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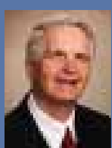
THE SCOTT LETTER is intended to educate global investors about closed-end funds. Closed-end funds can be a valuable and profitable investment tool. To learn about closed-end funds, visit our web site, www.CEFAdvisors.com, and in particular, read our article, *What Are Closed-End Funds*. Feel free to 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

IN THIS ISSUE:

Source Capital, Inc. Seeks Maximum Total Return for Common Shareholders

First Pacific Advisors, LLC (FPA) manages Source Capital and strives to provide consistent, long-term and superior investment management services and returns for clients. Source states: "We will create an environment in which talented individuals can work together, pooling their expertise and experience, to meet this goal. At all times, preservation and growth of our clients' capital will be paramount in our minds."

First Pacific Advisors also manages five open-end mutual funds, in addition to separate accounts for institutional investors. Source Capital is a major, diversified, publicly traded investment company with total assets of approximately $400 million. The investment portfolio includes a wide range of securities with primary emphasis on common stocks.

Source Capital has common and preferred shares outstanding; both trade on the New York Stock Exchange. Each of the 1,969,212 outstanding preferred shares has a prior claim of $27.50 on assets and $2.40 per year on income. The balance of the company's assets and income are available to the 8,655,240 shares of common stock outstanding.

Source Capital's investment objective is to seek maximum total return for common shareholders from both capital appreciation and investment income to the extent consistent with protection of invested capital and provision of sufficient income to meet the dividend requirements of preferred shareholders. The investment approach emphasizes primarily equity investments to achieve these objectives, although a portion of the portfolio is invested in high-yield bonds as well. The balance between equity versus fixed-income investments is subject to market conditions.

Source Capital's investment philosophy states that the best way to achieve substantial returns for shareholders is to buy superior businesses at reasonable prices and to hold them for the long term. Superior businesses are defined as those that have a history of earning high returns on invested capital, have relatively unleveraged balance sheets, possess a sustainable competitive advantage and have a proven management team in place. Investments are chosen via a bottom-up stock picking style, using fundamental analysis, e.g., investing in the best companies they can find.

The company has adopted a flexible distribution policy, designed to pay common shareholders quarterly distributions at a rate that is substantially in excess of net investment income. The rate will be adjusted periodically in response to sustained changes in the net asset value, market conditions and changes in investment company regulations and tax laws. Only a portion of such distributions is paid from net investment income. The remainder is paid from any net realized capital gains and/or paid-in capital, as determined by each year's results. To the extent the company realizes net long-term capital gains for any year in excess of the amounts distributed under the company's distribution policy, such excess willl be distributed to shareholders. All distributions are taxable to shareholders as taxable income or capital gains distributions since the company has accumulated earnings and profits from prior years. The fund states that "it is the intention of the Board of Directors to continue paying quarterly distributions at a rate that is substantially in excess of current income."

Eric S. Ende (64) is president and chief investment officer; Steven R. Geist (55) is executive vice president and portfolio manager of Source Capital. We telephoned the two managers on June 19, 2009.

SL: How many people are involved in your research?

Ende: The team has two portfolio managers and one senior analyst. As portfolio managers, we also perform company research, ably assisted by Gregory Herr. Steve, Greg, and I also manage two open-end mutual funds (invested in the same style as Source).

SL: How do you pick your stocks?

Ende: There are many ways. We use Wall Street research for background information and participate in quarterly conference calls with companies. Most importantly, we meet with company managements and attend broker-sponsored conferences where we can have one-on-one meetings with several management teams in a short period of time. We also visit company locations and invite many companies to visit in our offices here in Los Angeles.

SL: Are most of your company choices small cap?

Ende: We think of the portfolio as small/mid-cap with an average weighted market capitalization of just over $2 billion. The typical company, at time of investment, can have a market cap of any where between $500 million to $5 billion.

SL: Are you more value or growth-oriented?

Ende: We think something such as core or blend is probably the most appropriate label. After all, our companies grow faster than those in our benchmark (Russell 2500) and are priced at lower price/ earnings (P/E) ratios.

SL: Some analysts question the use of P/E ratios as the best way to pick stocks. They are the most common measure for valuing stocks and markets, but, as you know, it can be calculated several ways. Do you think circumstances now make it harder to apply the traditional rules about P/E ratios in assessing valuations of the markets in the future after the debacle we have seen in the markets in 2008-2009?

Ende: We use many criteria in evaluating whether or not we will purchase a company for the portfolio.Valuation is just one of these metrics. We typically use trailing 12-month earnings, but in times of economic dislocation as we have now, this becomes difficult. We need to look more at normalized earnings and how the earnings expectations have been reset in the current environment.

SL: In the 1990s, I met with George Michaelis, your former portfolio manager. I remember two things about the visit, besides being impressed with how well the fund was managed: George mentioned that Warren Buffett once was interested in acquiring the Fund and that there were movie studios all around the office. What can you tell us about Warren's interest?

Ende: After the stock market collapse in 1973-1974, Source was selling at a substantial discount to its net asset value (40%-50% range). Charlie Munger and Warren Buffet found they could buy an investment company for $0.50 on the dollar. Even better, not only could they purchase it at a (huge) discount, they could change the investment process to their liking if they purchased enough shares to get a seat on the Board. George Michaelis thought that the "Buffett way" was a very reasonable way of investing. Source Capital, however, has been managed the "Buffett" way ever since. (See story on Warren Buffett on page 5.)

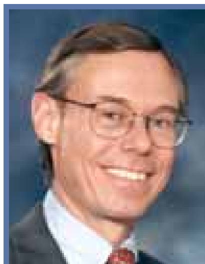
SL: There is a very interesting parallel here. Erik Bergstrom, whom I've known since our college days, was able to purchase a block of shares in the troubled Diebold Venture Capital Fund, selling at discounts of over 50%. My family and clients were part of Mr. Bergstrom's investment group. Once we had bought a "working control" of over 30% of this fund, the Board was eager to part with it. An opportunity like this doesn't come along very often. It not only changed Erik's life but also led me into my specialty.

As a result, I became a Board member of the newly acquired fund, which was relocated from New York to Seattle. Soon afterwards, I was using closed-end funds for most of my clients. In 1996, I purchased Closed-End Fund Advisors in Santa Barbara and moved the firm to Richmond.

In 2002, Mr. Bergstrom was interested in merging his closed-end fund (Bergstrom Capital) into Source Capital but found that the fund wasn't interested. What can you tell us about that?

Ende: The Board of Directors carefully looked into the proposal and eventually decided against it. At $200 million, Bergstrom Capital was roughly half the size of Source. It would be a very large investment for us, and in addition, Source had always invested in individual companies rather than acquiring other funds. The Board decided that the complexity of such a deal could lead to an outcome where our shareholders might have ended-up with an unfair price.

SL: Erik was disappointed and now holds a large number of shares of Source Capital in the Bergstrom Foundation. The Fund appears to have strong, long-term shareholders – a good thing. However, we have found that the spread is often wide,



Eric S. Ende

Eric S. Ende - Partner

Mr. Ende, who joined First Pacific Advisors (FPA) in 1984, manages a closed-end mutual fund, (Source Capital, Inc.), two open-end mutual funds (FPA Perennial Fund and FPA Paramount Fund), and separate accounts in the Small/Mid-Cap Quality Value style. During the previous 15 years, Mr. Ende was an analyst for The J. Paul Getty Trust, Occidental Petroleum and the Ford Motor Company. He earned a bachelor's degree in History (cum laude) from Yale College, a master's degree in Modern History (with honors) from Oxford University, and an MBA from New York University.

Steven R. Geist

Steven R. Geist, CFA - Partner

Mr. Geist manages a closed-end mutual fund (Source Capital, Inc.), open-end mutual funds (FPA Perennial Fund and FPA Paramount Fund) and separate accounts in the Small/Mid-Cap Quality Value style. He joined First Pacific Advisors in 1992 after working as a research associate at Joel Mogy Investment Counsel and was previously an Engineer for TRW. He received a bachelor's degree in Electrical Engineering (magna cum laude) from New York University, a master's in Electrical Engineering from Purdue University, and an MBA from the University of California, Los Angeles.

and the daily volume is quite low. Comments?

Ende: We have a long-term ownership constituency which invests in Source to receive income on both the common and preferred shares. However, we are not very well served by the New York Stock Exchange specialists. The stock is illiquid and has a large spread so there is little that we can do about it.

SL: That often is a problem for closed-end funds, but we work around it by being patient. We wait for the best price to come to us using limit orders.

I particularly like your statement: "At all times, preservation and growth of our clients' capital will be paramount in our minds." Do you have anything to add regarding the investment climate we have seen in the last 12-18 months?

Geist: We have an investment process that has produced excellent long-term results. This process is independent of what the markets are doing, whether it be the tech bubble at the turn of the decade or the market implosion of the fourth quarter of 2008.

Ende: Protecting capital is hard ... harder than you think. Just about every long-only equity manager did not achieve this goal in 2008.

SL: That is certainly true and reminds me of what Sir John Templeton once said: "Investing is hard work." In your March 31, 2009 report, you mention several negatives, but you also see some encouraging signs such as improving commodity prices. What are your views on this subject now?

Geist: Commodity prices can be extremely volatile over the short term. We were using the year-end 2008 prices as a reference in the report. For example, at the end of June 2008, oil was priced at $140 per barrel; yet by the end of December 2008, oil prices were down to roughly $35 per barrel. It has rebounded to over $60.

Higher commodity prices are typically associated with an economic recovery as demand increases. Daily price movements are irrelevant. The long-term trend is what is important, and we are monitoring this activity.

SL: Why do you favor the oil service companies over energy companies, many of which pay good dividends?

Ende: We view oil service companies as better investments for us. If you invest in exploration companies, you need to track drilling costs, number of dry wells and so on for each individual company. For a service company, such as Noble Corporation, you track macro data such as whether or not more wells are being drilled, and in our case, whether the fields are in shallow or deep water. Even in an environment where there is less drilling for oil, our companies can survive since existing wells still need to be serviced.

SL: What are your thoughts about sustainability of continuing higher and higher oil prices that will affect the Nobles and other energy companies?

> **"At all times, preservation and growth of our clients' capital will be paramount in our minds."**

Geist: The jump in oil prices is a function of a couple of things. First, oil prices went down an awful lot (50%) in the second half of 2008 so we have only recovered about 40% of that loss. Next, oil prices are a function of demand. When the global recession is over, oil prices/demand will likely increase, and over the long term there is a secular decline in oil supplies which also means higher prices.

SL: With higher prices, the Canadians start to bring on more oil share production, which really bothers me in terms of the environmental degradation that results. Do you have any comments?

Ende: I don't know what the shape of the recovery is going to be, and I think we have a lot of speculative elements in oil and a lot of other commodities. To extract oil from the Canadian oil sands requires a complex extraction process and only makes economic sense in a period of high oil prices.

SL: We notice that you have invested in a local company (CarMax) here in Richmond. This successful company did very well over the years, especially in 2009 when they exceeded earnings expectations. Is CarMax an example of a typical purchase for Source Capital?

Ende: It is a company where the customer can buy a used car at a no-haggle price, that has been inspected and serviced. The car comes with a 7-day money-back guarantee. The company revolutionized the business of selling used cars in a way that is good for the customer and shareholders. CarMax typifies a Source investment in that it has a unique business model (no other company has emerged to compete with it on a nationwide scale). There are also high barriers to entry.

SL: We see that the largest sectors of Source are business services and supplies and durable goods. Does that mean that you find more candidates in these sectors?

Geist: I think it is more accurate to say that these are very broad categories, each containing a wide variety of investable companies that may be operating on a different business cycle from one another. As such, our portfolio weighting may be higher than, say, in technology, and there is much diversity within each sector. In the business services sector, for example, we own a temporary help firm (Manpower) and a manufacturer and distributor of consumables and instrumentation to companies performing biotech research (Life Technologies). Clearly, these very different companies are uncorrelated to one another with respect to the broad economy.

SL: You own about 30 companies, two real estate trusts and bonds and debentures to cover the dividend of your common and preferred shares at the end of 2008.

Ende: If you buy two companies in this sector, their performance could be uncorrelated with one another. If you buy two companies in the energy sector, you are buying companies that are highly correlated with the price of oil. As a result, their stock prices will tend to move in tandem. Therefore, a 20% weighting in business services is a much different investment than a 20% weight in energy.

SL: You also wrote in the 2008 annual report that "the company's managers believe that the company holdings are value stocks, adding that 'there will be no assurance that others will consider them as such'." Have you ever used growth stocks in the portfolio, or have you always a used "value" approach or a combination?

Ende: We have always considered our portfolio to be value-based in the sense that the valuation of the portfolio is less than that of our benchmark (Russell 2500). Individual companies within the portfolio also have a lower valuation than the benchmark at time of purchase. Unfortunately, the index is reconstituted on an annual basis, so if a stock does well it can be classified as a value stock one year and a growth stock the next year. We do not buy or sell companies based on how they fall within the two sub-indexes. Therefore, at different points in time, if one were to compare how many companies we own in each sub-classification, you may reach a different conclusion.

SL: Steve, please tell us more about the fixed income portion of the portfolio.

Geist: The fixed income portion of the portfolio is invested with the intent of covering the preferred dividend. I look for high-yield corporate bonds that have a yield-to-maturity greater than 8.75%. I am also looking for a low-risk investments so that, unlike a pure bond fund that is reaching for every basis point in return, I can be happy with a bond yielding 9% and sleep well at night.

SL: How flexible are your decisions regarding coverage of future common distributions, and what are your thoughts on this subject going forward? Does the entire preferred dividend come from the bond, convertibles and preferred shares of the portfolio?

Geist: That would be the ideal, but we're not there. We have to use some of the capital gains to cover the preferred dividend as well. The preferred dividend is fixed and will not be cut. Only the common dividend is allowed some flexibility in the pay-out. We are very sensitive to the income needs of our shareholders and try our best to set a pay-out that can be sustained over a long period of time.

SL: We try to make it clear to our readers that the pay-out is not a true "dividend". They must realize that the "distribution" – a better term – includes both income and realized capital gains. This is part of the total return to shareholders. We have observed that some funds promise a particular "managed distribution" of, say 8% annually. In weaker markets, when they cannot cover the distribution from income and realized capital gains, they are forced to pay-out a return of capital to continue the level of distribution, which is not what the shareholders deserve.

What comments do you have about future distributions?

Geist: Source Capital has always been what we refer to as a "lightly balanced" fund in that it is primarily invested in equities, normally on the order of 80%. The common dividend is funded from both dividends earned on the equity portfolio and also in large part by taking capital gains. Likewise, we always intend to cover the preferred dividend using income from the fixed income portion of the portfolio. Depending on the amount of assets dedicated to bonds, this form of coverage has been difficult to achieve in recent years. As such, the preferred has also had to use capital gains from the equity portfolio in order to pay the dividend.

SL: How liquid is the preferred stock versus the common shares? Who are its primary shareholders?

Geist: It is very illiquid, even more so than the common. The book value is only $50 million. The preferred is mostly held by investors looking for a long-term steady pay-out.

SL: Do you think that there is any possibility of an increase in the dividend on the common shares in 2009?

Geist: At each quarterly Board of Directors meeting, the dividend policy is always discussed. We give them our opinion, based on performance of the portfolio, but it is ultimately their decision. Conceptually, an attempt is made to set a dividend pay-out that can be sustained over a long period of time.

SL: Are there other factors that may be taken into consideration for adjusting the quarterly distributions?

Ende: Not really, the cornerstone of the dividend policy is portfolio performance and sustainability of the pay-out. Under current tax law, we must pay out all realized gains via a regular or a special year-end dividend.

SL: Is there any requirement that Board Members own shares in Source Capital?

Ende: No, but all of the Board members own some stock.

SL: We think it is important for management and Board members to own shares as they will then be on the same side as the shareholders. We also would like to know if you have ever repurchased your shares and what are your thoughts about this strategy?

Ende: We have not repurchased shares to reduce the share count. When Source is at a discount, however, we will purchase shares on the open market for use in the dividend re-investment plan.

SL: Source has been recently selling at a discount above 16% so we hope that your Board might consider repurchasing shares to both improve the net asset value and reduce the discount. There are a growing number of funds that do that as matter of investment policy. For example, Adams Express and General American Investors are just two funds that regularly repurchase shares when the discount widens. Some of these funds have a policy that whenever the discount deepens to a certain level, e.g., –10%, they will automatically buy back shares as a matter of investment policy.

Our weekly data service, ***The Closed-End Fund Universe,*** helps us analyze which funds to choose for our clients. We urge the readers of ***The Scott Letter,*** especially those who manage money, to subscribe to this very useful service. Besides being helpful in my portfolio work, John Cole Scott also finds the *universe* extremely useful in choosing funds for his clients.

Has Source Capital ever sold at a premium, and if so, do you offer shareholders a rights offering?

Ende: We have never done rights offerings. Every shareholder can choose to participate in the dividend re-investment plan.

SL: We hope that your Board will consider it in the future as we think it is another way to benefit shareholders, especially when the fund sells at a premium, when the shareholders have no dilution.

What are your concluding remarks?

Ende: Thank you for the opportunity to discuss Source Capital. We hope your readers will have a better understanding of our fund.

Geist: Thank you as well. We hope your readers who are interested in a fund generating income, will take a look at Source Capital. The common shares currently have a yield of close to 6%, and the preferred shares yield just about 8%.

SL: The portfolio of Source Capital was valued at $542,523,691 at year-end 2008 with 92.2% of the portfolio invested in common stocks. The expense ratio, based on average total net assets on June 30, 2008, was 0.87%, and the portfolio turnover rate as of June 30, 2009 was 7.91%. ■

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Institutional investors should contact Pursuit Capital Marketing by phone at 508-520-3700 or via e-mail to info@pursuitcap.com.

Clients of Closed-End Fund Advisors and family members of George Cole Scott own shares of Source Capital, Inc.

Source Capital, Inc.
Portfolio Characteristics as of June 30, 2009

Total Returns (%)

	Market Price	NAV
Year-to-Date	26.40	23.14
1 Year	-29.63	-21.49
3 Year	-16.11	-7.93
5 Year	-5.50	-0.54
10 Year Average	5.16	6.19
20 Year Average	8.83	9.52
Since Inception	11.89	11.93

Sector Weightings (% of Equity)

Consumer Cyclicals	24.3%
Healthcare	18.3%
Technology	13.7%
Capital Goods	13.5%
Transportation	12.7%
Energy	9.9%
Miscellaneous	4.6%
Finance	3.1%

Source: Thomson Reuters

Berkshire Hathaway Looks Stronger Than Ever. So Why So Cheap?

Warren Buffett has taken advantage of the past year's financial turmoil to make more than $20 billion of promising investments for Berkshire Hathaway. Berkshire's class A Shares (BRK–A) itself looks appealing, according to Barron's estimate of its current book value of $72,000 a share.

In the past decade, the stock has traded for an average of 1.6x to 1.7x book value, a measure of shareholder equity per share. The current price-to-book ratio is near the low reached in early 2000, when Berkshire's class A shares bottomed at about $40,000 per share.

That price doesn't seem outlandish in terms of the projected price-to-book value ratio. Berkshire's class B shares (BRK- B), worth 1/30th of the A shares, fetch about $2,750 each and look like a better buy than the A shares, because they sell at a 3% discount to their theoretical value. The discount, however, has persisted for some time and could continue, as the B shares can't be converted into A shares.

Berkshire's book value, which stood at $62,250 per share on March 31, 2009 likely has risen since then because of the market's powerful rally. Berkshire only reports its net asset value once each quarter. The value of the company's famed equity portfolio, now totals more than $50 billion.The market value of Berkshire's equity and bond derivatives also has increased, and Barron's assumes the company earned more than $1,000 a share from operations in the second quarter, in line with reported first-quarter figures.

Following Buffett's advice, most Berkshire watchers focus on book value as a measure of the company's valuation, as reported earnings can be distorted by realized investment gains and losses. Historically, Berkshire's shares have tracked changes in book value.

The sluggish performance of Berkshire's shares may be due to several factors. Investors recently have favored economically sensitive and other "offensive" stocks. Berkshire is perceived to be defensive due to its financial strength, including a cash position of $23 billion on March 31, 2009.

It doesn't help that shares of property and casualty insurers are out of favor amid concerns about weak insurance pricing. Berkshire owns Geico, the No. 3 domestic auto insurer, as well as reinsurer General Re and a specialized insurance business focused on hurricanes, earthquakes and other high risk events.

Some investors also worry that Berkshire's large size – the Company now has a market value of $132 billion – makes it tough for Buffett to generate high returns. Then there is his age. The Great One turns 79 in August.

At the annual meeting last May, Mr. Buffett noted that the stock hadn't kept pace with the growth in retained earnings in recent years. Asked whether Berkshire's competitive advantage would die with him, Buffett replied that Berkshire's strength, including a unique business of business culture and a patient shareholder base, will outlive him.

Buffett's likely successor may be David Sokol, chairman of Mid-American Energy, Berkshire's big utility.

Some clients of Closed-End Fund Advisors have held Berkshire Hathaway B shares for stability and its excellent record, even though it is not a closed-end fund. We decided to sell the remaining shares after so much negative news about its performance came out. Now that the shares appear to be oversold, we are considering buying the B shares again, but we haven't made a decision yet. George Cole Scott purchased some of the B shares in mid-July. ■

Source: *Barron's*

How Major Powers Determine the Future Shape of Globalization

The global economic crisis has called into question many of the tenants of the world economy. The free markets dominating economic orthodoxy for decades have been shown to have significant shortcomings. What will this do to free trade?

The answer is that globalization is under scrutiny. What will this new version look like? What countries will see their role in global and political affairs enhanced in this new world?

A new era has begun with developing countries playing a more important role. Some say that the implosion of western finance will create only one winner from the developing world: China. Others believe that the United States can recover its preeminence and reign supreme over the world economy for decades to come.

The economic crisis that began in 2008 still retains its power to shock. Global trade volumes may fall by 10% in 2009. The International Monetary Fund in April again downgraded its expectations for global growth and now expects a contraction of 1.3% in 2009. Meanwhile, annualized industrial output is down by 38.4% in Japan, 20.6% in Germany and 12.2% in the United Kingdom.

"This kind of deep recession and crisis inevitably encourages countries to turn inwards and become more protectionist and will also increase regulation," says Russell Jones of RBC Capital Markets.

Meanwhile, the U.S. has delivered huge bail-outs to industry. Consequently, globalization and the opening of markets have delivered a sizeable hit. At the same time, many emerging market countries have already completed the necessary reforms to recover from the crisis and are less exposed to financial services.

As a result, they will be less affected, and there will be an acceleration of movement of economic power from West to East. Martin Jacques, author of *When China Rules the World: The Rise of the Middle Kingdom and the End of the Western World,* believes that this movement of power is part of a longer process.

"There has been – and will increasingly be – a relative decline of rich countries in the West in terms of their share of GDP and a rise of developing countries. In particular, it's about the rise of China but also to a lesser extent about Brazil, India and other countries," he writes.

The G20 grouping, which represents a much greater part of global trade flows than the G7, includes Argentina, Brazil, China, and India. Indonesia, Mexico, South Africa, South Korea and Turkey. This represents around 90% of world trade. The invitation to large emerging market countries to play a greater role in global economic and trade discussions might, therefore, be genuine. Moreover, it came at a time of desperation.

By 2040, it is estimated that China's rapid growth will have overtaken the U.S. as the world's largest economy ....

The G20 could have added emerging market leaders such as China or India. Both the G7/G8 have never been truly representative, with its four European Union members and Canada, so merely adding China would not have made sense. For example, can South Africa really speak for all of sub-Saharan Africa?

"There are understandable concerns that the West has lost its authority on economic matters, and the liberalization agenda will suffer. The real goal of the G20 is to prevent the worst deviations from market reform," says RBC's Jones.

Brazil, Russia, India and China (BRIC) have their own ideas and once admitted to the top tier of countries are unlikely to be cowed in the company of the Western countries. The BRICs, in particular, are now in a stronger position to manage the pace of development – in terms of managing their capital accounts and tariff reform – rather than be forced into a rigid timetable. The pace of liberalization in emerging markets is unlikely to be as fast in the future as the industrial core would like it to be.

"The 1990s were a golden age for the market economy and the U.S., driven by the fall of communism, a wave of new technology and a mood of general optimism," says Riccardo Barbieri, head of international economics research at Banc of America Securities-Merrill Lynch.

"Then it all turned to excess. Issues that should have been addressed to maintain the U.S. leadership position, such as the savings ratio turning negative –" were not. Instead there was a decision to accept certain imbalances as a byproduct of a market economy. Moreover, the U.S. took the view that, as long as China and the rest of the world were becoming a market economy, it was winning overall.

By 2040, it is estimated that China will have overtaken the U.S. as the world's largest economy, so the dominating role of the U.S. will inevitably be lost. The current crisis, essentially a debt crisis, is accelerating the transfer of power because the U.S.'s major creditor is China. Certainly, the adjustment taking place, in terms of risk appetite and leverage, will be hardest felt by the U.S.

However, there remains plenty of skeptics about China's ability to usurp the U.S.'s unique global role, as the U.S. remains the prime power and the largest economy.

"Even if China is growing rapidly, it is not strong enough to act as a locomotive for the global economy. It is sensible that as China gets a bigger role in global forums, the movement of power from the U.S. to China will be evolutionary change rather than revolutionary," Jones says.

"This is because China has traditionally been an inward-looking country that has never been able to expand globally due to language and structural barriers. Its ability to lead is absent because its economic model cannot be exported. In reality, the U.S. remains the only game in town; it just needs to amend its economic model."

Whether or not China becomes the largest economy in the world, its power will continue to grow. While the long-term game may be in the balance of power between the U.S. and China, in the short term, the rebalancing of world power toward China and some other emerging nations will show itself in the IMF and other global bodies.

"Ultimately new institutions will be required, and more dramatic shifts in the global infrastructure may be necessary. Moreover, it is uncertain whether existing bodies will retain their utility or whether the shift toward bilateral trade deals will increase," says Jacques.

Clearly, the nature of how the global economic system operates will change in the coming years, and which countries dominate the world scene will continue to remain fluid.

China's growth could yet be derailed by environmental catastrophe or political insurrection, as we have noted in previous issues. Nevertheless, while the model of capitalism is clearly under strain, it is not under threat of disappearance.

To paraphrase Winston Churchill, "Capitalism is the worst economic model apart from all the others that have been tried."

We may see a new economic model of globalization emerge, but there is not going to be a wholesale retreat from the existing economic system. ■

Source: *Global Finance*

Emerging Markets Retain Footing

One of the more startling developments of recent months has been the near-vertical recovery of emerging markets stocks. Despite the collapse of those markets in late 2008, investors sentiment toward them has quickly switched from hate to love, with nothing in between.

Emerging markets have soared above all others, especially in the second quarter, even as those other markets were gaining altitude themselves. The outperformance carried a broad-based MSCI Barra index of shares in the developing world close to record highs, relative to the broadest index of stocks in mature economies, after touching a three-year low in late 2008.

The rally provided an opportunity for shareholders in emerging markets funds to dig out of a very deep hole. The average portfolio specializing in them rose 35.1% in the second quarter, after falling 54.4% in 2008 and an additional 1.7% in the first quarter of 2009.

CEFA has invested in the Asia Pacific Fund (see interview in June-July 2009 issue of *The Scott Letter*) to cover the Asia region and is considering adding to its holdings in The European Equity Fund.

After such stunning outperformance, you would think that investment advisors would lighten up on the emerging markets and spread the cash around into the mature markets. They haven't.

The consensus seems to be that the emerging markets remain the better bet, although it may be prudent not to place it just yet. One portfolio manager sees it as a return to normality.

Optimism about the outlook for China's economy has recently helped lift Asian equity markets, with commodity stocks among the biggest gainers. Official data showed that its economy expanded 7.9% in the second quarter, faster than economists have expected, an apparent confirmation of the effect of the country's stimulus program on domestic demand.

Many developing economies are enduring the global recession and financial crisis in relatively solid shape. Their stock markets suffered more than others through no fault of their own. One factor was the scarcity of credit that forced many Western investors to sell assets to raise cash.

"You had to sell what you owned, and that's what everybody owned," said John Maxwell, portfolio manager of the Ivy International Core Fund. ■

Source: *The Wall Street Journal*

> *"A man is rich in proportion to the number of things he can afford to let alone."*
>
> – Henry David Thoreau (1817-1862)

Adams Express Company Outperforms for the First Half of 2009

The Board of Directors of The Adams Express Company (ADX: NYSE) had strong performance for the first time in 2009.

For the six months ended June 30, the total return on Adams Express' net asset value, with dividends and capital gains reinvested, was 6.5%. Comparable figures for the S&P 500 and Lipper Large Cap-Core Mutual Fund Average were 3.2% and 4.8%, respectively.

For the 12 months ended June 30, the total return on Adams Express' net asset value, with dividends and capital gains reinvested, was -20.6%. Comparable figures for the S&P 500 and the Lipper Large Cap Core Mutual Fund Average were -26.2% and -25.9%, respectively. The total return for the 12 month period for market value was -23.9%.

During the three months ended June 30, Adams Express added these new names to the ADX portfolio: Capital One Financial Corp., Gilead Sciences, Qualcomm, Inc. and United Health Group. It increased its holdings in Bank of America, Dean Foods, J.P. Morgan Chase, Medtronic, PNC Financial and WGL Holdings. The Fund sold Atmos Energy Corp. and Schlumberger Ltd., and reduced its holdings in Goldman Sachs, Hansen Natural and 3M. For more information, visit www.adamsexpresscompany.com. ■

Closed-End Fund Review: Second Quarter 2009

The second quarter was excellent for closed-end funds and investors who have been patient and/or were buying as discounts widened to historic levels at the end of 2008 and into 2009. They were rewarded with meaningful positive returns during the quarter.

Of the 633 closed-end funds tracked by Fund Data, the average fund was up 21% on a total return basis during the second quarter and up 24% year-to-date. Not only was the average gain very impressive during the quarter, but the breadth of the gains was also impressive. Every major category and sub-category was positive for the quarter with the exception of the small category (consisting of two commodity funds) which was lower by only 0.26%. It was a very broad, deep and powerful rally for closed-end funds.

There were several factors that led to the significant improvement in performance for closed-end funds in the quarter. The biggest contributing factor was more stability and healing in the overall equity and credit markets as well as some stability in the overall macroeconomic environment during the quarter.

While total returns of 21% during a three month period is very rewarding, particularly after a difficult 2008, fund investors shouldn't expect these types of returns going forward. Most of the positive performance was the result of narrowing discounts in the funds and share prices catching up to NAVs. Now that average discounts have narrowed closer to historic levels, I believe there will be less of a contraction.

Therefore, investors need to look farther to find value and focus on funds which invest in asset classes that have upside return potential. ■

Source: Jeff Margolin
Closed-End Fund Analyst
First Trust Advisors

Portfolio Manager's Review

What a ride for the stock markets so far in 2009! Recent market strength appears to be sustainable; we may be coming into a period of cautious optimism, after earlier fears of a global recession. Once investors realized that the world was not coming to an end, stocks sharply rebounded worldwide. The question now is where do we go from here?

There is still a weak economic outlook in the U.S. and emerging markets. Continued correlation has not yet been reduced, although these markets, particularly those in Asia and Latin America, have given Closed-End Fund Advisors its best performance in a long time. For the year, all of our portfolios are sharply higher.

Even though many of the discounts have narrowed, we still see good values in many of our favorite funds such as Adams Express, Central Securities, General American Investors, and Source Capital, meaning that there are still bargains in these and other funds to be found. This includes many of the beat-up real estate funds. The discounts on the foreign funds, however, have narrowed so we are more cautious there.

This is bargain-hunting time for these funds. We have been taking advantage of the still good prices of many of the domestic as well as some of the foreign funds. The latter have narrowed their discounts substantially, so we are looking for substitutes at better prices.

For the October/November issue of *The Scott Letter,* we have arranged to interview the managers of the Latin America Equity Fund, now managed by Aberdeen Asset Management. ■

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