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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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Asia Pacific Fund: China Is the Envy of the Whole World

CEFA interviewed the portfolio manager of The Asia Pacific Fund, Khiem Do, by telephone on April 28.

SL: How are the Asian markets doing after one of the worst bear markets in history?

Do: In 2008, the MSCI World index, in gross USD terms, fell by 41.8%, while the MSCI Asian ex-Japan index fell by 52.2%. The Asian markets have been recovering strongly since early March. Exports are gradually recovering as well after a difficult year for all equity markets, including those in Asia.

SL: Please update us on the impact of the government stimulus programs in China, Malaysia, India and other countries in the region.

Do: Government stimulus programs announced by Asian governments over the past six months to address the impact of the global financial crisis and recession vary from a low 0.6% in India to a high 15% in China. As a percentage of their 2009 GDP forecast, we have Indonesia +1.5%, Thailand +1.7%, Taiwan +2.2%, Philippines +2.5%, Malaysia +9%, Singapore +8.5% and Korea +6.8%.

In the ASEAN bloc, while Indonesia and the Philippines have been able to escape a recession, Malaysia, Singapore and Thailand have had to cope with a recessionary environment. Except for Indonesia, these markets have lagged behind their northern neighbors.

In USD terms, the worst year-to-date performance (as of April 28, 2009) came from Singapore (-1.7%), Thailand (+2.2%), Malaysia (+5.5%) and Philippines (+6.6%). Indonesia shone with a +21.3% return year-to-date.

Additionally, the Asian markets continue to trade at reasonable valuations. For the region, we have the following metrics: 15.7x 2009 estimated P/E (based on forecast of EPS falling by 11% this year, after a decline of 22% last year), a 2009 return on equity of 9.3% and trailing dividend yield of 3.5%.

In 2010, the IBES stock analysts project a sharp EPS recovery for Asia, led by a return to positive growth in Taiwan and Korea.

SL: How has the "trickle down" effect impacted the rest of China in view of the global slowdown after the Olympics?

Do: The effect of the global slowdown was felt the strongest in Guangdong, Shanghai and the export regions of China.

SL: Press reports show that many of the Chinese people were sent back to their villages after the economic boom of the Olympics and are now unemployed. Is this true?

Do: Yes, the unemployment situation in some parts of China has worsened from 12 months ago, especially since the export and construction slowdown. That's why the government has decided to implement its huge construction program, equivalent to about 15% of GDP.

SL: What global growth rates do you expect for 2010?

Do: Asia should enjoy a higher growth rate than 2008 and 2009, but lower than 2007 (about 6%-7%.). Barings' global economics team forecasts a continuation of solid growth in China and India. They also see a mild recovery in 2010 for the G7 economies (Canada, France, Germany, Italy, Japan, United Kingdom and the United States).

SL: What is the status of monetary easing in China as well as the expected inflation rate for 2010?

Do: China's monetary policy is very accommodative. Since January, bank lending quotas have been abolished. This, together with lower interest rates and the release of more funds to the banking system via cuts in the reserve requirement ratio, has significantly boosted bank lending growth in the 1Q09 to a growth rate of over 25% per annum.

One note of caution: Not all the bank lending growth is new. Some of the activity reflects a switch from bill financing by corporations to bank lending, such as for financing arbitrage.

SL: Has the allocation for the Asian Pacific Fund (APB:NYSE) increased or decreased for China and Hong Kong since your March 31, 2009 report?

Do: We have been overweight in China for two years now because it is the only country we see growing strongly in 2009. This is expected to continue into 2010 as valuations are not expensive.

Overweighting China has been a consistent theme for APB during the past two years, based on our long-held view that China is the envy of the whole world as a growth leader. There have been undemanding equity valuations since its stock market bottomed in the fourth quarter of 2008.

As of March 31, 2009, the Fund's weighting in China was 33% (overweight relative to the benchmark index) while Hong Kong was 11.4% (underweight).

China's stimulus package, while somewhat helpful to exporters to China from the rest of Asia and the world, will not be a panacea for the latter. China's GDP is still only about 6%-7% of world GDP, while its consumer spending is only equivalent to about a 1/10th of its U.S. counterpart.

Thanks to growth in China and India, Asia slowed down without a recession. Asian exports were hard hit by negative external developments, notably the global financial crisis, the G7 recession, and by a tight China monetary policy. A number of Asian economies, heavily dependent on global trade from the financial sector (notably Hong Kong and Singapore), followed the G7 trend and slid into recession since mid-2008.

Relatively speaking, China continued to be the "Cinderella" growth story. Its economy has been recovering strongly, thanks to the government's swift implementation of the massive infrastructure spending program. China's domestic economy was boosted by the abolition of bank lending quotas and lower interest rates which gave a strong boost to the residential property and construction sectors.

Khiem Do

Khiem Do has 30+ years of investment experience and is responsible for the management of portfolios for clients located in Asia. He was appointed to be a member of the Strategic Policy Group, Baring Asset Management Company's global macro research and asset allocation team in 2006 and headed the Asia Pacific Specialist Investment Team from 1997-2006. He has co-managed the Baring China Absolute Return (long-short hedge fund) since July 2004.

Khiem joined Baring Asset Management in 1996 from Citicorp Global Asset Management in Sydney, as the Australian Chief Investment Officer, chaired the Australian Asset Allocation Committee and is a member of the CGAM International Asset Allocation Committee. Prior experience includes seven years at Bankers Trust Australia and seven years at Equitilink Australia Ltd.

Khiem received his B.A. in Economics (Honors) from Macquarie University and is an Associate Member of the Securities Institute of Australia. He is fluent in English, Vietnamese and French.

The Asia Pacific Fund
Performance* as of March 31, 2009

Market Price (USD) Return Gross	1 Year to 3/31/2009	3 Years to 3/31/2009	5 Years to 3/31/2009	7 Years to 3/31/2009	10 Years to 3/31/2009
Asia Pacific Fund - NAV	-45.1%	-13.7%	24.2%	61.0%	122.3%
Asia Pacific Fund - Price	-42.0%	-2.6%	35.2%	88.1%	172.9%
MSCI AC Far East Ex-Japan	-42.7%	-16.3%	19.5%	52.4%	62.1%
MSCI World	-42.2%	-34.8%	-14.1%	-5.5%	-16.5%
S&P Composite 500	-39.7%	-38.4%	-29.2%	-30.5%	-38.0%
MSCI Europe	-49.6%	-36.0%	-6.3%	7.9%	-5.6%
MSCI Japan	-35.9%	-43.6%	-23.8%	5.8%	-21.4%

*Investment involves risk, and past performance figures shown above are not indicative of future performance.

As a result, the 8% GDP target established by the Chinese government appears to be quite achievable, despite much skepticism earlier this year by many observers. The Shanghai and Shenzhen stock markets have also performed well, thanks to the commitment by the government to achieve around 8% growth in 2009 and beyond and the recent bounce in economic activity.

[**Editor's Note:** China's two stock exchanges now include its version of New York's NASDAQ. The largest and oldest exchange is located in the financial capital of Shanghai while the second is located in the southern city of Shenzhen, across the border from Hong Kong. Beijing has now opened a "Growth Enterprise Market" (GEM) in the booming city of Shenzhen. GEM will allow companies with just three years of operation, net assets of $20 million renminbi (just under $3 million USD) and combined profits of $10 million renminbi to sell stock to the public.

That says a lot about the economic competence – and the confidence – of the Chinese as its leaders see the global downturn as a chance to expand its reach in capital markets – to grow while others are faltering. (Source: *Newsweek*)]

SL: Is it true that the domestic retail business in China is suffering because saving rates are so high?

Do: Yes, to a certain extent. At the national level, however, retail sales in China continued to grow solidly, up about 10%-11% year-on-year in real terms in the past 12 months. The people have to save for sick days and their old age, but they are spending. China is growing quite nicely now, but there are problems in the export-related provinces.

[**Editor's Note:** If the U.S. economy consumed too much, China is spending too little. In recent years, the Chinese savings rate has risen as high as 50% of GDP. Even families with incomes of less than $200 a year still saved 18% of their income. One of the main underlying causes is the weakness of the social safety net. Many Chinese put a large chunk of their wages into bank accounts because they are worried about pensions, education expenses and, most of all, the prospect of a big hospital bill if a family member falls seriously ill. (Source: *Financial Times*)]

SL: How much has the weak U.S. economy hurt China's exports?

Do: Exports to the U.S., Europe and Japan have slowed down dramatically, but they should pick up again as the developed economies restock due to low inventories.

SL: Dr. Mark Mobius of Franklin/Templeton Investments and the founder of emerging markets investing, told us in December that China realizes it cannot depend on export-led growth and consequently has been stimulating domestic consumption for growth.

In the last few months, we have seen rising oil and copper prices. Do you see a new global commodity boom cycle?

Do: It is unlikely that the current recovery in China will cause another commodity boom anytime soon. One needs to see a strong resurgence of sustainable growth in the OECD as well as in the other emerging nations. However, commodity prices are unlikely to make lower lows than those recorded over the past six months.

SL: That should mean higher prices. We note some improvement. Crude oil prices are rising now that there is more confidence that the global recovery is taking hold. The Baltic Dry Index has now risen to its highest level in 2009, due to rising demand from China, raising freight costs for dry bulk commodities such as iron ore, coal and grains.

[**Editor's Note:** The Baltic Dry Index (BDI), a measure of freight costs widely watched as an indicator of the global economy, shows that the BDI hit a fresh high for 2009 on May 21. Strength in iron imports to China from Australia, Brazil and India were stimulated by the lowest prices since 2005. (Source: *The Wall Street Journal*)]

SL: What can you tell us about trading volumes in the region's stock markets?

Do: Daily volumes in Asian markets have, on the average, returned to normal. The daily turnover on the combined Shanghai and Shenzhen stock exchanges may now be higher than the NYSE.

SL: Really! Besides China, which countries in the region do you favor now? Where are you most negative?

Do: APB has been overweight China, Taiwan and Singapore for two years now and underweight Korea and Malaysia. China is the only country that is expected to grow strongly in 2009 and possibly in 2010. Low stock valuations make it likely we will maintain China's overweight.

SL: Foreign fund managers in China expect the assets they manage with local partners to double in the next three years, along with the number of retail investors they serve. This renewed sense of optimism is despite continued global financial problems, according to a survey conducted by Price Waterhouse Coopers.

Please update us on Korea.

Do: The Korean equity market has done well year-to-date. The Kospi Index rose by 7.2% in USD terms through April versus the S&P 500's decline of 5.1%. Although the Korean economy is currently coping with its own recession, the recent emergence of what is called the "green shoots" of world economic recovery, together with a pick-up in the price of technology components and a very competitive Korean won, have benefited its stock market.

[**Editor's Note:** The Bank of Korea has kept its benchmark interest rate unchanged at an all-time low of 2% for a third consecutive month amid growing signs the economy is improving. The Korean stock market has gained 27% in 2009 (to June 12) after dropping more than 40% in 2008. The state-run pension fund, the world's fifth largest, also plans to resume overseas investments in June, encouraged by the won's sharp appreciation against the U.S. dollar. The fund holds more than 5% in 107 Korean companies, including Samsung and Posco. (Source: *Financial Times*)]

SL: Taiwan stocks were 18.3% of the portfolio on March 31, 2009 versus 15% in 2008. Has there been any change there?

Do: We have added to Taiwan because technology stocks in Taiwan were so cheap and so unloved by investors six months ago when technology stocks were out of favor. This gave us an opportunity to buy at very good prices. Over the past six weeks, they rallied strongly. In Taiwan, despite its economic recession, the stock market has also performed well, rising by 18.4% year-to-date, boosted by the better than expected technology corporate results and news flows, as well as an improved sentiment among the local investment community.

SL: What about Singapore?

Do: We have reduced our investments in Singapore because we don't see many earnings surprises there, redirecting the money into Taiwan and Korea.

SL: How does your view of the region fit into the growth of the 10 ASEAN nations of Southeast Asia? The group recently agreed to an integrated economic community similar to the European Union.

Do: I doubt whether Asia will be successful at creating a common trade and currency bloc, similar to that in Europe as the euro is more political than economic. The political, social, cultural and economic fabric of each country is too diverse to influence the formation of such a trading and monetary bloc. Trade between the eight countries is quite good as these countries have been trading with each other for about ten years.

Asia has played a starring role in the story of globalization. This has given the Asian economies some of the fastest growth rates in history, cushioning some of the impact of the global economic crisis as well as limiting the region's total subprime losses.

SL: The strong financial positions of Asian countries cannot compensate for the long-term problems with the region's growth model as the global recession continues despite Asia's strong financial position. What are your comments?

Do: To a certain extent, that's true. Asia has been a very efficient manufacturer and outsourcing center for many corporations in the developed and emerging nations. The Asian governments can try to boost their domestic economies by pulling their fiscal and monetary levers for a year or two. In the longer term, if the U.S. and other G7 nations were to remain in a recession, Asia will definitely suffer as well.

There is little doubt that the growth engines of China, India, Indonesia and Vietnam will still be running strong for many more years. The Asian region will likely continue to achieve a much higher growth rate than Latin America, eastern Europe or Africa, let alone the struggling G7 Developed Economies bloc.

Please note that a sustainable bull market in equities does not have to be based on a strong economic growth rate. What is needed is a balanced growth rate, ideally funded by a healthy banking system and a balanced current account, based on high labor productivity.

We think that Asia can achieve that, having continuously restructured their economies over the past 10 years, after the shocking 1997-98 financial crisis. Asia is also blessed with favorable demographics and fertile lands, which will allow the basic needs of each household to be met at relatively affordable prices.

Most Asian countries have either surpluses, or the banking system is not too leveraged. The loan/deposit ratio in Asian countries is about 75%-80%, much lower than in other countries.

Even banks in Indonesia, the Philippines and Korea are working normally, paying off their loans and interest, whereas in the U.S. and Russia, people are defaulting left and right. Asian bank lending is proceeding as normal, and it was the only region in the world where credit did not stop as there is plenty of money to lend.

SL: Cash distributions are important. APB paid two large distributions totaling just over $15 in 2007 and 2008 from realized capital gains and income. Prior to the ex-dividend date, The Asia Pacific Fund was selling around $12 per share. As a result, we decided to sell all of our shares in late 2008 because we didn't want to have a $5 stock in a declining market. We usually take the distribution in cash rather than shares in order to have the choice to either build-up cash for other opportunities or invest it in the same fund at better prices.

We decided to wait until APB was selling near the $5 level, and then we repurchased shares. This resulted in good timing, as the Fund has now risen sharply. Has the APB board ever considered paying the distribution in shares as many other funds offer to do?

Do: We did discuss that option, but there were legal complications. That option would have involved paying out 20% or 30% of the distribution in cash and the rest in shares.

SL: Some funds do that. When I served on the Board of Directors of a closed-end fund for 26 years, I was more aware of dividend reinvestment plans.

One cannot accurately predict the income distribution of a fund, although the *Closed-End Fund Universe* data we publish weekly, is available to subscribers. It reports unrealized capital gains and gives other important data to subscribers.

As you know, both mutual funds and closed-end funds have to pay out income and realized capital gains on a yearly basis or reinvest it in new shares.

As a watchdog for the industry, we are aware of the desire now for all investors to have a steady cash flow in terms of what is called "managed distributions". Are you aware of this trend?

Do: The Asia Pacific Fund pays all of the income earned/realized on a yearly basis, based on strict accounting and regulatory rules. Hence, we do not get involved in "managed income distributions".

SL: It can be difficult for a foreign growth fund to do this, but some funds covering the emerging markets make more frequent distributions.

Do: You should note that the distributions can include unrealized as well as realized capital gains. It is too early to tell now what will be paid out in 2009.

SL: What conclusions do you have for the region?

Do: The Asian markets were sold down too much last year. We have seen a bounce of 14%-15% year-to date, but I think that there is more to go in the Asian markets over the next 6 to 12 months because the global economies will be recovering. China is now powering ahead, and India will follow at some stage. There are more gains to be had in Asia.

Regarding Hong Kong and China, there has been such a strong rise since the 27th of October, that there has been some profit taking at these levels. I think, however, that these markets will continue to rise over the next 6 to 12 months.

Hong Kong and China are the markets to buy on weakness.

SL: If that is true, your shareholders could expect a good distribution for 2009. ■

Some clients of Closed-End Fund Advisors hold shares in The Asia Pacific Fund.

Prudent Chile Thrives Amid Downturn

During the emerging markets' commodities boom a few years back, Chilean Finance Minister Andres Velasco was a wet blanket at the fiesta.

While Chile, the world's largest copper producer, was reaping a bonanza from the quadrupling of the metal's price, Velasco was squirreling away over $20 billion into a rainy day fund.

The 48-year-old Velasco, wary that a flood of copper income could generate consumption bubbles, stood his ground. Latin American history, he cautioned, was full of "booms that had been mismanaged and ended badly".

Today, Velasco looks like a prophet. Since the onset of the global economic crisis, copper prices have fallen 50%, in line with the sharp decline in other commodities, but it has rebounded.

Emerging economies that got too giddy in the good years are now coping with nasty hangovers. Argentina is facing another debt default while oil-rich Russia is bailing out banks and companies that are over their heads in debt.

Chile is now in a position to bootstrap its own recovery from the global recession.

The government hasn't had to spend a peso on bank bailouts, while foreign debt was paid down during the fat years. As a result, Chile is now a net creditor nation, with an upgraded debt rating by Moody's.

Chile has enough cash on-hand to stimulate its economy, which it did for 2009 at 2.8% of GDP, ranking behind Russia, South Korea, Saudi Arabia and China, but ahead of the U.S.

During the boom of the emerging economies that started in 2003, governments that were raking in export dollars from commodities or manufactured goods often paid lip service to the idea of husbanding wealth for leaner years and setting up sovereign funds. Today, many have high debt levels, draining resources that might otherwise go to stimulus.

"Bubbles in banking, real estate and consumer spending can easily inflate," says Velasco. Meanwhile, dollar earnings from commodities can make the local currency grow too strong, hurting the competitiveness of manufactured exports, and make the economy vulnerable to a crisis when the commodity falls, as Chile learned during the last copper crack-up in the early 1980s.

To offset this, in 2006 Velasco required the annual budget to be based on an independent estimate of average copper price over the next 10 years, not current prices. Income above the budgeted price went into a savings fund, outside the country.

After he got a $4 billion stimulus package through Congress in January 2009, Chile has endured only a mild recession, but the effects will be eased by a stimulus two or three times the amount most other Latin American governments are enacting relative to GDP.

Chile is putting $700 million into a huge infrastructure program, designed to create at least 60,000 jobs in construction of roads, airport upgrades and housing, which also features subsidies for middle and low income buyers.

"Putting on my hard hat is the greatest feeling in the world right now," said one previously unemployed worker.

There are three ways to invest in Chile. The purest play is the Chile Fund (CF: NYSE). There are also two regional funds: The Latin America Equity Fund (LAQ: NYSE) and The Latin American Discovery Fund (LDF:NYSE). These funds have had a strong run, so one needs to be cautious. ■

Source: *The Wall Street Journal*

Clients of Closed-End Fund Advisors hold shares in each of these funds.

What "Cuba Libra" Could Mean to Investors

Don't expect the Castro brothers to throw open Cuba for trade and investment merely because of moves in Washington to relax a 47-year-old trade embargo, states *Barron's* in its May 25, 2009 edition.

Cuba imports close to $700 million in agricultural products from the U.S. each year, but Americans are mostly deprived from visiting this beautiful island, which covers 44,218 square miles, has wide fertile valleys, 1,600 islands and three mountain ranges. The population exceeds 11 million.

Raul Castro, Fidel's brother, is open to discussing anything, including lifting the trade embargo with the U.S., but Fidel, the founder of the revolution, has sounded a much harder line.

The influential U.S. Chamber of Commerce favors elimination of the trade embargo. Chamber President Tom Donohue says, "Lifting the embargo would remove their excuses for economic failure and would help American farmers, businesses and workers – as well as the Cuban people. Americans may then be able to visit Cuba for the first time since 1960."

Thomas J. Herzfeld, living in Miami, has devoted most of his investment career waiting for Cuba to open up as he has an economic stake in this happening.

Herzfeld registered a closed-end fund, The Caribbean Basin Fund (CUBA), with the SEC in 1994. The small fund invests in Cuba-related businesses in the Miami area which would benefit when the embargo ends. It has traded at a large premium to its net asset value ever since word of Castro's demise was considered imminent, reflecting expectations that Cuba would soon open up. The net asset value of CUBA was $5.35 on June 8, 2009. The shares closed at $7.33 that day, for a premium of +37.01% to its net asset value.

We have known Tom since the early 1990s. He inspired me to visit Cuba in 1992 and again in 1995 as a journalist when I saw the advent of private capitalism aimed at tourists. Herzfeld has been optimistically, but perhaps unrealistically, expecting that once Castro died or became incapacitated, the resulting trade and tourist explosion would be a bonanza for his shareholders. He is still waiting.

Herzfeld's followers were a lot more optimistic that, when Castro is no longer around, Cuba will turn into a gold mine. Many have since realized that Cuba is a country strongly entrenched in a socialist government that will take a long time to change. Cuba has only had a democracy for three years since its independence in 1898.

"When Fidel became ill about three years ago, ... the stock spiked up," says Herzfeld. However, recently it has declined from its 52-week high as prospects for immediate change have subsided.

New York Rep. Charles Rangel, chairman of the U.S. House Ways and Means Committee, hopes to end the embargo in 2010. He says that, despite widespread Congressional support, "lifting the embargo won't be a slam dunk". Older Cuban-Americans with political clout oppose ending it, as do some conservative members of Congress.

It now appears that both Fidel and his brother Raul, the current president, would like to see more trade, but it isn't clear whether the Cuban government is truly interested in better relations.

The advent of a democratic government that Herzfeld and his Miami supporters have longed for is even more unlikely as the present government isn't in any hurry to open up to the U.S yet. ■

Source: *Barron's*

Signs of Downturn Easing

The president of the European Central Bank, Jean-Claude Trichet, signaled on May 11, 2009 that the global downturn had bottomed out with some large economies already able to put the recession behind them.

These comments added weight because he was speaking on behalf of the world's leading central bankers. His remarks came as the Organization for Economic Cooperation and Development (OECD) said there were signs of a "pause" in the economic slowdown in France, Italy, U.K. and China.

Although U.S. stocks fell after his remarks, tentative signs of "green shoots" across the global economy have led to a 40% increase in global equity prices since March 2009.

In late April, the central bankers and finance ministers were still extremely cautious when they gathered in Washington. They learned that the global economy would contract sharply in 2009 and recover only sluggishly in 2010.

Trichet had warned that in the 16-country eurozone "economic activity was likely to be very weak for the remainder of 2009, before gradually recovering in the course of 2010."

Now, Trichet has struck a much more optimistic note, ditching his previous refusal to spot "green shoots" for fear they might wither and die. He said the global economy was "beyond the inflection point" in some countries.

"In all cases, we see a slowdown in GDPs. In certain cases, however, we see a pick-up," he added.

According to the OECD, the severe declines in economic output across the world are moderating, and the pace of the deterioration is easing. ■

Source: *Financial Times*

Portfolio Manager's Review

During April and May, we purchased funds that continue to generate good income distributions while selling those that no longer met our criteria of being a high quality fund that fit into our asset allocations models. We also sold some of our global bond funds which have protected our portfolios in the downmarkets in favor of more equity exposure. We plan to spend the next few months investing in funds that closely fit our clients' investment objectives and risk parameters, periodically rebalancing their portfolios.

We have also been purchasing two funds which specialize in "green" investing with excellent long-term records. There are not yet any closed-end funds in this area. We previously purchased the domestic Winslow Green Growth Fund (WGGFX) and now are purchasing their global fund (WGSLX), which invests mostly in the foreign markets. We expect to balance the two funds in clients' portfolios.

We are particularly interested in Winslow's belief "that clean energy production and efficient resource usage will be an integral part of solving our energy, economic, environmental and security challenges."

"The transition won't be easy on the economy and or on investors, and we fully expect to see continued volatility as the world adapts to a new reality, but we hold a deep belief that the long-term financial beneficiaries will include investors in companies that are the leaders and innovators in the race to address the huge global market demand for green solutions. This long-standing belief continues to guide and shape all of our investment decisions."

For the next issue of *The Scott Letter,* we will be interviewing the portfolio manager of the U.S. equity fund, Source Capital. ■

George Cole Scott

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