

THE SCOTT LETTER: CLOSED-END FUND REPORT

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A Global View of the Closed-End Fund Industry

November/December 2013

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.



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Templeton Frontier Markets Fund: Most Experts Agree It Is Wise to Diversify But True Diversification Is Difficult

Franklin Templeton Investments is a global investment manager with over \$870 billion in assets under management as of November 30, 2013, with a core of multiple world-class management groups – Franklin, Templeton and Mutual Series – each operating independently and offering their unique perspectives to investment advisors and their clients. This multiple-manager structure allows the managers to offer exceptional, specialized expertise across key asset classes and investment styles that are supported by a single global platform, offering investors the opportunity for true diversification.

Most experts agree that it is wise to diversify, but true diversification is difficult to achieve at most firms. Because Franklin Templeton’s investment groups work independently, adhering to distinctly different investment approaches, they are able to offer broad diversification with a typically low number of common holdings. With offices in 25 countries, the firm offers a truly global perspective. Their local research presence around the world has helped to make them a leader in international investing for more than 65 years.

Mark Mobius, Executive Chairman of Templeton Emerging Markets Group, has been investing in emerging markets since 1987. In February of that year, he launched The Templeton Emerging Markets Fund (NYSE:EMF), a closed-end fund that pioneered investing in emerging markets. This fund has had an excellent investment record since its founding.

The Templeton Frontier Markets Fund (NYSE:TFMAX) was launched by Mark Mobius on October 14, 2008. This Fund seeks long-term capital appreciation by normally

investing at least 80% of its net assets in securities of companies located in “frontier market” countries. These markets are a subset of those currently considered to be “developing” by the World Bank, the International Finance Corporation, the United Nations, or the countries’ authorities or countries with a stock market capitalization of less than 3% of the Morgan Stanley Capital International (“MSCI”) World Index.

TFMAX, a mutual fund, is designed for the aggressive portion of a well diversified portfolio, and all of its investments should be long-term investments that could experience significant price volatility in any given year. Because the growth of the Fund has been so rapid, TFMAX is now closed to new investors. Present investors may add to their holdings (Source: Templeton Frontier Markets Fund, Semi-Annual Report, September 30, 2013).

Mobius travels constantly as he is intent on seeking opportunities for potential investments. His supporting team, many of whom travel with him, are Allan Lam, Dennis Lim and Tom Wu. We have spoken to these and other members of this expert team about their knowledge in the emerging markets.

Mobius now spends about a third of his time in the frontier markets. On November 15, 2013, we found him in the lobby of his Hong Kong hotel. He told us that he was traveling that day, first to Georgia and then to Dubai.

SL: Good morning, Mark. As you know, we have been following the emerging markets with you for many years. Please tell us as much as you can about the frontier markets and how you invest in them.

Mobius: Frontier markets present challenges for the average investor as these



Dr. Mark Mobius

stocks rarely trade on U.S. exchanges, which makes it difficult for U.S. investors to buy shares.

Keep in mind that we have navigated through past periods of economic uncertainty and market volatility by remaining committed to our long-term perspective and disciplined investment approach. First and foremost for us, this means using our on-the-ground research team to conduct rigorous, company-by-company analysis to find what we consider to be bargain opportunities. We now have \$3 billion USD in four funds investing in frontier markets, and some of it is private money.

Within the emerging markets universe, we believe that the frontier markets have now begun to take an impressive lead in terms of growth. The frontier markets include more than just African and Asian countries. It also includes all of the emerging countries in South America.

SL: Do you have any comments about the economic situation in the U.S.?

Mobius: From my point of view, the problems the U.S. is now facing with its budget and the discussion of the very likely

possible default could be inadvertently positive for some emerging market countries over the long term. This is because outflows from U.S. Treasuries could go into other markets. It could also incentivize investors who are heavily invested in U.S. debt and the U.S. markets to have second thoughts about putting too many eggs into an uncertain U.S. basket.

SL: How much time do you spend visiting the frontier markets?

Mobius: I spend about a third of my time in these markets, with Dubai, Eastern Europe and South Africa serving as hubs for access. While the emerging markets we visit today were considered niches or “exotic” investments when I first started investing in them in the late 1980s, many investors are now familiar with them.

SL: We see that TFMAX is only open to U.S. investors. What if we had a foreign investor with U.S. dollars who wanted to buy the shares?

Mobius: Non-U.S. investors should consider the Luxembourg fund. You can go to any of our U.S. representatives, and they will set that up for you.

SL: Good, where are you going next?

Mobius: To Georgia, which is a frontier market that is doing very well. They have an incredible reform program where they are now trying to attract capital investments. The Prime Minister, who recently stepped down, is a billionaire who made a lot of money in Russia. He is encouraging private enterprise. The Bank of Georgia is in TFMAX’s portfolio.

SL: When in Dubai, do you visit the neighboring countries?

Mobius: We invest in all kinds of companies all over the world; so, yes, we will definitely visit the neighboring countries. Since we also invest for the longer term, we want to consider a full spectrum of possibilities.

[Editor’s Note: “It has only been four years since the global economic slowdown plunged Dubai into a major debt crisis (near default), but the country is acting as if none of this happened. Money continues flowing everywhere. United Arab Emirates banks are expected to enjoy a 20% uplift in profits in 2013 Among projects under construction is Mohammed Bin Rashid City, which will contain 100 hotels, a theme park and the world’s largest shopping mall” (Source: Excerpt from “Middle East: Say Dubai to Caution,” *Global Finance*, November 2013).]

SL: We understand that you have to pay for the investments in certificates.

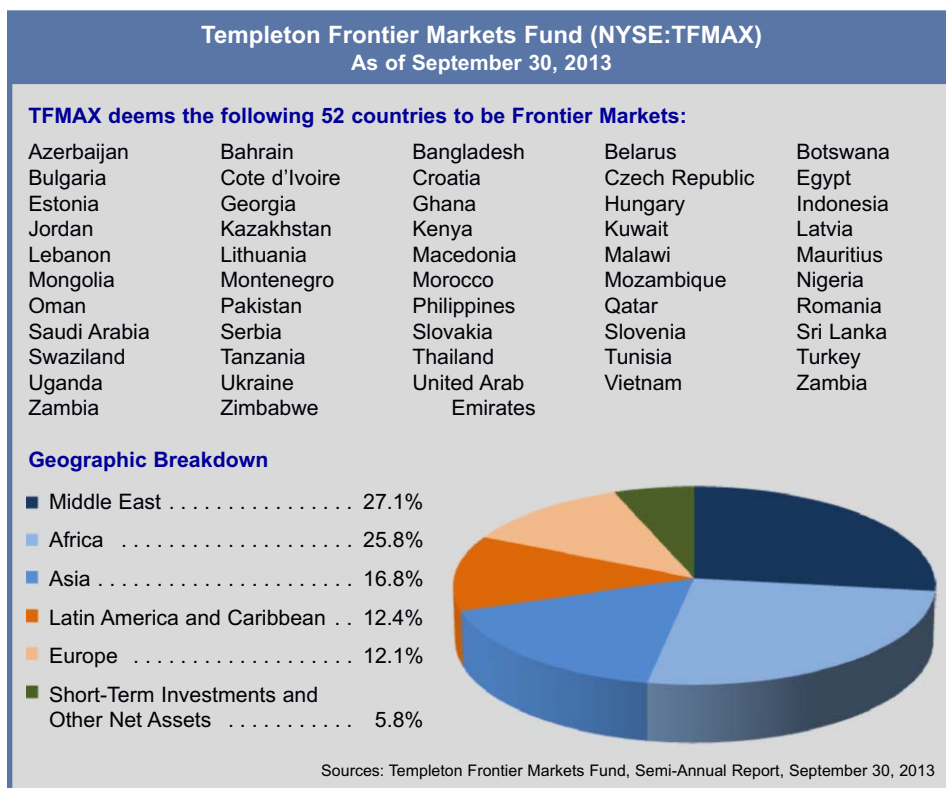
Mobius: Although Dubai has a public market, Saudi Arabia does not. Its market is closed to foreigners for direct investment so we deal with some of the big banks to buy shares, and they issue us a certificate. It’s somewhat like an ADR program. They’ve been talking about opening the markets, but we haven’t gotten the word yet.

SL: We notice that you invest in many banks in your portfolio.

Mobius: Banks in TFMAX’s portfolio weighting are prominent.

SL: How do you evaluate the large number of companies that you visit in a Fund that holds so many small companies? Is the valuation daily or weekly?

Mobius: We get a market price, which is deterred by the spread. Prices offered by people may be higher than market price.



SL: What kind of liquidity do these small markets have, if you need to sell?

Mobius: We have not encountered liquidity difficulties in the frontier markets. Although during periods of high liquidity, prices may be impacted if market participants try to sell at the same time. This is true whether it's the U.S. market or any other market.

SL: How often do you have that problem?

Mobius: We have no problem whatsoever in liquidating enough stock to meet redemptions. This is something that we are proud of, and it is the least of our problems.

SL: What if the shares don't sell for several weeks? What do you do then?

Mobius: What you often see in frontier markets is that many of the trades take place off market, i.e., privately between buyers and sellers. So just looking at the public data on Bloomberg doesn't tell the whole story.

We have many stocks in the portfolio. The problem is getting liquidity. In most situations, we would not want to sell an "illiquid" stock because the price we would get would not be a fair price. In that case, we would sell other stocks that are liquid.

SL: You have written that the frontier markets have a tremendous potential for the long-term investor. "If" – and it's a big IF, you wrote on your blog – if investors have patience and show perseverance, the potential for rewarding returns is there. Is that correct?

Mobius: Yes, that's correct. This is true not only for the emerging markets, but for all markets. Short-term thinking is very dangerous for investors.

SL: I couldn't agree more. At Closed-End Fund Advisors, we have discretion over our clients' portfolios, but our fiduciary responsibility is to always put their interests first and foremost. Therefore, we work hard to preserve and grow their investments over the long haul. Only a few of our clients who hold TFMAX have sold any of those shares. Isn't that the Templeton philosophy?

Mobius: Yes, that is the Templeton Way. We believe that there are bargains in

certain less liquid stocks to be found in the frontier markets, as you know from your own long experience.

You have to define what "long term" is for a full partnership between the investor and the manager. The manager will try to manage the positions to realize good profits by holding stocks for the long term. This is true in the emerging markets as well as in the frontier markets.

SL: Well said. According to our research, Nigeria is one of your largest exposure, but oil prices have been dropping in the U.S. where there is an oil glut. Is that hurting Nigeria?

Mobius: Not at all, because the demand from China continues to be strong.

SL: What kinds of growth rates do the companies in Africa have?

Mobius: The range can be substantial, depending on the sector and stage of a

"We are just scratching the surface of some of the smaller African countries,"

company's development. We hold a brewery in Nigeria, for example, that has an estimated 3-5 year earnings per share ("EPS") growth of 22%.

SL: Does that apply to some of the smaller African countries as well?

Mobius: Yes. We are just scratching the surface of some of the smaller African countries, as they are just beginning to enter the market economy.

SL: With all of the recent craziness that caused the bombings in Nairobi, Kenya, has it disrupted any of your portfolio companies there?

Mobius: No, there's been no impact at all. There are many fast-growing companies throughout Africa. The banks are interesting, and we own interest in Safaricom, a leading telecom operator. A number of the companies that have a "British rule" background are doing well.

SL: Your largest holdings are in Nigeria, Qatar, Kazakhstan, Kenya and the United Arab Emirates. Please update us.

Mobius: Nigeria and Saudi Arabia are the big ones. One of the challenges that Africa poses is many of these countries' boundaries were done artificially by the colonial powers who established political positions.

SL: Have they exploited the resources there?

Mobius: Yes, and you have tribes and tribal kings who established boundaries. They sit down with a map and draw a line at will, which causes problems for the future. It has happened in Rwanda and all over Africa, but this is a temporary problem. There could be a lot more of these events as modernization increases.

SL: How easily do the tribes find accommodations in South Africa?

Mobius: It is a matter of working on it and being patient.

SL: Are there companies in Africa that are liquid enough to put into your portfolio?

Mobius: Definitely. The question is how much growth is there when we invest in oil companies and banks in Africa.

SL: Is South Africa still considered an emerging market?

Mobius: South Africa plays both roles in the sense that it is an emerging country, but the threat is what is happening in southern Africa more and more. We buy stocks in South Africa with some exposure to the southern Africa region.

SL: Now, please tell us about your activities in Eastern Europe.

Mobius: My first trip to Romania was in 1997. The city infrastructure was in bad shape, few spoke English, and the cars were domestically produced. I have since visited Bucharest many times and seen considerable changes taking place.

The city's infrastructure has improved, there are better roads and airports as well as good accommodations for visitors. Luxury cars are imported from all over the world as living conditions have improved. Romania is now a market economy.

The Bucharest Stock Exchange, inaugurated in 1882, was closed during the Communist regime after World War II. It reopened in 1995, and in less than ten years, there were more than 70 listed

Templeton Frontier Markets Fund (NYSE:TFMAX)
As of September 30, 2013

Top 10 Equity Holdings

Company	Sector/Industry	Country	% of Total Net Assets
Ooredoo QSC	Diversified Telecom Services	Qatar	4.3%
OMV Petrom SA	Oil, Gas and Consumable Fuels	Romania	4.0%
Industries Qatar QSC	Industrial Conglomerates	Qatar	3.6%
Dragon Oil PLC	Oil, Gas and Consumable Fuels	Turkmenistan	3.4%
KazMunaiGas Exploration Production, GDR	Oil, Gas and Consumable Fuels	Kazakhstan	3.3%
MTN Group, Ltd.	Wireless Telecom Services	South Africa	2.9%
First Gulf Bank PJSC	Commercial Banks	United Arab Emirates	2.8%
FBN Holdings PLC	Commercial Banks	Nigeria	2.6%
Zenith Bank PLC	Commercial Banks	Nigeria	2.5%
Bank of Georgia Holdings PLC	Commercial Banks	Georgia	2.2%

Sources: Templeton Frontier Markets Fund, Semi-Annual Report, September 30, 2013

companies, with a market capitalization of \$12 billion USD, about 17% of Romania's GDP.

Unfortunately, it declined afterwards and like other Eastern European markets, was affected by the 2008 global financial crisis, much of it due to reduced trading activity by foreign investors. Although the Bucharest Exchange is dominated by residents, foreign investors play an important role as trend setters.

We opened an office in Bucharest in 2011 to manage a fund called Fondul Proprietatea, which was established to compensate Romanians whose properties were confiscated by the former Communist government. Since then, Grzegorz Konieczny, the Fund Manager of Fondul Proprietatea, has moved to Bucharest and spearheaded the Fund's listing on the Bucharest Stock Exchange. It is quite remarkable to see what is happening. The whole reform program was in trouble, but it is now paying off.

The investment fund that we managed was a closed-end fund with a discount of 70%, but now it's about 30% (as of November 15, 2013). We paid dividends to shareholders, and Elliott & Associates, one of the big shareholders, have begun buying shares, so it has been really exciting.

SL: We know that this is very unusual. When our investment group in the 1970s

attempted to take control of the tiny Diebold Venture Capital Fund in New York, we started buying shares when the fund was selling at a discount of over 50%. We got control of it and built it into a \$200 million closed-end fund that rewarded its shareholders for many years.

While I was on the Board of Directors of Bergstrom Capital, this experience led me to become a specialist in closed-end funds. I purchased Closed-End Fund Advisors in 1996.

You also manage the Templeton Russia and East Europe Fund (NYSE:TRF).

Mobius: Yes. We invest in Russia, Poland and all of the countries in that region. The frontier markets in the region are Romania, Bulgaria, and Serbia.

SL: We see that it is an important part of your frontier markets investments. How is Ukraine doing with all of the troubles there being reported in the daily press?

Mobius: I think what that is all about is an agreement to lend a piece of land so that the Chinese could come in and help the society with fertilizer and so on. I doubt that it is a situation where they will own the land. Ukraine has rich soil, and their agricultural companies are doing very well.

SL: Now please tell us about your holdings in Egypt.

Mobius: We still like Egypt, and I was there a few months ago. The faster growing

sectors are the big pharmaceuticals and telecommunications companies.

SL: What are your views about the BRIC countries (Brazil, Russia, India and China)? We see that some financial writers include South Africa as a part of the BRICs. Why is this?

Mobius: There is this crazy thing of adding South Africa to the BRICs which, I think, does not make any sense at all. I can't fathom why that is.

SL: We agree. However, there seems to be some criticism of the BRICs now because some of them, such as Brazil, have had slower growth. What are your thoughts about Brazil now?

Mobius: The Brazilian government has spent billions of dollars on their commitment to the World Cup and the Olympics, which is difficult for this country to do.

SL: That is certainly true. I was also interested in the fact that they were going to build a high-speed rail connection to link the cities of Sao Paulo to Rio for the World Cup and Olympics, but that project seems to have faded. However, we now see that Brazil seems to be oversold, and we are considering investing in this region again. Despite this, other countries in the region are doing well, including Columbia, Chile and Mexico.

Isn't Argentina now a frontier market?

Mobius: Yes, and I will be going there again soon.

SL: What about South American countries that are not in the Fund such as Bolivia?

Mobius: We are looking at those countries as well.

SL: Please tell us about your investments in Panama.

Mobius: Panama is a nice country to visit, and many people have retired there because of the tax benefits. It is also a free port. Right now, our holdings include the big airlines and some private equity companies in the consumer area as well as some trading companies.

SL: We remember that you once managed a Vietnam fund a few years back that you had to liquidate. Now times have changed, and Vietnamese companies are about 4% of the TFMAX portfolio. Please tell us about this fast growing country.

Mobius: Our big holdings there are petrochemical companies (PetroVietnam) and other production companies that are exploring for offshore oil. Rubber is also a big product there. We have also invested in companies producing plastics as well as in milk farms and pharmaceutical companies.

However, liquidity on the Vietnam stock exchange is not good. We have patiently picked up some stocks that have worked out very well and are worth more than the market price, but we would like to get access to a block of Vietnam shares.

SL: Mark, thank you for your time. We have learned a lot from this interview. ■

Disclosure: CEFA's clients and employees as well as family members of own shares of EMF, TRF and TFMAX. Closed-End Fund Advisors will not trade in these securities for 72 hours after the release of this Scott Letter has passed.

Templeton Emerging Markets Fund Press Release (December 2, 2013)

Templeton Emerging Markets Fund announced a total distribution of \$1.6899, comprised of net investment income of \$0.4381 per share and long-term capital gains distribution of \$1.2518 per share, payable on December 31, 2013. Ex-dividend date: December 11, 2013.

Frontier Markets Are the “New” New Emerging Markets

The Magaba market in northern Zimbabwe is a hive of activity during the week. Zimbabweans can find almost everything under the low-slung tents blanketing a mile-wide square. The buyer's paradise offers everything from Mazoe Orange Crush juice drinks to sheet metal to clothes to plumbing equipment. And, as Hedge Fund Manager Larry Speidell likes to note when he visits, none of this activity is recorded as a part of the country's official GDP, which grew 5% in 2012. “We call it ‘walking around GDP,’” he says.

Speidell is an investor in the so-called frontier markets, a term that dates back to the early 1990s, when an arm of the World

Bank drew a distinction between mainstream emerging markets and other far-flung economies, where markets were illiquid, infrastructure almost nonexistent, and economic development in very early stages.

Today, economies across Southeast Asia, Africa and South America present the same challenges for investors that BRIC countries did more than a decade ago. They offer the same potential for explosive growth and stock returns. We find opportunities in domestic sectors with good returns and predictable growth, and have identified many good entrepreneurial firms in India, Thailand, the Philippines, and Indonesia.¹

Global Finance Magazine sat down with Conrad Saldanha, Portfolio Manager, Emerging Markets Equities at Neuberger Berman, to discuss the future prospects for global emerging markets.

Saldanha says, “Several factors are responsible. The Magaba market in northern Zimbabwe is a hive of activity during the week. Zimbabweans can find almost everything under the low-slung tents blanketing a mile-wide square.”² ■

Sources:

¹Scott Cendrowski, excerpts from “The ‘New’ New Emerging Markets,” *Fortune Magazine*, May 23, 2013

²Excerpt from “Salon: Conrad Saldanha,” *Global Finance Magazine*, October 2013

Why Frontier Markets Are Still Attractive

Emerging markets have been in the limelight due to their stellar performance in the past few years, but they have lost their luster lately. So far in 2013, many emerging markets suffered steep declines, ... making investors reconsider emerging market in general.

Some of the emerging country funds from India, Indonesia, Thailand, Turkey

and China have been struggling with weak numbers. On the other hand, many smaller emerging markets or frontier markets have managed to remain rather unaffected by the turmoil in the broader emerging markets space.

One of the reasons for outperformance of frontier markets is the currency factor. Many of these countries peg their

currencies to the U.S. dollar. As such, these currencies remain steady while currencies of most emerging markets have suffered a lot of pain. Currency losses have been a big factor in emerging markets poor performance. ■

Source: Excerpt from “Why Frontier Markets ETFs are Still Attractive,” Zack's Equity Research, September 18, 2013.

Jim Haynie Assumes Roles with Adams Express and Petroleum & Resources

Jim Haynie joined the funds in mid-August as President of Adams Express Fund and Executive Vice President of Petroleum & Resources Fund. Haynie previously served as Chief Investment

Officer of U.S. Equities at BNP Paribas Asset Management.

Greg Buckley recently joined Petroleum & Resources Fund as Senior Equity Analyst. He also comes to the Fund from BNP Paribas Asset Management.

We plan on interviewing management of these funds for the February issue of *The Scott Letter*. We will query management about the potential of the Arctic for oil and gas exploration and the risks involved. ■

Portfolio Managers' Review

After the Federal Reserve issued their December 18 report that jump-started the world stock markets, we asked: "How does this relate to the frontier markets?"

The answer may be that what happens in the U.S. economy usually effects the behavior of the world markets, including the frontier markets. There is evidence of this as stock markets rallied worldwide on the Federal Reserve's announcement that they would be reducing the stimulus while pledging to hold interest rates near zero.

Following the announcement, the Dow posted its third biggest rally of the year to a record \$16,167.97. European stocks headed for their highest level in two weeks, and many other markets followed.

Trying to predict markets over long-term trends is very difficult. Mark Mobius (2012) in his *Little Book of Emerging Markets*, wrote: "These newer emerging markets, which we call 'frontier markets', are found all over the world – in Latin America, Africa, Eastern Europe, and Asia." (See list of countries on page 2 of this *Scott Letter*.)

What we learned from our recent interview with Mobius is that investing in the frontier markets comes with risk that should only be borne by investors who have the patience and forbearance to navigate these markets.

Client portfolios at Closed-End Fund Advisors ("CEFA") reflect a set of well diversified investments. All of our clients, particularly those who own shares of TFMAX, should know that our portfolio managers review both growth and risk factors quarterly to ensure we are meeting clients' long-term investment objectives.

Tax-loss selling is underway this winter. Municipal tax-free CEFs are getting some of the biggest pressures as well as CEFs that are under-1-year in

existence (IPO'ed after December 1, 2012). According to our CEF Universe data (as of December 13, 2013), national muni bond funds are averaging -9.5% discounts and 7.0% yields. This part of the CEF market has the longest duration as well as the biggest retail ownership.

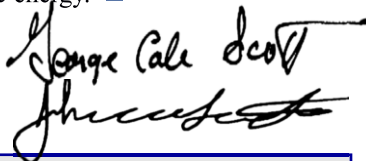
For investors who own these funds for credit quality or tax reasons, we stress monitoring NAV (manager performance), earnings coverage and relative pricing (discount levels). With 100 funds from which to choose, swapping trades without having to worry about wash sale rules is possible.

Taxable bond funds average a discount of -8% with a 7.8% average distribution yield. Even U.S. equity funds, which have had a great year, are at -10% discount levels with 1-year market total returns of +22.6% for the 41 funds we have grouped in this sector. If you are looking for other beat-up equity funds, look into REIT and MLP CEFs as they offer cash flow from an equity security that should be able to grow distributions in excess of inflation.

The next issue of *The Scott Letter* will be sent to subscribers in February 2014. We will interview the managers of Petroleum & Resources Fund to learn more about where the energy business is going.

Our research thus far shows "the outlook is for oil prices to have a small pullback from recent levels of about \$95 per barrel in the U.S. Prices at the pump will tick down too" (Source: "Kiplinger's Economic Outlooks," *The Kiplinger Letter*, December 6, 2013).

We will also take a look at what's happening to shale oil and the progress of alternative energy. ■



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