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CLOSED-END FUND REPORT

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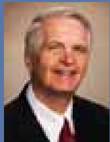
THE SCOTT LETTER is intended to educate global investors about closed-end funds. Closed-end funds can be a valuable and profitable investment tool. To learn about closed-end funds, visit our web site, www.CEFAdvisors.com, and in particular, read our article, *What Are Closed-End Funds*. Feel free to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

Petroleum & Resources Corporation:
A Broadly Diversified Exposure to Energy and Natural Resources

Petroleum & Resources (PEO:NYSE) is an equity investment fund for investors who seek a broadly diversified exposure to the energy and natural resources sector in a conservatively managed fund. The investment objectives are preservation of capital, attainment of reasonable income from investments and opportunity for capital appreciation.

The portfolio is managed with the expectation that it will generate solid returns that compare favorably to the returns of the Fund's benchmarks. Investments are made with an eye toward protecting shareholders' original investment and generating dividends and capital gains that can be used as a source of income or re-invested to increase their holdings in the Fund.

Petroleum & Resources, with assets of approximately $650.7 million, is the largest (5%) holding of Adams Express and is managed by the same. Adams Express has assets of approximately $1.045 billion. The Baltimore-based fund is managed by chairman and president Douglas G. Ober, who has managed both funds since 1986. Mr. Ober is supported by a team of research analysts who look for investments offering long-term earnings growth at a reasonable price. Nancy Prue is executive vice president of Petroleum & Resources Corporation.

PEO, with a low portfolio turnover, is internally managed so that additional expenses are not incurred to pay an outside advisor. The expense ratio for 2009 was 0.96% versus 0.53% in 2008.

We telephoned Doug Ober and Nancy Prue on February 23:

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Asia Pacific Fund: Interview with Khiem Do
APB Staged a Sharp Rebound in 2009

Closed-End Fund Advisors interviewed Asia Pacific Fund's (APB:NYSE) portfolio manager, Khiem Do, at his Hong Kong office on February 25, 2010.

SL: Since we last spoke in May 2009, share performance has declined in the last 12 months partly because no distributions were paid for the year. Is this true?

Do: No, to the contrary. The year 2009 can be remembered for the sharp rebound for Asian equities from the lows recorded in 2008. As far as the Fund's dividend is concerned, the modest capital gains derived from sales were offset by capital losses during last year. Please note that while we were locking in gains during the period of strong markets from 2006 to 2008, stocks which were bought to replace the former were traded out in 2009. These resulted in realized losses. Consequently, the Fund did not make a distribution in 2009.

It would be fairer to assess the Fund's dividend distribution power within this context over the past four years. Over the period 2006 to 2009, APB paid out a total of $16.16 USD per share, averaging about $4.00 USD a share, which is extremely high compared to many other closed-end investment funds. Investors benefited from the appreciation of 58.7% in the Fund's NAV in 2009.

APB underperformed the reference benchmark index in 2009 due to its defensive positioning aimed at preserving capital in the midst of the global financial crisis. The equity markets staged a sharp rebound, but our bias was toward quality and stable sectors such as

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consumer staples. In the final quarter of the year, APB stock appreciated 8.2%.

Let me turn to China for a second. In 2009, China's economy grew 8.7%, while the rest of the world was suffering from a global contraction. As business is back to normal in China, there is no longer the need for an excessively easy monetary environment.

Thus, the need to normalize liquidity/stimulus measures earlier than in most countries is totally justified. While the Chinese equity market weakened on this announcement, we believe this is a positive step taken by the Chinese central bank to avert overheating risks that could later create more downside risk to growth. If China were to attempt to sustain a low-inflation-robust-growth environment for a long period, it must be prepared to neutralize all excesses as soon as they appear.

SL: China is being pressed to revalue its currency. Isn't it a mistake to become obsessed with this, as the U.S. has? The global economy needs China to grow and its current account surplus to drop.

Do: We agree there is too much obsession on the renminbi currency. The best solution is to let China import more instead of exporting less. We believe its currency is likely to appreciate against the U.S. dollar when its exports grow strong again and its import prices become excessively expensive. Based on our understanding of the workings of the Chinese government, the rate of appreciation will be gradual, instead of a revaluation at this juncture.

[**Editor's Note:** China's central bank chief has laid the groundwork for an appreciation of the renminbi, but he gave no timetable. He also described the current dollar peg as temporary after months of tough opposition in Beijing to a shift in exchange rate policy. Zhou Xiaochuan, governor of the People's Bank of China, gave the strongest hint yet that China will abandon the unofficial dollar peg, which has been in place since mid-2008. He said it was a "special" policy to weather the financial crisis. (Source: *Financial Times)*]

SL: Many investors now are wondering if the global recovery is sustainable. The Shanghai Composite Index is now just above the 3,000 level but is still down 6.8% for 2010. Some analysts see the possibility of a bubble in the China market because inflation is up and interest rates have been raised. What are your thoughts?

Do: We believe that the Chinese, Asian and U.S. economies are likely to surprise on the upside in 2010, which will lead and sustain global recovery. There have been some weak spots in Europe [and in Dubai]. The overall U.S. financial system has stabilized, and the global financial crisis is behind us. At the 3,000 level, the Shanghai Index is still 50% off its high of October 2007, when the valuations of Chinese A-shares were much more expensive.

For the record, let me say that at Barings we do not believe that China is in a bubble as yet. There are pockets of "exuberance" in a number of major cities' luxury property deals, but there is no bubble in the overall economy at this stage. We believe that the concept of a "bubble in China" has been misinterpreted and somewhat abused by the Western press.

In addition, the Chinese government has already proactively introduced policies to cool down any speculative activity in the property sector. Moreover, while China's real estate prices rose by 23.6% nationwide in 2009, this must be viewed within a context of falling property prices in 2008. At the absolute price level, China's real estate prices are still much lower than their equivalents in the U.S., the U.K. or Hong Kong. The media appears to have extrapolated the pricing of a small number of property deals in Shanghai and Beijing and the trend of money supply in the first six months of 2009 to "bubble" proportions.

China's annual inflation rate, as measured by the latest consumer price index, is not excessive at 1.5% (as of January 2010). Chinese economists believe that inflationary pressures in the domestic economy are likely to set in, thus potentially pushing up China's inflation rate to 3%-4% in 2010. In our view, this is manageable.

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, he 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 February 28, 2010

Market Price (USD) Return Gross of Net	1 Year	3 Year	5 Year	10 Year	20 Year
Asia Pacific Fund - NAV	75.0%	12.8%	71.9%	119.2%	384.0%
Asia Pacific Fund - Price	76.9%	10.5%	74.5%	180.4%	324.8%
MSCI AC Far East Ex-Japan	80.5%	9.3%	63.6%	80.5%	318.9%
MSCI World	55.2%	-17.4%	9.4%	5.3%	237.6%
S&P Composite 500	53.6%	-16.1%	1.9%	-3.0%	409.4%
MSCI Europe	57.8%	-22.4%	11.5%	20.1%	366.65
MSCI Japan	34.2%	-29.0%	-0.2%	-22.9%	-20.5%

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

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China last saw high inflation of 7%-9% back in 2007/2008, pressured by skyrocketing food prices (due to swine disease which led to shortage of pork and the global mania in all commodities). One only needs to look at the falling price trend of wheat, soybeans and corn to realize that 2009-2010 is not the same as 2007.

As far as China's monetary policy is concerned, over the past few weeks, China has twice raised the banks' reserve requirement ratio, with the aim to siphon off excess liquidity in its banking system (the latter derived from trade surplus and net capital inflows from foreign direct investments). Following global trends, China's medium- and long-term interest rates have also risen modestly. It is important to note that the People's Bank of China ("PBOC") has not yet officially raised interest rates.

The major economic thrust of the Chinese government remains "pro-growth" but is "balanced". Their strategy is twofold. First, they wish to consolidate the on-going recovery without triggering inflation of asset and consumer goods prices, and secondly, they will encourage more consumption and a little less fixed capital investment.

The Chinese economy grew 10.7% in fourth quarter 2009, the strongest showing by any major economy. The policies so far convince us that Beijing wants to stabilize the on-going momentum while reining in some of the excessive liquidity derived from the $4.0 trillion RMB ($588 billion USD) stimulus package and the strong loan growth encouraged in the midst of the global financial crisis. While it is a balancing act by the PBOC to sustain growth and control inflation, this growth rate in China, one of the strongest in the world, offers tremendous opportunities for long term equity investors.

SL: We anticipated your answer would be positive as usual. However, as objective analysts, we have to look at all sides of the equation. How sustainable is China's growth rate in view of the Shanghai Composite Index's sharp decline?

Do: China is still in a the early stage of urbanization and industrialization. In the coming 5-10 years, we continue to expect a strong secular growth trend in infrastructure spending and domestic consumption, underpinned by growing affluence and wealth. China also has massive foreign currency reserves and a manageable outstanding government debt. Hence, it can self-finance its development needs, whereas the U.S., the U.K. and some European nations will require the kindness of offshore lenders to balance their books.

Regarding domestic automobile sales, China has overtaken the U.S. in 2009 as the largest automobile market in the world. China's GDP will overtake Japan within the next 1-2 years, and China should be included in the top G3 nations by 2012!

As far as the volatility in the Chinese equity markets is concerned, given China's leading status in the world economy, we can naturally expect to have an increasing number of financial participants, all with differing views which will cause more market volatility than usual. Let's not forget that the Shanghai Composite Index rebounded with a massive 79.9% rise in 2009. Thus, some consolidation in the short-term is deemed natural and healthy. We remain bullish on China and will continue to add on market dips.

SL: Your latest report shows that your largest allocation is in China, including Hong Kong at 42.1%. We are concerned about this heavy exposure in a regional fund that has a mandate to cover the entire Asia Pacific region, including India, which appears to have lost much of its momentum. Please explain.

Do: We believe China will continue to be the strongest engine of economic growth in Asia and the world. The Chinese companies will continue to be more profit-growth, rather just sales-growth focused. We are comfortable with the Hong Kong-listed China H shares, the valuation of which is about 12.5 times 12-month prospective earnings (based on IBES consensus on February 19, 2010).

SL: Which of the other countries in the region do you think have the best chance for sustainable growth?

Do: Taiwan and Korea are expected to witness a stronger earnings potential, boosted by a strong rebound in global technology demand, as well as from a smaller base effect.

SL: Do you expect to keep the overweight allocation to Hong Kong and China in 2010, or are there better opportunities in other countries in your region?

Do: In this post-financial crisis, we see exciting opportunities in the whole region. We believe Asia has emerged from this global crisis even stronger than before, as exhibited by the strength of economic rebound and improvement of the corporate balance sheets in these countries. Nonetheless, at current price levels, we believe that the valuation of HK-listed China shares is cheaper than the rest of Asia. Hence, we continue to retain this high weighting for the moment.

SL: We now question that most of the Asian economies invest more, not consume more. It has been said that Asia's current account surpluses are to blame for causing the global financial crisis for this reason.

Do: The region is too diverse to generalize. Different countries have different rebalancing needs. India has the least dependence on exports and has to spend a lot more on infrastructure needs. In China, the investment-to-consumption ratio is already at a very high level. Thus, it is private consumption that needs to be stimulated, and recent government policies are focused on ensuring that this will happen. The rest of the region probably needs to boost investment, which has never recovered from the pre-Asian financial crisis levels, as well as consumption.

Asia is consuming and happily spending money. However, unlike in the U.S., Asians are mindful to save for rainy days, such as for the possibility of unemployment, healthcare and the caring of themselves and their children in old age. The Asian governments do not make forlorn promises, nor will they print money to fund all these needs as the U.S. does.

SL: You usually give us so much on South Korea and Taiwan. How badly were these countries hit in 2009?

Korea

Do: The Korean equity market has been sold off this year in line with the rest of the region. On its macro front, we think the outlook for exports driving growth is

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still buoyant, helped by cheap currency and technology innovations. The Korean automobile manufacturers are probably gaining some advantage over Toyota's untimely misfortune. The Korean policymakers may be delaying the monetary tightening cycle, which may help provide some support to domestic demand. Overall, we see 4%-5% growth in Korea's GDP this year.

Taiwan

Taiwan has a dynamic economy with gradually decreasing government guidance of investment and foreign trade. Exports, led by electronics and machinery, generate 70% of Taiwan's GDP growth. This heavy dependence makes the economy vulnerable to downturns in world demand as exports contracted 4% in 2009.

China and Taiwan have increased cross-strait travel and tourism, as China has become Taiwan's second largest source of imports after Japan, and is becoming the island's No. 1 destination for foreign direct investment. They signed three financial memorandums of understanding in January 2010. Greater investments from the mainland are occurring, and there are many new opportunities for Taiwan firms operating in China.

We expect growth in Taiwan to recover to 4%-5% in 2010, underpinned by a very strong improvement in exports (mainly to China and other emerging nations), as well as support from government infrastructure projects. We also expect stronger demand for technology products on the back of the corporate PC replacement cycle and higher consumer demand for more affordable notebooks and LCD TVs.

Singapore

Singapore is a highly cyclical open economy, with about half of its non-oil domestic exports shipped to the high-growth markets of Asia. In addition, inbound tourism will provide a major boost to services and export receipts, thanks to the pulling power of Singapore's new integrated resorts (IR) which could add a lot more buzz to its economy in 2010.

Indonesia

Indonesia offers some exciting investment opportunities. A more stable political environment combined with huge infrastructure spending and strong domestic consumption have led the Jakarta Composite Index to be the best performing market in Asia last year. Our APB Fund has an overweight position in Indonesia.

India

SL: In your December interview with Bob McKee, who was less bullish on China than you are, McKee suggested that India would lead in world growth versus China. Please explain.

Do: As far as India versus China is concerned, try to look at the situation 10 years from now. It is quite plausible India will be growing faster than China. This rationale is based on the fact that India is still significantly behind China in terms of infrastructure spending and level of GDP per capita. In addition, the Indian demographics profile is relatively younger than that of China. (India does not implement the one-child-per-family rule as China's government has done.) Nonetheless, in the coming 5-10 years, we continue to expect China to lead India in terms of economic growth and status.

India is developing into an open-market economy. Economic liberalization began in the early 1990s, and its growth has accelerated. India has capitalized on its large numbers of well-educated people to become a major exporter of services.

India escaped the brunt of the global financial crisis because of a relatively low dependence on exports and cautious banking policies. Domestic demand has re-emerged as a key driver of the economy as exports have fallen.

The government is committed to fiscal stimulus in 2010 and to deficit reduction for the following two years. It has proposed limited privatization of government-owned industries, in part to offset the deficit. India's long-term challenges include inadequate physical and social infrastructure, limited employment opportunities, and insufficient basic and higher education opportunities. In the long run, a huge and growing population is their fundamental social, economic and environmental problem.

SL: Has domestic demand emerged to drive the Indian economy forward? Is there sustainability, and what kind of growth rate do you see for India in 2010 and beyond?

Do: We have always viewed India as a domestic-demand driven economy while exports have always been a small portion of its economy. Government initiatives at boosting urban infrastructure, public sector reforms and divestments should all bode well for sustained investment growth.

We believe that India's future growth rate can be sustained in the 7%-8% range. This growth profile is not just a cyclical blip but a robust structural long-term growth story. Urbanization will be a secular growth theme underpinned by strong infrastructure spending and public investment.

Concluding Remarks

SL: This has been, as usual, a very informative interview. It is difficult for us to know what is really happening in China. How would you like to conclude?

Do: We believe China and Asia have emerged from this global crisis even stronger than before, as exhibited by the strength of economic rebound in recent quarters. Corporate balance sheets are much stronger, resulting from the de-leveraging process since the Asian financial crisis. In terms of capital management, the Asian financial systems are much healthier than in 2009, and the national saving ratio has been much higher than elsewhere. Domestic consumption will be a strong theme for Asia, underpinned by favorable demographics, especially with the growing affluence of the middle income class.

We remain bullish on the Asian region and Asian equities, both near-term and long-term.

SL: We are particularly interested in your views on India as some of our clients hold shares in The India Fund. Thank you, Khiem, for your insights. ■

Petroleum & Resources Corporation

(Continued from page 1)

SL: Good morning, Doug and Nancy. *The Scott Letter,* now read by over 2,000 subscribers, is published bi-monthly and features manager interviews in each issue. We interview 6-8 portfolio managers each year, both in the U.S. and overseas. A significant portion of our readers contact us for more information, and some become clients of CEFA.

We are impressed that you take on the huge responsibility to manage two large funds. You have also spent a great deal of time educating investors about closed-end funds as well as serving as the first president of the Closed-End Fund Association (www.closed-endfunds.com) after its launch in 1998. The Association offers fund data and other information to educate investors interested in learning more about the virtues of closed-end funds. We are now associate members.

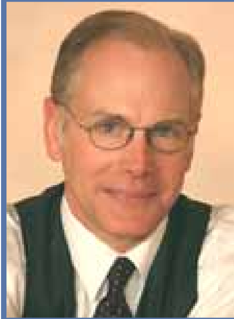
Ober: We feel it is incumbent to continue to educate investors on the benefits of closed-end funds. In 2009, we redesigned the web site for both funds (www.peteres.com and www.adamsexpress.com), making it easier for shareholders and prospective shareholders to navigate these web sites. We have seen an increase in market activity, particularly after making presentations and when the quarterly reports are issued.

SL: How old is PEO?

Ober: The Corporation, founded as a closed-end investment company in January 1929, has weathered the Depression, World War II, the Cold War, disco, and all of the ups and downs in the market during the past 79 years.

SL: How do Petroleum & Resources (PEO:NYSE) and Adams Express (ADX:NYSE) make their investment decisions?

Ober: Both funds are internally managed. We have a staff of research analysts and portfolio managers, so we avoid paying fees to outside advisers. The research analysts use a "bottom up" approach in selecting the stocks they recommend.



Douglas G. Ober

Douglas G. Ober, CFA, is the Chairman and CEO of two closed-end funds (The Adams Express Company and Petroleum & Resources Corporation) with combined assets of approximately $1.7 billion. Both funds have traded on the New York Stock Exchange since 1929, with Adams Express having previously been involved in a nationwide delivery business. Mr. Ober joined the firms in 1980 as a research analyst, became a member of the portfolio management team in 1986, and was elected Chairman of the companies in 1991.

Mr. Ober received his B.S. in Engineering from Princeton University, a Masters in Finance from Loyola College in Baltimore, Maryland, and a certificate from the Advanced Management Program of the Wharton School of the University of Pennsylvania. Mr. Ober is often cited as a source of information and insight into the energy sector by Reuters and *The Wall Street Journal.*

Nancy J. Floyd Prue

Nancy J. Floyd Prue, CFA, Esq., is the Executive Vice President of Petroleum & Resources Corporation, a closed-end fund with assets of approximately $650 million. Ms. Prue was appointed to that position in July 2009. She joined Petroleum & Resources and the Adams Express Company in 1982 and held the positions of Vice President since 2005 and Vice President of Research since 1986.

Ms. Prue graduated summa cum laude with a B.S. from Villanova University. She later earned a Law degree and MBA from the University of Baltimore.

A Chartered Financial Analyst, Ms. Prue is a member and past president of the Baltimore CFA Society and a member and past president of the National Association of Petroleum Analysts. She is also a current member of the New York Society of Security Analysts and the Maryland State Bar Association.

Petroleum & Resources Corporation
Performance* as of December 31, 2009

Market Price (USD) Return Net of Fees	1 Year	3 Year	5 Year	10 Year	20 Year
PEO – NAV	26.7%	0.0%	8.8%	8.1%	9.2%
PEO – Market	30.3%	-1.0%	8.2%	9.0%	9.3%

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

We look for investments in energy and natural resources that offer long-term earnings growth. A team of three portfolio managers reviews the analysts' recommendations and decides which stocks to purchase and, importantly, which to sell.

SL: What are the Fund's objectives?

Ober: PEO is an "energy and basic materials" fund. While great strides are being made in the development and commercialization of non-petroleum sources of energy, oil is still the fuel that drives the energy sector. However, we are not blind to the future as we are always looking for viable forms of alternative energy. We will invest in a variety of basic materials, including coal, nuclear and hydroelectric power, copper and potash.

SL: Recently *The Wall Street Journal* published numerous articles on the "alternative energy future", stating that the clean energy industry is poised for record growth in the U.S. As air and water pollution are now grave problems in many countries, there is a fast growing industry that is trying to address this issue, and thousands of jobs are being created.

The American Wind Energy Association (www.powerofwind.com), recently placed a full page ad in *The Wall*

Street Journal pointing out that wind power is providing hundreds of thousands of new jobs, adding that we risk losing the wind industry to more stable markets overseas. The group promotes comprehensive legislation with a strong "renewable electricity standard" and urges its members to contact their members of Congress. There are also many other kinds of alternative energy sources, which must be proliferating now that oil prices are rising again. Has your research team found any alternative energy companies for your portfolio?

Ober: We do not yet have any of these companies in the portfolio; however, we have owned a wind energy company and a biofuels company. As long-term investors, we have to be sure that the economics work. The sales of these companies' products are so dependent on grants and tax credits that they would likely be losing money for an indefinite time. In a conservative fund, we don't want to invest in companies so dependent on government largess.

SL: In what types of alternate energy would you consider investing? As you know, many countries are investing heavily in this area, particularly Europe, China and India. Each of these countries has an economic stake in producing materials for this exciting new growth industry.

Ober: When there is a viable industry, we will take a look again. Between the incentives for alternative use and escalating oil prices, that will happen, but at this point, the issue is so highly politicized that it is difficult for us to assess the future of companies participating in the industry. You said that wind energy is moving offshore, but I am not quite sure what you meant by this.

SL: We try to follow these developments closely for our clients and readers. T. Boone Pickens and others are active in lobbying Congress for both wind and natural gas energy tax credits so the U.S will be less dependent on foreign oil. The big push now for wind energy is coming from Denmark, Germany and other European countries.

We think that one way for you to get into alternative energy could happen when one of the portfolio companies of PEO purchases an alternative energy company that is starting to become profitable, as in the case of the drug companies that buy biotech firms showing promise.

Ober: General Electric is one of the largest producers of wind turbines in the world. This results in installation jobs, new windmills and other energy sources such as solar energy. We won't lose the industry to other markets because the energy can't be transmitted overseas.

SL: The wind power industry is growing very fast, although transmitting electricity from turbines located in rural areas to the large cities is still a problem. However, Oakland, Sacramento, and some smaller cities are now getting electricity from wind farms involving the public company, First Solar.

Wind energy – promoted by tax incentives – is expected to increase fivefold in the next decade, according to industry sources. By the end of 2010, the number of wind turbines is expected to increase 150% to nearly 2,600, from just over 1,000.

We also see other types of clean electricity production developing, such as solar and geothermal, as well as other sources. As dam building is largely a thing of the past, the question is how many of the nearly 80,000 U.S. dams can be removed. Only 3% of them generate power, supplying about 6% of the nation's electricity. The Sierra Club reports that it's possible to squeeze more clean energy from existing dams without much environmental impact, either by upgrading aging turbines or by turning dams built for irrigation or flood control into power generators.

Doug, are you aware, that smaller nuclear power plants are going to be built that will enable recycling of nuclear waste? General Atomics has launched a 12-year program to develop a new kind of small commercial nuclear reactor about one-quarter the size of a conventional one that could run on spent fuel from big reactors. They are joining a growing list of companies willing to place a long-shot bet on reactors that could be built in factories and hauled on trucks or trains. The company believes that the time is right to make a nuclear push, once it is approved by the Nuclear Regulatory Commission.

Ober: I think that the faster we build new nuclear power plants, the better off we will be from an environmental and energy standpoint. I don't think we will be energy independent but the more we are able to produce electricity without relying on imports, the better off we will be.

SL: I am a Sierra Club member who agrees that nuclear power plants need to be built again, the sooner the better. As our local newspaper says, "Conservation and green energy are important, but even on the romantically idealistic scale they are not nearly enough to close the gap. The U.S. needs more nukes." (Source: *Richmond-Times Dispatch)*

As you know, nuclear waste is still a problem. France is able to recycle nuclear waste, and we can't. They generate up to 79% of their electricity from nuclear power plants, many of which I have seen while traveling across France. Their emissions are minimal, unlike the dirty coal-fired plants. What do you think about this?

Ober: France has a socialist government that said this is what we are going to do, and it is the best thing for everyone. In the U.S., nuclear energy is an extremely polarizing subject, and the government cannot dictate what will happen. If we can recycle the waste products from nuclear generators for fuel, this is a tremendous way to address the waste issue and will enable us to put small nuclear plants in places that can be safely guarded.

SL: As there aren't any closed-end funds focusing exclusively on green investing, we have invested some of our clients in a green mutual fund that seeks capital appreciation through environmentally responsible investing. Winslow Green Growth Fund (www.winslowgreen.com) has been a pioneer in the field of green investing since 1983 and has an excellent long-term investment record. We will be interviewing their managers for the June edition of *The Scott Letter.* I also plan on meeting with them after attending the May annual meeting of the CFA Institute.

We like the fact that you are open to the future of green investing and hope that there will soon be a green closed-end fund that invests in alternative energy. As you know, there is a growing interest in this

important sector from investors. If there were a fund available in this area, would PEO invest in it?

Ober: We have talked about it. With Adams Express owning PEO shares, we certainly would be interested but have some reservations. We have also considered owning exchange traded funds ("ETFs") in this area.

Whether it is an ETF, a closed-end fund or a mutual fund, we would look at it from a relatively short-term strategic standpoint. If we decided we wanted exposure to the solar industry, there may be a solar ETF, and if there is one available, we wouldn't hesitate to buy it. We would then research the individual companies to determine whether they are what we want to own. As you said, we would be able to spread the risk across an ETF or a fund.

In doing this, you have the issue of doubling up on management fees which we deal with on the Adams side when looking at the petroleum fund. If we were to invest in three or four different funds, then we could double or triple up on management fees. This is something we try to avoid.

[**Editor's Note:** The expenses of ETFs are low because they are index funds with little turnover. Actively managed funds have either tied or beaten ETFs in eight of 12 major sectors so far in 2010, according to Morningstar. The active managers are making inroads in part because they have more flexibility to buy small- and mid-cap stocks, which are usually among the first to rally in an economic recovery.

In contrast, many indexes are composed of stocks weighted by market capitalization, so they tend to consist of the largest companies whose performance has recently trailed. Fidelity, for instance, manages $42 billion in 71 sector funds, and is outperforming ETFs in eight of ten key sectors in the trailing 3-month period. Historically, small-cap stocks fare better than large-cap stocks early in a bull market. (Source: *The Wall Street Journal*)]

SL: Doug, would you ever increase your holdings in PEO for Adams Express?

Ober: We have considered that as we sometimes invest the year-end distributions from PEO or Adams Express into more shares of PEO. If we feel that the long-term outlook for PEO is a good one, we often will reinvest, particularly due to the discount. The only difficulty we have is selling PEO because Adams owns 9.6% of PEO shares or roughly $52 million in value, which is 5% of Adams assets. We would have to get SEC approval and do an issuance of those shares or a distribution of some form.

SL: Nancy, have you been with the oil industry for a long time?

Prue: Yes, I have been with Adams Express for 27 years. We do not have exposure to pure plays in alternative energy stocks due to valuations and their dependence on subsidies.

Ober: We own Royal Dutch Petroleum, which has some significant holdings in solar investments, but those holdings are pretty small pieces of the companies in the PEO portfolio now.

SL: What is your long-term forecast for oil prices, and do you believe in what is known as "peak oil"?

Ober: We think that oil prices over the long-term will definitely rise. Whether the world has reached a peak in terms of production is a contentious issue. We don't believe that an absolute peak can be reached at this point. Iraq can produce about nine million barrels a day, but they are only producing about 2.4 million barrels a day. Venezuela, in the right political climate, could produce substantially more oil. That said, we believe oil supplies are going to remain at a fairly even level, and we expect that worldwide demand will grow on an annual basis by around a million barrels a day. So, if we are squeezing supply at this point, while demand continues to grow, prices are what will balance that market.

[**Editor's Note:** So-called "peak oil" is the point in time when the maximum rate of global petroleum production is reached, according to Wikipedia (http://en.wikipedia.org/wiki/Peak_oil). The first models were created in 1956, when M. King Hubbert accurately predicted that U.S. oil production would peak between 1965 and 1970. Other observers, including those in the petroleum industry, believe that as long as there is high dependence, relative low cost, and high availability of oil, there will be a post-peak production decline and possible increases in prices. This could, the report asserts, have negative implications for the global economy which could be reflected in 2020, assuming that no major investments in alternative energy are occurring.

Because 90% of transportation in the U.S. relies in oil, the suburbs' reliance on the automobile is an unsustainable living arrangement, according to a new book *(The Next 100 Million America in 2050)* written by Joel Kotkin, an urban futurist in California. He says "peak oil" would leave many Americans unable to afford petroleum for their cars and force them to use non-petroleum vehicles such as electric cars, battery electric vehicles, bicycles, new trains, or to move to rural/higher density areas, where walking and public transportation are more viable options.

"The shift to alternate fuels should be encouraged for many reasons," Kotkin adds. "Over time, biofuels will create new jobs, increase commodity prices and farm income, improve the country's balance of trade and reduce our dependence on imported fuel and chemicals. These products will likely expand beyond corn-based ethanol and toward other, perhaps more sustainable non-food fuels based on wood, agricultural waste and switchgrass."

"Equally important, a strong domestic energy industry would allow the country as a whole to slow down, or even reverse, the flow of capital to often hostile oil–rich states in the Middle East and elsewhere …. In many places, contrary to claims that the world is about to run out of fossil fuels, higher energy prices have stimulated new production of oil and lower-carbon natural gas in such areas as the Great Plains and the Intermountain West".]

Mr. Kotkin thinks Americans "would be forced to use non-petroleum vehicles" if "peak oil" becomes a realty. He must be aware that Americans are already driving many hybrid cars and soon will be buying all-electric vehicles. As this happens, won't there be a lid on oil prices?

Ober: New technologies will certainly enable us to find more [oil] and natural gas. That said, the oil fields today have been declining, so what was producing 500,000

barrels a day one year ago may only be producing 400,000 barrels a day now. Mexico is in a terrible situation because one of their oil fields is declining around 25%-30% per year. We have new oil coming on, but all of the fields, including those in the North Sea, are suffering from some levels of decline.

This is where the "peak oil" argument comes in. Fields will be running dry as fast as we can discover more oil. As demand continues to grow, oil prices have to go up in order to balance supply and demand.

Petroleum-based transportation fuels are impacted by the use of alternative energy sources so U.S. prices will weaken. Oil is a global commodity, and most of the growth is coming from the emerging economies like China and India. Although U.S. demand may flatten or decline, we think that global demand will keep prices high worldwide.

SL: That may be true. We have been studying the larger emerging market countries for several years now. I have visited two of them (India and China) and plan to go to Brazil and visit their national oil company, Petrobras. I also want to visit Russia to learn about their oil business as Mark Mobius of Franklin/Templeton is still positive on Russia, despite their many problems. He told us in an interview for our last *Scott Letter* that Russia is much too dependent on oil revenues and needs to diversify their economy.

The State of Virginia, headed by our new governor, Bob McDonnell, has just announced that he wants to make it state policy to support oil and natural gas exploration 50-100 miles from Virginia's coast. This has been a controversial move, opposed by the coastal resort and environmental communities, because of oil spill fears. Is there much concern in Maryland about offshore drilling?

Prue: Maryland's governor, Martin O'Malley, is less in favor of offshore drilling than Virginia's governor. As you've pointed out, there are environmental concerns. Our governor is more in favor of development of offshore wind power.

Ober: The issues are essentially the same for Maryland as for Virginia. Anything that jeopardizes the environment will be very difficult to approve. The idea of drilling for oil and gas off the Maryland coast is tough as the Maryland beaches are big revenue generators. Even if there is drilling off the coast, it will be a long time before it goes into actual production. However, it can be done reasonably safely, and there are ways to protect the environment surrounding the drilling. We are, however, concerned about the possibility of drilling off the coast.

SL: We hope that there are strong conservation organizations in Maryland fighting these proposals as we have here in Virginia. The EPA has also been concerned about it, and there may not be much oil or gas in the South Atlantic.

Now for some corporate governance questions. What is the expense ratio of the PEO fund, and how does it compare to other similar funds?

Ober: As an internally managed fund, we are able to keep a very tight rein on our expenses and operate with a lean staff. Our expense ratio last year was 0.49%, while the average ratio for a U.S. diversified mutual fund was 1.36%. While an expense ratio of 0.50% or less is quite typical for our funds, during the first quarter ended March 31, 2009, our expense ratio increased to 0.96% because of some non-recurring expenses on top of the sharp decline in net assets over the previous six months. As the stock market has recovered, the resulting increase in net assets should lead to a more typical expense ratio.

SL: Thank you for being so transparent on this issue. How would you describe the relationship between the two funds?

Ober: The philosophy is the same: preservation of capital and an opportunity for capital gains. Adams is a broadly diversified fund, and Petroleum is a sector fund. PEO is in an industry that is riskier than the broader economy. The same management group manages both funds, and PEO staff members specialize in the energy business.

Nancy and her senior oil and gas specialists are part of our professional management team. We have four analysts who cover the rest of the world and focus on their particular industry sectors. David Weaver and I work on the Adams portfolio. There are significant differences in these two funds from other fund families.

SL: Please tell us about your share repurchase program.

Ober: The Board of Directors of Petroleum & Resources Corporation voted in December to extend its share repurchase program and has authorized the repurchase of up to 5% of the outstanding shares of the Corporation's common stock through December 31, 2010. Purchases may be made in the open market when the shares are trading at a discount of at least 6.5% and as market conditions and portfolio management considerations otherwise warrant. As of December 10, 2009, the corporation had 23,746,585 outstanding shares, which means that if the company were to repurchase all of the shares authorized today by the Board, it would be 1,187,329 shares. The repurchase program was initiated in 1999 and has been reauthorized by the Board each year.

[**Editor's Note:** The discount of Adams Express on March 19 was -15.1%; and -12.1% for Petroleum & Resources.]

SL: Have you done any research about how the repurchase program actually reduces the discount on PEO, accounting for the shares needed for the distributions?

Ober: We have not purchased enough shares in the last few years to fully offset the number of shares over what we have to pay out in distributions. In 2009, we purchased 216,000 PEO shares versus 282,000 in 2008. Our shareholders took a lot of the shares in distributions in 2008, despite the low price of oil. In the first three years of the program, we saw little impact on the discount. Sometimes the discounts narrowed, and in other cases they widened, even when we were actively buying shares. We continue to purchase shares as long as it makes sense. We now have a low cash position so we are not sure whether we want to invest it in our own shares or in the energy sector. We recognize that it results in a higher expense ratio because we have fewer assets.

SL: Repurchasing shares raises the net asset value and sometimes reduces the discount by creating a floor price under the shares. You have been quoted that you like discounts, while the rest of the industry

tries to do everything they can to reduce the discount. We agree with you, and we all know about the magical leverage of the discount.

Ober: Yes, and it does provide support for market prices. So we have a few things going in opposite directions.

SL: Our next question deals with your strategy of writing covered calls and collateralized puts. I am sure many shareholders do not understand how this works. What is the philosophy behind that strategy?

Ober: These are integral to our investment program. We will write collateralized puts on stock that we want to add to the portfolio. They are collaterized either with Treasuries or other stocks in the portfolio. Hypothetically, we may write a $55 put on Exxon because we want to add to our Exxon position, if it goes below $55. We could write covered calls on Exxon with a $70 strike price and place a sell call option with a target price of $70 for a dollar on each contract.

This is an attractive way to discipline ourselves to sell. If the shares get called away, that is what our investment decision was, and we are fine with that. You might forego opportunity costs in a bull market, but we do this on a limited basis and never write options on more than 20% of the portfolio. We occasionally purchase calls on Adam Express' holdings, when the stock has run-up dramatically. This is a way to protect our gain, but we haven't done so for PEO.

SL: What are your views on "managed distributions" for closed-end funds?

Ober: After a lot of research, we decided that it doesn't make much sense for us. We ran some models in 1999 and found that our distributions have given our shareholders an 8% return for Adams, while our distributions for Petroleum have averaged 6%.

We looked at it again in 2006, when many other funds had managed distribution policies to try to narrow discounts. With very few exceptions, it had a negligible impact on narrowing the discount.

SL: Thanks, Doug and Nancy. We plan to attend your annual meeting on March 23. I look forward to seeing you there. Keep up the good work! ■

Portfolio Manager's Review

For the first quarter of 2010, we see a continuing positive stock market environment for the balance of the year as the U.S. economy continues its slow recovery, with earnings and cashflows improving in all of our markets. Inflation is down to 2% from 2.7% in 2009, crude oil has been trading over $80 a barrel, and consumer confidence has been inching up.

During the quarter, we purchased more shares of Adams Express, our largest holding, as well as increased our holdings in Cohen & Steers Opportunity Fund, making it one of our largest holdings as well. We probably won't add to it further as the discount has narrowed substantially. Other closed-end funds purchased were Petroleum & Resources (when oil prices dipped) and Templeton Emerging Markets Fund, until it nearly closed its discount. We like this fund because it covers the emerging markets world, including Russia, Turkey and South Africa, that our other funds do not cover and has been a superb performer over many years, thanks to the expertise of Dr. Mark Mobius. Sales included elimination of The European Equity Fund, because of the economic crisis in Europe.

For income-oriented clients, we added to covered-call, preferred equity and high yield funds on sector weakness. We also swapped senior loan funds, and stop-losses were realized by a few funds trading at premiums to NAV. We continue to look for funds that are earning their dividends while trading at good discounts to NAV.

We remain positive for 2010, and our clients are beginning to feel better about the stock markets after the recession which ended last June. Growth in our portfolios has been steady since then. ■

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