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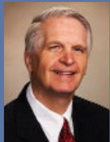
THE SCOTT LETTER is intended to educate global investors about closed-end funds. Closed-end funds can be a valuable and profitable investment tool. To learn about closed-end funds, visit our web site, www.CEFAdvisors.com, and in particular, read our article, *What Are Closed-End Funds*. Feel free to forward this newsletter to anyone who you believe could benefit from information on closed-end funds or global portfolios.



– George Cole Scott
Editor-in-Chief

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Healthcare Is A Good Defensive Place To Be Invested: Hambrecht & Quist Capital Management, LLC

Hambrecht & Quist Capital Management, LLC ("HQCM"), a registered investment adviser based in Boston, Massachusetts, is currently the investment adviser for two closed-end equity funds: H&Q Healthcare Investors (NYSE:HQH) and H&Q Life Sciences Investors (NYSE:HQL). These funds invest in growth equities, both public and private, in the healthcare and life sciences industries.

Both HQH and HQL are broadly diversified closed-end healthcare funds that invest primarily in biotechnology, medical devices, and pharmaceuticals. The funds' objectives are to provide long-term capital appreciation through investments in healthcare and biotechnology companies that are believed to have significant potential for above-average, long-term growth. Stock selection will emphasize growing emerging companies, with these companies having a maximum of 40% of the funds' assets in restricted securities of both public and private companies. Management believes this provides a unique opportunity not usually available to mutual fund investors.

Distribution Policy

Pursuant to a SEC exemptive order, HQH and HQL have implemented a fixed distribution policy. This permits the funds to make quarterly distributions at a rate of 2% of the funds' net assets to shareholders of record. The funds intend to use net realized capital gains when making quarterly distributions. This policy could result in a return of capital to shareholders, if the amount of the distribution exceeds the fund's net investment income and realized capital gains.

It is anticipated that net realized capital gains in excess of the total distributed under this policy would be included in the quarterly distribution, most likely to be declared in stock. The funds' distribution policy has been established by their Boards of Trustees and may be changed by the Boards of Trustees without shareholder approval.

We telephoned Dr. Daniel R. Omstead, President and Chief Executive Officer of Hambrecht & Quist Capital Management, LLC at his Boston office on March 25th:

SL: Since we last interviewed you, *The Scott Letter* has increased its distribution to over 2,000 subscribers in Canada, Europe and Asia as well as in the U.S. We are adding as many as 50 new subscribers each month, primarily in North America. There is no charge for the *Letter,* and we ask present subscribers to pass it along to friends and associates.

Would you tell us the major differences between the portfolios in your two funds, HQH and HQL?

Omstead: HQL favors relatively earlier stage, smaller companies, including some environmental and agricultural companies. HQH, the original fund, favors later stage and larger companies.

SL: What is your overview of the healthcare industry?

Omstead: Healthcare is a good place to be. It has long been a defensive sector producing steady returns both in good times and bad and is very solid to this point. Healthcare spending was $2.4 trillion in 2008 or about 16% of GDP, one of the biggest components of the economy. We think it will continue to produce investment success, and the funds hold a number of companies that are developing new technologies which will be both safe and effective.

SL: Your predecessor, Alan Carr, who founded the two funds, was convinced of the same thing. Isn't the industry now more political because of the specter of reforms coming

from Congress and controversies about certain drugs? Some work and some do not.

Omstead: The industry has done very well by increasing their budgets by 10% or more for the last 20 years and developing a number of new drugs. There are many drugs on the market, but the industry has turned conservative lately. It is harder and harder to find new drugs.

SL: How are the companies dealing with the fact that many drugs have gone "off patent"?

Omstead: Some of the larger companies take the mergers-and-acquisitions ("M&A") route. They are buying companies to fill pipeline gaps in the next four to five years, resulting from patent expiration.

That is one way to do it – to keep revenue growing at a reasonable rate to get at least a 10% bottom-line growth. Merck acquired Schering Plough to keep earnings near the same level.

Another way is to try to develop their own drugs, but the big pharmaceutical companies are not great at that.

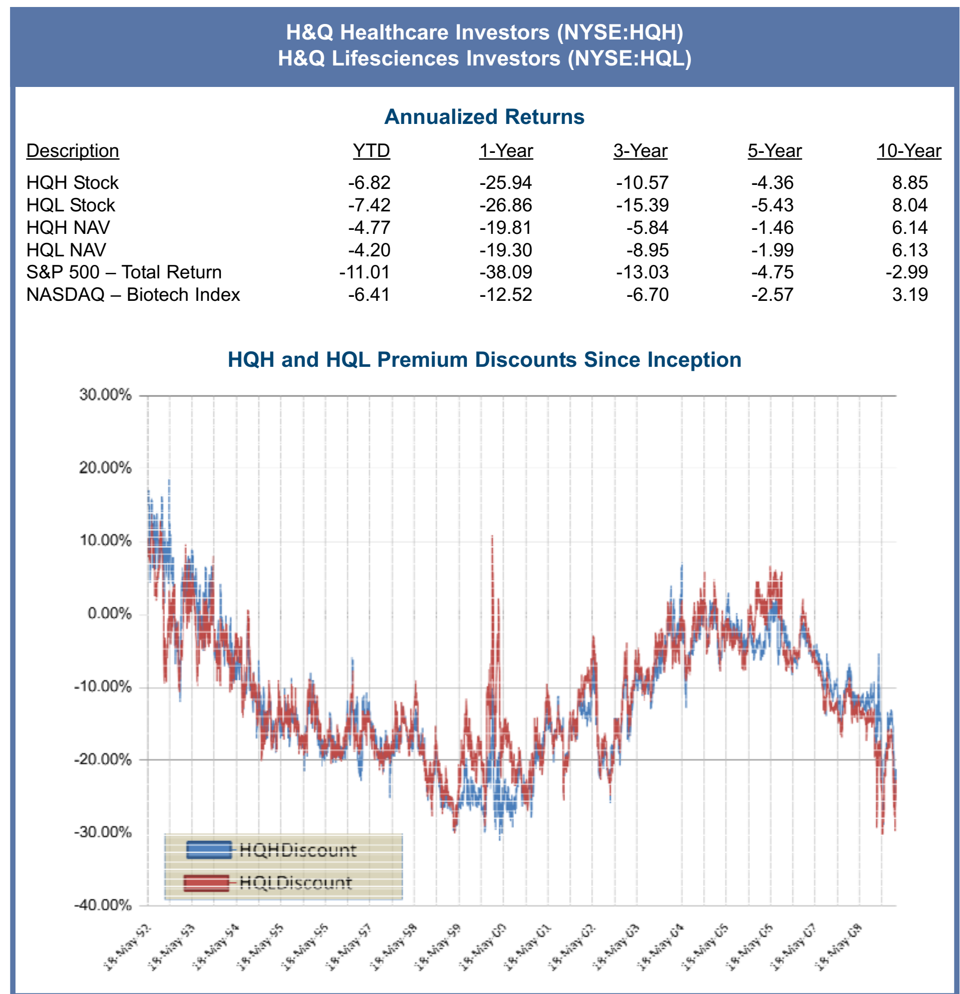
The alternative is for them to acquire smaller biotech companies which are developing novel technologies such as a compound with a niche indication that is either approaching the market or on the market.

A third trend is generics. Merck is trying to develop or acquire "bio-generics." These drugs contain compounds similar to such products as Epogen (Amgen) and Procrin (J&J's version of Epogen). This is what is presently going on and may prevail.

SL: HQH owns Amgen shares. When I was on the Board of Directors of a closed-end fund, we knew about this company before it went public. We purchased Amgen when it was a private offering and added to it substantially later. When it had its historic rise in the 1980s and 1990s, it became the largest part of our portfolio and powered our performance so much that we became known as the "Amgen Fund".

I still own a few shares. What are your thoughts on this company?

Omstead: Amgen is not a young company anymore – it probably had $15 billion in sales last year. They face the


H&Q Healthcare Investors (NYSE:HQH)
H&Q Lifesciences Investors (NYSE:HQL)

Annualized Returns

Description	YTD	1-Year	3-Year	5-Year	10-Year
HQH Stock	-6.82	-25.94	-10.57	-4.36	8.85
HQL Stock	-7.42	-26.86	-15.39	-5.43	8.04
HQH NAV	-4.77	-19.81	-5.84	-1.46	6.14
HQL NAV	-4.20	-19.30	-8.95	-1.99	6.13
S&P 500 – Total Return	-11.01	-38.09	-13.03	-4.75	-2.99
NASDAQ – Biotech Index	-6.41	-12.52	-6.70	-2.57	3.19

HQH and HQL Premium Discounts Since Inception

same problems that the pharmaceutical companies do, as they are dependent on a smaller number of products to get their growth rates. They have a new product, Denosumab, for osteoporosis in women. It is approaching the market, but Amgen is very dependent on the success of that one product going forward in my opinion.

SL: That was true for Epogen as well. However, Amgen is still the largest biotech company and is a bellwether leader in the industry.

[**Editor's Note:** Despite these concerns, Amgen recently said that it is aggressively building its sales force for the new drug. If Denosumab is approved, they will make the case for its advantages over the cheap, generic version of Merck's Fosomax.]

Omstead: Amgen was very dependent on Epogen for a long time. Drug companies, including Amgen, have to worry about meeting Wall Street expectations. It is always a balance between increasing the size of the sales force versus keeping costs down to maximize profits. As a product matures and growth slows, there is a tendency to decrease the size of the sales force. This happened to Amgen as part of the Epogen market contracted.

SL: What sectors of your portfolios are showing the best returns now?

Omstead: We think the diagnostics sector (approximately 20% of the portfolio) as represented by such companies as CardioNet and Myriad Genetics will do well. CardioNet monitors EKG and helps to diagnose heart fibrillations. This lets you know about your cardiac condition so your doctor can help you with the disease, reducing your cardiac morbidity.

[**Editor's Note:** Atrial fibrilation causes more than 70,000 strokes each year

in the U.S. Every year more than 160,000 new cases are diagnosed.]

SL: Under your predecessor, this sector was a strong profit center for HQH when the private companies went public for the first time. Have you had any recent successes in this area?

Omstead: We have both public and private companies in our portfolio. CardioNet has been a public company since 2008 and has done very well. Myriad Genomics tests for the gene that may be present in breast cancer tumors, helping women and their doctors decide how the disease should be treated. Other companies are working on diagnostic testing for other possible cancer genes.

The cancer area is where many companies are focusing now. It has done very well for them and has good prospects for the future. Most companies are looking at a combination of diagnostic testing and personalized medicine to find exactly what drug will be most effective for particular symptoms.

SL: The managed care sector was a big winner in the 1990's. How well has it done lately?

Omstead: The managed care sector consists principally of health insurance companies (HMOs) that pay for products and services in exchange for individual and group premiums. The sector did poorly in 2008 but was up at the end of the year. In 2009, it declined about 15% since President Obama made his healthcare proposals that are perceived to be negative. I am not sure that it will turn out that way. We are looking and projecting what will happen and haven't yet made a decision about this sector.

President Obama is proposing to make a lot of 2009 budget changes in how Medicare is managed, which will affect HMOs. Other proposals include importation of drugs from other countries. I think some of these proposals have spooked investors. Whenever people make changes, especially at this level, investors assume the worst and get very nervous.

We think that two things will happen. First, the proposals will not get done as originally planned, and second, you have to get everybody to agree. Ultimately, what we think will happen is that there will be a more moderate agreement. You will get a plan that improves access to healthcare without the enormous proposed changes.

This won't be as scary as some people anticipate. Healthcare will actually benefit as more people are covered, and [overall] healthcare will improve. This will play out in a couple of months, and, in my opinion, will result in good returns for the sector.

Some of the healthcare companies could be under pressure, but I think that the President's ambition to cover everyone will increase insurance coverage by about 30-45 million people. The net result is that the healthcare sector will grow as expected.

My sense is President Obama will get significant healthcare reforms done but not in one single step. He can get it done in four or five steps. By the end of his first term, a significant number of new people should be covered, and there will be some cost savings as well.

[**Editor's Note:** In late March, Congress took a big step toward clearing the way for passage of President Obama's ambitious plan to overhaul the healthcare system, but questions remain over how to pay for it, according to a *Wall Street Journal* report.]

SL: What is your opinion of the effectiveness of the FDA at this time?

Omstead: There has been a more conservative trend at the FDA with increased requirements, particularly a trend toward increased safety concerns regarding specific drug products already approved. There are particular concerns for the cardiovascular side effects for diabetes drugs. They have approved fewer new drugs because the FDA has to balance safety as well as efficacy. I am confident that the new people coming in will do a good job.

SL: What are your views about allegations that the drug companies are pushing their products onto doctors with gifts, dinners and so on? My doctor will not talk to the drug companies, but this must be a temptation for the younger doctors.

Omstead: Most of the doctors whom I know are unwilling to take anything that looks like a gift as they don't want to appear biased because they are not. The drug companies are offering fewer of these things now because they recognize that the doctors are put in a difficult situation.

SL: We are glad to hear that. We have a client in California who retired from Schering. He is now involved in researching new biotech companies in the Palo Alto area and tells us that money for new biotech ventures has nearly dried up. He said recently, however, that the situation has been changing for the better. Are you aware of this trend, and do you see any improvement?

Omstead: I think that there is very little capital for the small micro-cap companies now. Even for the companies we own, funding has been difficult. For new opportunities, there are fewer dollars chasing what is available. We think that we will be able to benefit from the lack of capital from others by making investments that have good valuations with less competition for the best deals. Our average percent of venture deals is down lately, as expected. We think that is an opportunity to get up to historic averages at very good valuations.

SL: Does that still include Gilead Sciences which Alan Carr first purchased in the 1990s and now is one of your big winners?

Omstead: Gilead is doing well fundamentally. I would say that there is a lot of value out there, particularly in specific subsectors. We have been able to buy at good prices.

SL: What subsectors look best to you now?

Omstead: We see opportunities in biotech, the diagnostics space and the medtech sector which has been hurt badly.

SL: What about the venture capital companies that have powered so much of your portfolios in the past?

Omstead: Our venture capital portfolio has done well over time. The CardioNet IPO has done very well since inception.

In our view, healthcare is a good longterm investment opportunity, particularly because of the recent decline in the equity markets. Some sectors, including those we like, have very good valuations. The biotech stocks are trading at average P/E's

in the 14-15 range, which is the lowest valuation I can recall that they have ever traded. Traditionally, these stocks trade over 20x earnings.

SL: Yes, your funds have declined with everything else this year. How long do you think it will be before you have positive returns?

Omstead: We have had negative returns for over a year, but by our estimate, there are about 150 other managed healthcare mutual funds, all of which were down in 2008. Although I am cautiously optimistic about the future, healthcare will do fine going forward.

SL: We are still in a recession so there is some evidence that consumers are skipping out on seeing their doctors because they do not want to spend the money. Will this have some long-term ramifications for their old age?

Omstead: I think that there is some anecdotal evidence that people are seeing their doctors less, but I think this is a transient issue. Most people value their health in my experience and will put it near the top of their economic commitment. I think in a few months you will see that trend reverse.

SL: I certainly hope so. With the changes in healthcare coming, that could be positive for more doctor visits as more people are covered by insurance.

Do you hold any foreign companies in your portfolios?

Omstead: Yes, Teva Pharmaceuticals is an Israeli company that is a leader in generic pharmaceuticals. It has held its own, and we expect that space to do well.

[**Editor's Note:** Teva said in mid-March that it got final approval for its generic version of its acne treatment drug and has begun shipment.]

SL: Your last report showed that you have about 5.4% invested in generics. What about the concern some people have about getting generics rather than a brand product such as Lipitor for elevated cholesterol, which they think is a better product although it is more expensive.

Omstead: I think comparative effectiveness is a great thing. If you are going to charge a premium price for a drug, it should be better than the generic equivalent. It is reasonable for the insurance company to ask you to show them that the generic doesn't work before they pay for Lipitor.

SL: How can the consumer know the correct answer?

Omstead: Your doctor prescribes Lipitor, and the insurance company says they want you to take a similar generic equivalent. You go on it for a month or two with no side effects. You then see what happens to your cholesterol. If it goes down to an acceptable level, then drug has been effective for you. If it doesn't go down, then your doctor can say to the insurance company: "The generic has only reduced the cholesterol 25%, and I need it to go down 35%. Lipitor will do that."

Then the insurance company will allow the patient to go on Lipitor. I think that is a perfectly reasonable thing for insurance companies to do. If you do it that way, only the patients who need Lipitor will get it, and the cost will be reduced for everyone.

SL: What about the expensive ads used by the big pharma companies to promote their products which have to be paid by the consumer?

Omstead: I think that [it] can be a positive for the big pharmaceutical companies as they try to promote the benefits of their proprietary products directly to consumers. Most people believe what they are told, and the companies are honest. They can tell their doctor that they like a particular drug. It is then the doctor's job to determine whether the patient will benefit, but the insurance companies will try to use the cheaper generic drug first.

SL: That is a big issue. Do you believe that the generics have improved?

Omstead: Yes, but 30 years down the road, you have to find other ways to reduce healthcare costs. That may be by using another drug that has a lower cost as opposed to the best one. I think that all of that is coming in the healthcare field.

SL: Yes, most Americans are still concerned about the high costs of healthcare which the media calls "the healthcare crisis". Let's hope it will be resolved soon.

We see that you write call options on some of your positions. Has that been profitable for you in these down markets?

Omstead: Yes, we sell call options for income in a stock that is waiting for an event or a value to be created and to increase the net returns. We write them a "little out of the money".

SL: Both of your funds are trading at significant discounts, as much as 20%. Why do you think that the market is not recognizing the value?

Omstead: Our net asset values ("NAV") have been better than the S&P index. We are a part of the significant increase in their discounts as we are on the riskier part of the closed-end funds spectrum.

Despite the upside provided by the venture portfolio, there is a transient lack of understanding of valuation. There may be some concerns about our valuation processes that I think is inappropriate.

SL: We have seen these kinds of concerns regarding those funds that invest in a large number of private companies, but we have no concerns about this issue for Hambrecht & Quist.

Do you ever repurchase shares to reduce the discounts? We have evidence from some funds that do this regularly. Adams Express and General American Investors have shown that it works.

Omstead: No, but we have a share distribution policy. We have distributed shares or cash each quarter since 2000. (For details on this policy, see page 1). Most of our shareholders think this is an effective policy.

SL: We like these programs as long as the funds do not pay a return of capital to meet the payments, which they are required to disclose. We strongly believe in the leverage of the discounts to increase the number of dollars working for shareholders. Share repurchases provide a floor under the shares and increase the NAV of the funds. Managed distributions also help reduce discounts and often raise share prices.

It is tough, however, when the discounts continue widening as yours have done lately. This is a good reason to repurchase shares, especially when they sell at such deep discounts as your funds do.

Omstead: That situation should improve if the markets continue to

strengthen and if the President's proposals pass, thereby improving the overall healthcare situation.

SL: One thing we noticed on the charts we have is that before the start of the recent rally there was significant volume in HQL. Perhaps there was a large seller, but when the prices of HQL improved, the volume dried up. Have you noticed this?

Omstead: I think that when you reach a bottom you get a lot of capitulation in stocks and in the market in general. Maybe that is evidence of new people wanting to come into the stock market.

Our funds are equity-based, and we are expecting that the stocks will move up as we think they represent good values.

SL: We agree that your funds represent good values. We have stepped up purchases of both HQH and HQL for our clients. We look forward to seeing better performance from your portfolios as the stock markets improve.

Now it is about time to wrap-up this very informative interview.

Omstead: Thank you for the opportunity; it has been a pleasure. My take on the world is that healthcare is a really good place to be long-term. Demographics clearly indicate that as people get older, they are consuming more healthcare products, as diabetes and obesity are increasingly becoming a healthcare burden.

We think that all of this will increase utilization and, therefore, revenue for the healthcare sector. As a result, we think that this is one of the truly reliable spaces where you can account on growth of revenue and income in a sector that counts for 16% of the GDP. In my view, that is why you want to have some of your assets invested in healthcare.

We think healthcare in general is a place to invest and that our funds, HQH and HQL, are well-diversified and focused on growing companies that will produce revenue and income. ■

Disclosure: George Cole Scott and his family own shares of HQH and HQL.

Daniel R. Omstead, Ph.D., is President and Chief Executive Officer of Hambrecht & Quist Capital Management, LLC. He is also President of H&Q Lifesciences Investors and H&Q Healthcare Investors. Prior to joining HQCM, Dr. Omstead was President and CEO of Reprogenesis, Inc., a private development stage biotech company developing therapies in the field of regenerative medicine. In 2000, Reprogenesis was merged with two other biotech companies to form Curis, Inc.

Before joining Reprogenesis, Dr. Omstead was Senior Vice President of Research and Development at Cytotherapeutics, Inc., a public biotech company that developed CNS therapies. Prior to entering the biotech industry, he was employed for 14 years in the pharmaceutical industry at Ortho Pharmaceutical Corporation and R.W. Johnson Pharmaceutical Research Institute (both are divisions of Johnson & Johnson), Merck and Sharpe and Dohme Research Laboratories (a division of Merck and Company, Inc.). While at J&J, Dr. Omstead participated in the development of biological products, and at Merck, he worked on the development of other traditional drug products.

He holds Doctoral and Master's degrees in Chemical Engineering and Applied Chemistry from Columbia University and a B.S. degree in Civil Engineering from Lehigh University.

Ten Reasons to Consider Global Funds

Funds that invest globally are looking like savvy buys right now.

Conventional wisdom says international stock markets are much more "risky" than Wall Street.

Many Americans agree, judging by their investment choices. According to data from the Investment Company Institute, American mutual fund investors hold more than three times as much in domestic equity mutual funds as they do in funds that invest internationally.

As investors have fled the market, they have been cashing in their overseas stock funds proportionately (twice as fast as their domestic funds). After all, global funds faced a double whammy last year. Equity markets declined almost everywhere, and a strengthening dollar made foreign assets worth less to U.S. investors.

But is the conventional wisdom right?

There are ten reasons to think that it isn't. If you are looking to get back into the market, it may actually be safer to buy a "global" fund than one which only invests in the U.S.

Consider the following:

1. You have plenty of exposure to the U.S. economy already. You work here. You may own a home here, as do most of your friends and family. You hardly need to double down.

2. Investing in one country increases the so-called "Japan" risk, i.e., the possibility that your investments may languish in a single, ailing stock market, as happened to Japanese investors after 1989. But those who invested globally were able to profit from rising international markets.

3. The days of the almighty dollar look numbered. Yawning federal deficits are again raising questions about the greenback. Ultimately, the dollar will sink again, and when it does, U.S. investors owning foreign equities will benefit.

4. The U.S. stock market is the biggest and best known market in the world. Thus, it is more likely to be overvalued than foreign markets. That's bad news for investors. The domestic market trades on 1.7x book value, while the rest of the world trades at 1.1x.

5. The "foreign is risky" argument dates back to the days when very few foreign countries were capitalistic. Today that view seems woefully out of date and somewhat ridiculous.

6. That argument also dates back to when the U.S. accounted for half of the

global economy. Today it accounts for about a quarter. Restricting your investments to that small share of the pie makes no real sense.

7. Even if we avoid a further economic meltdown, the U.S. economy is still struggling with a mountain of debt. Asian economies, on the other hand, have mountains of savings. Choosing to bet on the former and not the latter is a gamble.

8. Investing globally ensures you are exposed to fast-growing emerging markets as well as older, more developed ones. Who knows which economies will boom over the next decade?

9. While many international markets have been worse investments over the past two years, over longer periods of time, the picture is better. Someone who invested all their money on Wall Street 10 years ago would still be down 3% today, even when you include reinvested dividends, according to FactSet. Someone who shunned Wall Street and invested overseas would be up 38%.

10. Global investing has minimized risk at key moments in the past. Many economists say that investing globally would have greatly helped investors even during the great crash of 1929-1932. Even when including reinvested dividends, U.S. markets lost about 69% by the lows, while global markets overall gained about 53%.

Of course, back then it was hard for private investors to invest in overseas markets. No wonder most investors had to stick to Wall Street and got canned. Today there are a legion of global mutual and exchange traded funds that anyone can buy. ■

Source: The Wall Street Journal

[**Editor's Note:** We agree with the author of this article that the foreign markets, especially the emerging markets, have better valuations than most U.S. stocks and are consequently buying funds in this area. We prefer regional rather than single country funds to access these markets. The most comprehensive fund for the emerging markets is the Templeton Emerging Markets Fund (EMF), which has a large exposure to Asia. We interview its manager, Dr. Mark Mobius, each year. These interviews are available on CEFA's web site.

David Swensen's Guide to Sleeping Soundly: Financial Wisdom for Troubled Times from Yale's In-House Warren Buffett

Yale's Chief Investment Officer, David Swensen, raised the Yale endowment from a little more than $1 billion in 1985 to $22.9 billion last June. Today, it is worth about $17 billion. He has had 20 consecutive positive returns in the stock market.

This editor met Mr. Swensen at the 2007 CEF Institute Annual Conference in New York. We were delighted to learn that he uses closed-end funds in some of his portfolios.

Swenson influenced us mostly on the concept of rebalancing portfolios for investor protection as well as to increase returns. We found that his strategy worked well for us during normal times, but when we have stock markets like we have seen in the last 18 months when every sector fell, it is more difficult, as Mr. Swensen admits.

In the March/April 2009 issue of the Yale alumni magazine, Swensen writes that after his equity holdings went down step-by-step with declines in the market, he continues to recommend that investors rebalance.

"Rebalancing is even more important amidst these huge declines in the stock market because it presents a great opportunity. People can sell their Treasury securities that have appreciated dramatically to bring their allocation to the 15% range, and they can then redeploy those funds into domestic and foreign equities, emerging markets equities and real estate investment trusts – all of which are now cheaper and hence have higher prospective returns," he said.

Swensen sees that asset allocation is the tool you use to determine the risk and return characteristics of your portfolio.

"It's overwhelmingly important in terms of the results you achieve. In fact, studies show that asset allocation is responsible for more than 100% of the positive returns generated by investors," he said.

Should people be afraid of stocks now?

"Not only should they not be afraid, they should be enthusiastic. One of the great ironies is that if you had talked to the average investor 18 months ago, he or she would have thought it was a pretty good idea to buy stocks. In recent months, the same investors despair about their portfolios and are fearful about putting money into the equity market.

"That's 180° wrong. They should have been cautious 18 months ago, when prices were much higher than today. They should be enthusiastic today."

Swensen now recommends that investors have 15% of their assets in real estate investment trusts and raise their investment in emerging stock funds to 10%.

Mr. Swensen says that he is "cautiously optimistic" that we will have some sensible regulatory reforms prompted by this economic and financial crisis.

Should young adults have hope?

"I am an incredible optimist. We should be careful not to underestimate the resilience of this economy. I think we could have, in the next couple of years, a very hard slog. Looking 5-10 years down the road, I'm very optimistic that we will come out of this strong and better."

We recommend his book, *Unconventional Success: A Fundamental Approach to Personal Investment* (Free Press, 2005) to better understand how Mr. Swensen used periodic rebalancing portfolios to become one of Wall Street's most successful investors. ■

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Finally, Global Markets Are Going Their Own Ways

Global stock markets are striking out on separate paths, in contrast to the universal collapse in 2008.

There was a wide divergence in market performances in the first quarter of 2009, with results ranging from poor to middling to stellar.

Shares in developing countries like China and Brazil will outpace those from developed regions like the U.S. and Europe. That marks a change from late 2008, when global stocks crumpled.

While one quarter doesn't make a trend, the divergence could be a sign that some of the fear gripping investors around the world is abating, even if the economic picture remains grim.

The Dow Jones World Index, excluding U.S. shares, fell 12% in dollar terms compared with a 13% drop in the Dow. A Morgan Stanley index tracking emerging-market stocks rose 0.5% in dollar terms and 4% in local currency terms.

The benchmark indexes of Russia and Brazil both jumped 9% in local currency terms, while India's index edged into positive territory. China's domestic stocks led the pack with the Shanghai Composite surging 30%, even though it fell 65% in 2008. Analysts say that there are signs that the Chinese economy is stabilizing.

In Japan and Canada, declines were more modest compared to the U.S. In Europe, declines were in tune with or worse than in the U.S. ■

Source: The Wall Street Journal

Portfolio Manager's Review

In early April, there has been more optimism about the economy, with the Dow Jones Industrial Average moving above the 8,000 level, after an impressive fourth straight week of gains. The NASDAQ composite also finished up 1.6% for 2009 at the same time.

There is clear evidence that the markets were oversold during the first quarter. Now that there has been better-than-expected economic data, a relaxation in bank accounting rules and reassurances from the world's finance leaders at the recent G20 Summit, we are the most positive we have been in a long time.

This aggressive four-week rally, the best in 70 years, comes as the first quarter earnings season begins, and unemployment data continues to show weakness in the U.S. economy. Year-to-date data (to April 3) showed positive 2009 returns for Brazil, Canada, China (up 32.9%), Hong Kong, India, Singapore, Korea and Taiwan.

In order to have more cash for equity funds, CEFA has been reducing bond fund exposure. During March, we significantly increased our exposure to Asia, adding to the Asia Pacific Fund. Other funds we increased included H&Q Health Sciences Fund and H&Q Healthcare Investors.

In the foreign sector, we increased Templeton Emerging Markets Fund.

We sold all of our shares of Berkshire Hathaway Class B and the Cohen & Steers Worldwide Realty Fund, as these funds eliminated their distributions. Most of the Ellsworth Fund was sold in favor of its sister fund, Bancroft Convertible Fund.

Despite continued volatility, we see more positive signs that the U.S. recovery is starting to take hold. As Mark Mobius pointed out to us in December of last year, once the U.S. recovers, so will China. China will again be a key driver of global demand for commodities as the recovery continues. ■

George Cole Scott

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Globally Diversified Growth & Income
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International & REIT