Q08	3Q08	YTD
The Latin American Equity Fund, Inc. (inception date October 26, 1991)							
Market Price Return	44.10%	61.60%	42.50%	4.40%	10.30%	-31.70%	-27.93%
NAV Return	47.90%	48.70%	50.40%	-4.60%	-9.50%	-31.59%	-28.66%
MSCI Emerging Markets							
Latin American Index	50.00%	43.20%	50.40%	-1.43%	10.90%	-32.59%	-26.31%
The Chile Fund, Inc. (inception date September 27, 1989)							
Market Price Return	57.70%	2.40%	49.50%	-14.60%	-12.10%	-20.01%	-40.01%
NAV Return	1.90%	30.70%	24.70%	10.50%	-11.30%	-11.35%	-13.10%
MSCI Chile (Net) Index	20.90%	28.70%	23.10%	9.71%	-11.94%	-10.35%	-13.38%
Chile IGPA (US\$ return)	11.50%	29.50%	21.90%	8.99%	-9.36%	-15.54%	-16.57%
Chile IPSA (US\$ return)	18.70%	32.10%	24.20%	8.68%	-14.14%	-12.44%	-18.29%

SL: Previously, you were negative about the BRIC countries, of which Brazil is the first. Have you changed this view?

Hickman: I hate the word “BRIC” because it pulls together four countries with very little in common, other than the fact that they are big.

SL: I see your point, but when you look at the emerging market economies, they are not only the biggest but also the most influential in trade and political influence. People pay the most attention to them as they represent major economic powers. These emerging market countries have economic policies to retain and improve the quality of their existing jobs and to induce foreign corporations to shift production facilities and technology to them. That is why we see their importance.

What is the growth rate for Brazil?

Hickman: We should not focus too much on the growth rates. It's like the story of the tortoise and the hare; what counts is consistency and staying power over time. Regarding that, Brazil once had a “Chinese” level growth rate.

China and Brazil have completely different histories and economic structures. It would be very difficult for Brazil to grow at this rate today without generating significant macroeconomic imbalances. We are on track for a little more than 5% growth in 2008, a pretty high growth rate for Brazil.

Economic growth in 2009 is going to be much lower, perhaps as low as 3%,

given the global recession, but strong domestic demand should provide support as Brazil has a large internal market.

When you look at exports as a percentage of GDP, it is a relatively small number – only around 14%. On the other hand, when you look at the stock market, about half of the MSCI Brazil index companies are commodity-related, so the stock market is more sensitive to international trade than the wider economy.

Chile is the exact opposite. It has a much smaller internal market and is, therefore, more sensitive to international trade than Brazil. Its stock market has no companies of any significant size producing copper. You have to look at the structure of corporate profits; you cannot draw conclusions about the stock market by looking at the wider economy.

Iron ore and other metals are the key commodities for Brazil. The big question is how deep will the global recession be and how long will it last.

SL: Where do most of Brazil's exports go?

Hickman: Brazil has a fairly even pattern of trade. It sells a lot to Asia (30%), Europe (20%) and North America (20%), with the balance going to other Latin American countries. Brazil as a play on China's growth is a strong theme, but in the near term, the winds are blowing in the wrong direction.

What happens to China as we look forward? China is slowing down more than we had anticipated three or four months ago, when expectations for 2009 GDP growth was in the 9%-10% range. Today, its GDP growth is anticipated at 8%-9% with the more bearish projections down in the 7% range. This growth rate is a material slowdown, as China had been growing at 11%-12%.

China accounts for about 80% of the marginal growth in Brazilian copper. The growth percentages for other commodity products, particularly base metals, is similar. In the near term, the outlook is tricky. Longer term, however, the urbanization of China and the need for greater spending on infrastructure are very strong themes.

[Editors Note: China's output growth is at the lowest in seven years, well below forecasts, according to a recent report in the *Financial Times*.]

Having been pretty bullish on Brazil for 4½ of the five years that I have been running this portfolio, we have been underweight in Brazil since January of this year for exactly this reason. This has paid for our overweight positions in Mexico and Colombia.

SL: What about the upgrade in Brazil's sovereign bond rating to investment grade in April?

Hickman: Rating agency upgrades are completely immaterial for equity investors. It's like trying to drive forward while looking through the rear view mirror. Rating agencies look backwards and have an impressively bad track record when they try to look forward. When Brazil received the investment grade rubber stamp, it certainly led to a significant short-term stock rally, but the performance for Brazil's market after this milestone was reached has been absolutely horrible. It's significantly worse than Mexico and Chile as concerns started to mount about global growth and commodity prices.

[Editor's Note: Until recently, Brazilians might have thought they could avoid the financial meltdown, but Sao Paulo's stock market recently halted trading and economists are slashing growth expectations for 2009. Ironically, Brazilian

banks are sound. Mortgages hardly exist in Brazil, but the real has plummeted against the U.S. dollar as investors have pulled out money. This has shaken confidence in Brazil's commodity export sector.

SL: What is your assessment of the large off-shore oil find made by Petrobras, the state oil company of Brazil?

Hickman: Two years ago, Brazil went from being a net importer of oil to a net exporter. We don't know exactly how much oil has been discovered in the deep water area of the Campos basin. The estimates range up to 55 billion barrels of oil, which would catapult Brazil into one of the top 10 countries in terms of oil reserves.

SL: Is production on-stream yet?

Hickman: Petrobras currently produces 2.22 million barrels per day, but it will be another five to six years before we see any of that pre-salt oil. The find is quite far out to sea and is in very deep water (between 5-7 kilometers down). We believe that no oil company has ever drilled that deep or on that scale. There are also weather factors to consider.

The question is at what price is this oil economical? The range of oil prices varies from \$50 to \$70 per barrel. That is a pretty wide range. Oil is a scarce commodity, and although global demand is currently weakening, the supply side is still difficult. The medium term fundamentals for oil are still good in our view.

[Editor's Note: Petrobras has said it expects to be pumping 100,000 barrels a day by the end of 2010. The company stunned energy analysts in November when it reported finding up to 8 billion barrels of recoverable oil at the Tupi field, 7 kilometers (10.5 miles) below the waves.

A similar discovery at the Jupiter field may hold four times as much. Success may come at a price as now that the company has made significant discoveries, politicians in the capital might look for a bigger piece of the profits.

SL: Isn't Petrobras looking for oil worldwide?

Hickman: Yes, they have tried to become an international player, but they still have much to do on their own turf. I don't want to see them going into Angola

and Mozambique just because they speak Portuguese there.

SL: We have also seen reports that the sugar growers have encroached on the forest lands because of their expanding profits. Do they obey the environmental laws there and in the Amazon?

Hickman: I believe that there may be some encroachment, but it would be coming from informal activities, not from the agribusiness. Almost certainly not from the sugar growers who require large scale support from operators with crushing capacity. It is inconceivable to me that this is happening with larger companies.

This Brazilian government is now very vigorous in its defense of environmental standards as well as lands reserved for indigenous tribes. These days most governments are pretty keen in being perceived as environmentally-friendly. Additionally, there are dozens of foreign-funded activist pressure groups who are constantly looking for things to complain about. Encroachment is only happening today on a very small scale.

Mexico

SL: Good. Turning to Mexico, how positive are you on the Mexican economy which historically has been dependent on the U.S. for its economic growth?

Hickman: Mexico is the inverse of Brazil when you look at its stock market which is not very sensitive to international trade. There are relatively few companies that are correlated to U.S. industrial production or U.S. GDP growth. It is also quite sensitive to consumption. They have a number of large retailers, telecommunications companies and media companies.

A deep slowdown in the U.S. would have secondary effects on economic activity and employment in Mexico as 80% of its exports (e.g., oil, autos, auto parts and consumer electronics) go to the U.S. Weakness in U.S. labor markets will also lead to further drops in remittances as workers return to Mexico.

On the other hand, we think that there is good value in the Mexican stock market as it should prove more defensive than the Brazilian market in the current environ-

ment. We like the strong secular themes such as infrastructure and homebuilding. The homebuilding sector in Mexico tends to react in sympathy with homebuilders north of the border, but the underlying industry dynamics couldn't be more different. Pent-up demand for housing is very strong, almost limitless, but the problem is financing. Unlike the U.S. which is over-penetrated and over-leveraged, Mexico is under-penetrated and under-leveraged in its mortgage lending. The government has aggressive programs to support home ownership and access to credit, which have proven very successful in recent years. We expect growth to slow to the mid-teens in the months ahead.

Many Latin American governments, including Mexico, have also made significant progress in improving government finances. High commodity prices have boosted international reserves which should give governments room to maneuver in a world that is in the middle of a deleveraging process.

In 2007, the Mexican stock market was a big underperformer. In early 2008, I was buying as it looked pretty cheap. Mexico has outperformed in the current financial crisis so this positioning has worked out well on a relative basis.

[Editor's Note: Latin America's second biggest economy is getting squeezed, according to a report in the *Wall Street Journal*. The currency has plunged, and its economic prospects are dim. This has wrought havoc on the balance sheets of Mexican companies which have been borrowing cheaply in dollars since the nation achieved investment grade status. On the bright side, the government has low debt and a war chest of reserves that should prevent a full-blown crisis. Mexico has also been overhauling its nationalistic oil laws, allowing private companies to produce more oil as output has declined.]

Chile

SL: Chile is a small open economy which is commodity-dependent but has the strongest sovereign bond rating in South America. Have there been any significant changes there?

Hickman: Chile is about 4.1% of the portfolio today versus 5.1% at year-end, but it is a safe haven, with a low beta market. When you look at how the sovereign bond spreads have increased for the riskier markets like Brazil, Chile has hardly budged and has outperformed in this environment, while Brazil has sold-off heavily so its stock market has dropped less than the others.

You might wonder why Chile, a commodity-dependent, outward-looking, trade-driven economy, isn't suffering more in a world where global growth conditions are slowing sharply. The answer lies in the differences between the structure of the economy and that of the stock market. Few people realize that copper has almost no impact on the corporate profits or the economic activity of publicly traded corporations in Chile. The copper industry employs relatively few people, unlike other industries that have a lot of jobs up and down the value chain.

Chile was the first country in the region to really pioneer and invent the current model for pension reform – individually capitalized, personal and portable funded plans. They were introduced in the early 1980's and are mandatory for anyone with formal employment.

Pre-1980, Chile was heavily exposed to capital flows both in and out of the country. During the Pinochet years, nobody would lend them money so they had to save their own money. They have been successful in saving, which has created a large pool of peso-denominated, domestic, captive savings. This is a key reason why the Chilean equity market has a lower beta and is a more highly valued market than others in the region. Initially these funds were tightly regulated and were not permitted to wander far from home, but over time the government has felt confident enough to allow this pool of money to be invested in different asset classes in other parts of the world.

Now up to 40% of this money can be invested in assets outside Chile, but that still leaves 60% which is basically focused on Chilean investments. This is why the Chilean stock market is historically expensive, coupled with the fact – a separate

argument – that the macro fundamentals for Chile are outstanding. Arguably, Chile has a stronger institutional base and a longer history of this framework working efficiently.

Where are we now? As Brazil and Mexico have outperformed, Chile has become, on a relative basis, cheaper. Five or six years ago, Chile was trading at double the levels of Brazil. Today that valuation premium is much lower than it was five years ago. Chile, on a relative basis, looks cheaper. The market has been telling us for decades now that you should pay more for Chile because it is lower risk than other markets in the region. In this crisis, Chile has defensive qualities.

SL: What kinds of companies are the most profitable there?

Hickman: There are three big groups. The first is in electricity generation and distribution, primarily hydro, as well as thermal assets. Chile doesn't have much in energy resources. In the past, they have imported natural gas from Argentina. After the Argentine devaluation, investment in the energy sector dried up, and the Argentine government banned companies from exporting their gas to Chile. Chile needs to diversify its sources of energy. Ultimately that may include importing natural gas from Bolivia. There are significant political foreign policy issues between Bolivia and Chile.

There are also the pulp-and-paper and retail sectors which are very well developed in Chile.

[Editor's Note: We looked at the Chile Fund and found that it is very thinly traded so we prefer to gain exposure to this country through a regional fund like the Latin America Equity Fund or the Latin American Discovery Fund.]

Colombia

Colombia is one of my favorite stories. On June 30, 2008, it was 3.43% of the LAQ portfolio versus 2.49% for the benchmark. It has been in transition from a country under the control of terrorist groups who were financed by the illegal drug trade. Now, the government has taken a hard line and has significantly reduced

the ability of these groups to operate. People, goods and services can now move around Colombia relatively easily where once the terrorists had managed to isolate parts of the country from each other. Investment has returned, and many Colombians have come home as security has improved. Once you stabilize a country, investment can flourish. Shares in state-owned companies have been sold to the public and to the pension funds as well.

The stock market in Colombia is somewhat opaque due to the existence of cross holdings, particularly among companies headquartered in Medellin. This should change over time.

Among the investments that LAQ has made is the state-owned oil company, Ecopetrol, a benchmark stock that should attract significant investor attention from abroad. Colombia has abundant reserves of oil and gas, mostly in the Amazon area, that have been under-explored due to security issues in the country.

As an export-oriented economy, the government has been keen to avoid excessive appreciation of the Colombian peso. This has been one of the reasons why they chose to introduce controls on capital

flows, creating significant uncertainty for equity investors. This means that Colombia fell off the radar screen until recently, when capital controls were lifted.

Conclusion

It is significant that many people missed the first round of the emerging markets boom. In my opinion, the current correction is offering a rare opportunity to buy into asset classes at very low prices.

The key question is: If Latin American equities have finally been pulled into the deleveraging vortex, are we in the process of giving back historical performance? Is this the end of the boom in Emerging Markets equities or is it a wonderful opportunity to reposition portfolios for future growth opportunities? Will Latin America be the first out or the last out?

Another key is: What shape will the global recession take? How hard will the external shock be felt by Latin American economies from a contraction in international trade?

I argue that, once the dust has settled, the strong macroeconomic fundamentals which many Latin American countries have worked so hard to put in place over so

many years will once again reassert themselves.

When that happens, these markets should be the first to snap back. The region is trading and making things that people want to buy. Until such time as the credit markets and global financial markets have stabilized, it will be very hard for Latin American equities to recover in any meaningful way. When they do, as they surely will, you want to make sure that you are fully invested there.

Historically, many investors associate the Latin American region with excessive government debt. The reality is that Brazil now is a net creditor country in foreign currencies. Current account surpluses and more conservative fiscal policies have improved Latin America's external debt and liquidity.

Since I can't time markets, I think that it is highly unlikely that they will get much cheaper than they already are. My suggestion is to start buying now.

I am most excited about Brazil. As the higher beta market in the region, Brazil tends to underperform on the way down but outperform on the way up! Reality reaches Latin America. ■

Closed-End Funds Begin to Cut Payouts

Difficult markets have forced a number of closed-end funds to cut their dividends (distributions), and more are expected to do so in the coming months. The reasons for the cuts vary, depending on the strategy, but few asset classes have been spared from the tumultuous rolling markets.

"I'm starting to see and expect dividend cuts when net asset values have been cut," said Mariana Bush of Wachovia Securities. "I think there's more to come."

In some cases, funds may make substantial cuts of 20% or even 50%, Ms. Bush said.

Source Capital Inc., a closed-end fund managed by First Pacific Advisors LLC that invests mostly in stocks, said it will pay a dividend of 50 cents per share on December 15, 2008, down from \$1 in the prior quarter.

The reduction "reflects the dramatic decline in the overall stock market and the resulting drop in the value" of the portfolio and the share price, the company said in a press release. The fund had \$358 million in assets as of November 11, 2008, down from about \$509 million as of September 30, 2008.

Source Capital, which adopted a flexible distribution policy in 2004, seeks to set its dividend at a level commensurate with the return the market will provide, said J. Richard Atwood, the fund's treasurer and chief operating officer of First Pacific Advisor.

"Our long-term vision is that the market is going to be in the low to mid-single digits for the next several years," he said. "So to set a dividend level as something that's higher than that just ends up

with us giving capital back to our investors."

First Trust Specialty Finance & Financial Opportunity Fund, a \$82 million closed-end fund managed by Confluence Investment Management LLC, said it will pay a dividend of 25 cents on December 1, 2008, down from 37 cents in the prior quarter.

The fund "has been affected by the turmoil in the financial marketplace, and its distribution is being decreased to bring it in line with its current earnings", it said in a press release.

As of August 31, 2008, First Trust Specialty Fund, which invests in specialty finance and other financial companies, had more than 62% of its assets invested in stocks of business development companies. They will provide financing for small and middle market companies. The

performance of its business development company and real estate investment trust holdings were mixed in the six months ending May 31, 2008, according to the fund's semi-annual report.

Ms. Bush said that clearly certain asset classes have suffered more than others. REIT funds, for example, have suffered more than high quality government fixed income funds. So far, the magnitude of funds' distribution cuts have been somewhat proportional to their decline in net asset value.

Ms. Bush also stated that as a fund's net asset value falls due to market declines, it becomes harder to sustain the same distri-

bution. For example, if the net asset value of a fund is \$20 per share and it pays an annualized distribution of \$2 per share, it offers a 10% yield. If that fund's NAV falls to \$10 per share, then the \$2 annual distribution represents a 20% yield. Is that truly sustainable?

The worst net asset value returns in October were among stock funds. Ms. Bush noted that among both taxable and tax-free fixed income closed-end funds, the lower the credit quality of a group of funds, the worse their average net asset returns were in October.

Closed-end funds, which trade on stock exchanges unlike mutual funds, may trade

at a premium to their net asset values when they are in demand or at a discount when demand is low.

"The average discount among all closed-end funds may never have been as wide as on October 10, 2008 when it reached 24%," said Ms. Bush. Despite some hefty reductions in distributions, however, fund prices haven't reacted much. Their discounts have remained fairly stable.

"It appears that the market is already anticipating at least a good portion of the dividend cuts," she said in a November 7, 2008 report. ■

Source: *The Wall Street Journal*

CEFA Universe Report: Unrealized Capital Gains as a Percentage of NAV

In the October 2008 issue of *The Scott Letter*, we discussed [Net Assets](#), [Expense Ratio](#) and the [Average Daily Trading Volume in \\$USD](#) from CEFA's Closed-End Fund Universe. This month we cover **Unrealized Capital Gains, expressed as a percentage of NAV.**

[Unrealized Net Investment Income \(UNII\)](#), the first data point we discussed in *The Scott Letter*, is a key indicator for income fund risk analysis. In September we added **Unrealized Capital Gains** to our data service to allow for a data point to be as useful in equity fund analysis as UNII is for income fund analysis.

Capital Gains

The Investment Company Act of 1940 requires that closed-end funds pay at least 90% of realized capital gains and dividend income to shareholders annually as dividend distributions. Compliance with this provision permits closed-end funds to pass their tax liability through to shareholders so the fund can avoid paying taxes on investment income and capital gains. Therefore, the unrealized capital gains (and earned income) that a fund carries at any given time create a potential tax liability for shareholders.

A report ("Dividend Distributions and Closed-End Fund Discounts") showed that

70% of the variation in a fund's discount can be explained by changes in a fund's overhanging tax liability associated with dividend distributions. More importantly, they found changes in discounts are positively correlated with the size of the annual distributions.

The Unrealized Capital Gains data point is collected from a fund's quarterly report. To aid in fund-to-fund comparisons, we divide a fund's Unrealized Capital Gains by its net assets. The intent of this data point is to analyze three factors:

1. What is the future potential tax liability to shareholders?
2. What is the current strength/weakness of the fund's recent portfolio holdings compared to their cost basis? This is

especially important during challenging stock market environments.

3. What is an estimate of the size or percentage of potential year-end dividend distributions? This demonstrates the ability of a fund to pay dividend distributions from their realized net capital gains.

In order to give our readers an understanding of the current investment environment, we include the table below to show how the various major groups of closed-end funds, on average, stand with regards to Unrealized Capital Gains.

This information should not be considered a performance metric, as it is based on recent portfolio holdings in the funds. Once the fund sells its position, a net gain

Funds	Number of Funds	Unrealized Capital Gains as Percentage of NAV
U.S. Equity Funds	61	+5.3%
Non U.S. Equity Funds	65	+28.8%
Specialty Equity Funds	113	-3.4%
Average Equity Fund	239	+7.6%
Taxable Bond Funds	153	-15.0%
National Muni Funds	104	-0.5%
Single State Muni Funds	159	-1.4%
Average Bond Fund	416	-5.8%
Average Fund	655	-0.9%

Source: CEFA's Closed-End Fund Universe, October 31, 2008.

or loss is realized which will affect a shareholder's tax liability.

Summary

Unrealized Capital Gains is a data point that is nearly impossible to track outside of our weekly service. It is not collected by the major data providers and so allows for deeper fund comparisons so that investors and professionals can make better buy and sell decisions. This not only applies on the fund level but also on the sector level.

In the next issue of *The Scott Letter*, we plan to discuss strategies for using the 26 data points contained in our weekly data service to potentially meet general investment objectives.

For more information about the use of our Closed-End Fund Universe in the analysis of CEFs, please contact [John Cole Scott](#) at 800-356-3508, ext. 3536 or visit www.CEFAAdvisors.com/universe.html in order to subscribe to this weekly service. Investors are advised to seek professional investment counsel before investing. ■

Portfolio Manager's Review

During October 2008, a challenging period for the world stock markets, we made every attempt to reduce portfolio risks. This included sales of weaker funds and purchases of those funds that will definitely pay normal year-end distributions, rather than those that have not or will be reducing their payouts.

This included purchases of defensive healthcare funds as that sector has been outperforming the other sectors which continue to show weakness. Other purchases included a few real estate funds that have been beaten down so much that they were too tempting to miss. Some shares of the Latin America Equity Fund were also purchased.

We continue to build Templeton Global Income ("GIM") into our largest holding as we see it as a cash alternative that behaves well in these markets, especially when it is selling at a deep discount. GIM pays a good monthly dividend and has proven itself to be a strong player in these markets. We were fortunate to have purchased GIM at prices near its low for the year.

On the sell side, we eliminated nearly all Allied Capital holdings because of weak performance as well as the mutual fund Alpine International Real Estate Fund. We would much prefer to hold closed-end funds.

Regarding our asset allocations, we are out of kilter because of the larger than normal allocation to GIM. Once the

markets stabilize, which we hope to see before too long, we will adjust our allocations as we have been doing twice a year. We urge all closed-end fund investors to hang in there, as the discounts on closed-end funds are at record levels so there are ample opportunities if you are careful. The use of [CEFA's Closed-End Fund Universe](#) can be helpful in making your choices. It is possible that [John Scott](#) will work out a special deal if you want to subscribe to this excellent service before year-end.

We recently ordered three CDs: "America and the New Global Economy" taught by Professor Timothy Taylor, managing editor of the *Journal of Economic Perspectives*. The 36 lectures are divided into topics often discussed in *The Scott Letter*: the rise of the euro, China's challenges for continued growth, India's turn toward market economics, markets or populism in Latin America, improving governance, fighting corruption, the economics of global climate change, and globalization and convergence. Readers interested in these lectures may visit The Teaching Company web site (www.teach12.com) or call 800-832-2412.

This will be the last *Scott Letter* published in 2008. In the meantime, we will be preparing to interview Dr. Mark Mobius on his views of the emerging markets for the January 2009 issue. ■

George Cole Scott

Disclaimer: None of the information contained herein should be construed as an offer to buy or sell securities or as recommendations. Performance results shown should, under no circumstances, be construed as an indication of future performance. Data, while obtained from sources we believe to be reliable, cannot be guaranteed.

Use or reproduction of any or all of The Scott Letter: Closed-End Fund Report requires written permission from Closed-End Fund Advisors. All rights reserved.

GEORGE COLE SCOTT
Founder and Editor-in-Chief
Portfolio Manager

LESLIE JANE DANIELS
Copy Editor

JOHN COLE SCOTT
Circulation Manager

MAMIE WOO MCNEAL
Production Editor

The Scott Letter Online
is published by

Closed-End Fund Advisors
Global Investment Counsel
P. O. Box 1100
Richmond, Virginia 23218
(800) 356-3508
www.CEFAAdvisors.com

Currently offering managed portfolios
with the following objectives:

Global Hybrid Income
Globally Balanced
Globally Diversified Growth & Income
Globally Diversified Growth
International & REIT

