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THE SCOTT LETTER: 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

– John Cole Scott, Contributing Author

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Cohen & Steers Quality Income Realty Fund

Cohen & Steers is a leading global investment manager with a long history of innovation and a focus on real assets, including real estate, infrastructure and commodities.

In 1986, Martin Cohen and Robert Steers established Cohen & Steers as the first investment company to specialize in real estate. As global real estate securities evolved, the company expanded their operations to Europe and the Asia Pacific, forming the industry's largest global investment team dedicated to real estate securities.

Through careful consideration, the firm has added investment offerings over the years and has developed related strategies designed to meet investors' increasing demand for dividend income and real returns.

As of March 31, 2014, the firm manages 10 closed-end funds, one of which is the Cohen & Steers Quality Income Realty Fund (NYSE: RQI). The primary investment objective of RQI is high current income through investments in real estate securities. The secondary investment objective is capital appreciation.

Jason A. Yablon

Its portfolio manager is Senior Vice President Jason A. Yablon, a U.S. and global portfolio manager with 14 years of experience. Prior to joining Cohen & Steers in 2004, Yablon was a sell-side analyst at Morgan Stanley for four years, most recently focusing on apartment and healthcare REITs. Yablon has a B.A. degree from the University of Pennsylvania and is based in New York (Source: Cohen & Steers).

Cohen & Steers was listed on the New York Stock Exchange in 2004, and as of March 31, 2014, the company had $49 billion in assets under management. Cohen & Steers is headquartered in New York, with offices in London, Hong Kong, Tokyo and Seattle.

The Scott Letter interviewed Mr. Yablon via telephone on May 2, 2014.

SL: Good afternoon, Jason. We have not updated the real state sector for some time, so this is a good time to do so. How long have you been with Cohen & Steers?

Yablon: I first joined Cohen & Steers as an analyst ten years ago and initially covered apartments and healthcare REITs. Over time, I gained more responsibility as a member of the global investment team.

SL: What do you mean by the "global investment team"?

Yablon: I covered Latin American global funds and later was promoted to portfolio manager. I am responsible for the investment portion of the real estate closed-end funds. Bill Scapell manages the preferred securities portion of the Fund.

SL: Do you still invest in REITs in Latin America?

Yablon: We have lots of different products by region. The one I referenced was our global open-ended regional fund, where we invested in Brazilian companies. Brazil doesn't have a REIT structure, just operating companies. However, there is now a REIT structure in Mexico. Lots of IPOs occur in that market.

SL: How do you assess the investment risks for your portfolio?

Yablon: When I think about investment risks, I separate them into risk buckets. The first and most important is business risk. What is the company investing in, and what is the underlying real estate?

This gets back to the supply-and-demand for the real estate in the companies' respective market or business segment. We figure out what the primary economic driver for jobs or household formation is.

We also focus on where supply growth originates and where it is developing in the competitive marketplace; this obviously has great impact. One risk is the fundamentals of the marketplace as it applies to the dynamics.

The second risk is company-specific, and that is really more of a financial leverage issue.

We watch very closely how much attention the company pays to leverage, i.e. the balance sheet, and secondly, to its liquidity, pay ratio and the general financial metrics.

A third element, from a portfolio management standpoint, is the liquidity of the stock that we are investing in and the diversification within the portfolio.

We want to be sure that we can get in or out of the stock as we alter the portfolio due to changing views of the economy, of a particular sector or of a particular stock. What ultimately drives real estate prices is the ability to push rent and occupancy, thereby getting more cashflow out of the property.

While people are concerned about a rising real estate environment, the reality is that you need to position the portfolio to take advantage of a better real estate market. This means you need to own properties that benefit from an improving economic environment. If interest rates are going up and the economy improves, that is good news for real estate securities as well as a good hedge against inflation.

SL: Your 2013 Annual Report shows that you look across a wide real estate universe. Please explain.

Yablon: Yes, we invest in real estate stocks and will leave no stone unturned. This is due to the fact that there can be a great disparity of returns between stocks and sectors.

If you look back over the last 10 years, the best and worst property sectors had a performance spread of roughly 40%. This means there is a 40% difference between how the best sector performed versus how the worst sector performed on average over the last 10 years.

In 2013, for example, hotel stocks were up 27%, and healthcare REITs were down roughly 7%. That is a huge spread which, in our view, presents a potential for active managers to add value.

SL: We see that you have a good mix of different types of sector breakdowns, based on managed assets listed in your 2013 Annual Report as follows:

Ten Closed-End Funds Managed by Cohen & Steers

Fund	Distribution Rate*
Cohen & Steers Quality Income Reality Fund (NYSE:RQI)	7.10%
Cohen & Steers Total Return Realty Fund (NYSE:RFI)	7.03%
Cohen & Steers Infrastructure Fund (NYSE:UTF)	6.59%
Cohen & Steers MLP Income and Energy & Opportunity Fund (NYSE:MIE)	6.69%
Cohen & Steers Limited Duration Preferred and Income Fund (NYSE:LDP)	7.61%
Cohen & Steers Select Preferred and Income Fund (NYSE:PSF)	8.02%
Cohen & Steers Dividend Majors Fund (NYSE:DVM)	5.90%
Cohen & Steers REIT and Preferred Income Fund (NYSE:RNP)	6.95%
Cohen & Steers Closed-End Opportunity Fund (NYSE:FOF)	7.87%
Cohen & Steers Global Income Builder (NYSE:INB)	9.19%

*Distribution Rate is calculated by dividing the last distribution paid per share (annualized) by the market price. A fund may pay distributions in excess of its net investment company taxable income and, to the extent this occurs, the distribution yield will include a return of capital.

Source: Cohen & Steers

Self-Storage (Common)	4.7%
Industrials (Common)	5.5%
Hotel (Common)	6.3%
Health Care (Common)	8.0%
Diversified (Common)	8.2%
Real Estate (Preferred)	10.2%
Shopping Centers (Common)	22.8%
Residential (Common)	12.0%
Office (Common)	11.7%
Other	10.6%

Which of these segments stand out?

Yablon: Right now, of our core holdings from a fundamental and investment standpoint, I like the office real estate market, shopping centers and self-storage space. This is where we find the strongest underlying demand which leads to improving the pricing power in these sectors. On the office side, our investment views are market-specific.

SL: Where?

Yablon: We like the West Coast market, especially the San Francisco Bay area where the lack of vacancies is driving up rents. This is a good way to play growth in the technology market.

We like the West Los Angeles office market, even though the big banks there aren't hiring aggressively.

We also like the New York City office market, which is tightening up and is healthier today than in 2012. Although the big financial houses aren't hiring aggressively, Google and other technology companies are expanding into that market.

The self-storage space is different as it has two elements. One is the large public operators who steal marketshare from the private operators, e.g., the mom-and-pop stores. The public operators can generally manage the properties much more efficiently when it comes to pushing rent and selling tenant insurance. On top of that, they have an excellent growth story through acquisitions, where they buy under-managed assets from the mom-and-pop owners.

This is happening while the fundamentals are extremely healthy, with these self-storage spaces generating high single-digit, same store operating growth. Unlevered capital return is coming from these properties, ranging anywhere from an extremely healthy 5% to 9%.

The other sector that I like within the retail space is the regional malls and shopping centers that have a theme. There is very limited new supply being built on the consumer side. However, we're filling up shopping mall space, so the fundamentals are improving.

SL: That's good. We once invested in a Canadian-owned shopping center REIT, Pan Pacific Properties. This once fast-growing company primarily held shopping centers from Seattle to San Diego. They made a great deal of money from grocery-based shopping centers that attracted upper-scale businesses. They were so successful that the majority stockholder liquidated the company and retired.

From this experience, we learned that grocery stores have been a magnet to attract high quality stores. Do you agree?

Yablon: Yes, that's right. Grocery-centered businesses have been very good, but that's not the driver of the story today. You need a good anchor to drive traffic, but the driver is much more the small shops which can increase occupancy of smaller spaces. This is the angle right now for companies benefiting from increases in the economic environment.

That's why we are underweight in healthcare and net leases, as long-duration leases don't really benefit from the economic environment. Similarly, if you have an economic environment with grocery-centered shopping centers, you don't have much upside. There is more upside from the centers that have more vacancies.

SL: Okay. So the environment for anchor tenants has changed. What properties draw the most in terms of renting out shopping centers in what may soon be a booming environment?

Yablon: We are very focused on shopping centers that choose the best stores for the location. The important thing is the population density surrounding the center and the income of that population. These are the two primary metrics that we use when thinking about where we want to invest.

SL: How are the job and housing markets affecting real estate?

Yablon: We like companies that own assets in Texas, where the job market is expanding. This leads to economic activity that drives demand.

SL: Do you mean mostly Austin, Dallas and Houston?

Yablon: Correct.

SL: Doesn't the demand for property improve dramatically when there is an improving labor recovery?

Yablon: That's accurate now, but in 2013, the U.S. government cut spending dramatically. Now that there is not so much of a headwind, we expect gross domestic product (GDP) growth to accelerate in the 3% range.

This is due to improving job numbers going forward. This is a good backdrop for commercial real estate demand because if you have positive GDP growth, it translates into positive commercial real estate activity.

On the flip side, we are at a point in the cycle where there is very limited supply of properties, only about 1%. If demand goes to 2.8% and supply is at 1%, landlords can increase occupancy and rents in that environment.

This is essentially a very healthy backdrop for driving internal growth. Same store income growth is leading to double-digit internal growth and high single-digit dividend growth. We are expecting growth of approximately 7% in 2014 and 2015.

SL: Do you think the economic cycle is at the mid-point now?

Yablon: Yes, the economy has slowly emerged from the financial crisis. However, the process has been slow and painful as we haven't had a lot of supply or credit growth in real estate. That's why I think we have a longer run here.

SL: Will rising Treasury yields be a concern that can hurt REITs?

Yablon: In 2013, REIT stocks over-reacted from rising interest rate expectations. However, when we look at the data, REITs are correlated directly to real estate, as well as to the underlying fundamentals.

One way to improve the portfolio is to take advantage of different property types. Those with shorter lease durations are more economically sensitive so they can benefit from an improving U.S. economy.

SL: Your 2013 Annual Report states: "returns diverged broadly across the REIT universe". Does this include hotels?

Yablon: Hotels are a classic example of a sector with shorter lease durations. This means that they can re-price nightly. Obviously, if the economy picks up, you will have more people traveling, more business meetings and conferences as well as more salesmen trying to sell their widgets in various marketplaces.

SL: I'm unsure what level of hotels you're referencing. Why does your portfolio hold lesser known names like Host and Pebblebrook rather than Marriot or Starwood?

Yablon: We are more focused today on U.S. hotel REITs, which are more domestically driven as opposed to those operators that have large international pipelines. Hotels have trailed a little lately, but the business should get better as the economy improves.

SL: CBS Outdoor America Inc. (NASDAQ:CBSO) has just gotten the

Cohen & Steers Quality Income Realty Fund
Total Returns as of March 31, 2014

	1-Year	3-Year	5-Year	10-Year	Since Inception (2/28/2002)
RQI Market Value	-2.52%	9.34%	49.58%	5.12%	8.06%
RQI NAV	5.65%	12.29%	43.76%	5.45%	9.21%
FTSE NAREIT Equity REIT Index	4.16%	10.65%	28.21%	8.23%	10.77%
S&P 500 Index	21.86%	14.65%	21.16%	7.42%	6.57%

Performance data quoted represents past performance. Past performance is no guarantee of future results. The investment return and principal value of an investment will fluctuate and shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. Returns are historical and include change in share price and reinvestment of all distributions.

Periods greater than 12 months are annualized. Returns are historical and include change in share price and reinvestment of all distributions.

The FTSE NAREIT Equity REIT Index is an unmanaged, market capitalization weighted index of all publicly traded Equity REITs that have 75% or more of their gross invested book assets invested directly or indirectly in the equity ownership of real estate. The S&P 500 is an unmanaged index of 500 large capitalization companies representing a variety of industries.

You cannot invest directly in an index and index performance assumes reinvestment of any and all distributions and does not reflect the deduction of any fees and expenses.

Source: Cohen & Steers

green light to convert to REIT status. This is seen as a positive sign for other companies awaiting similar rulings. It has been estimated that CBSO could save $85 million a year in taxes.

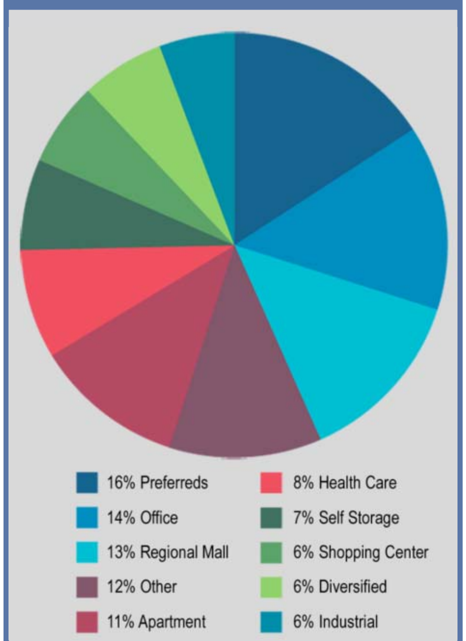
Does your management think these events will trigger a new wave of other conversions?

Yablon: Yes, a similar company, Lamar, which is in the same business as CBSO, i.e., billboards, also got its private letter ruling. Iron Mountain is another company that is trying to get REIT status since it operates in the data and paper storage industry, but it is not clear if they will get it or not.

I am not expecting a dramatic influx of new IPOs but something more esoteric in the real estate sector. They may get private letter rulings, but not much of that is occurring now.

I think: "If you are paying out all of your cashflow, how will you grow the business?" That is what you have to do if you want to become a REIT, as that business is very capital intensive. It has to be in real estate to qualify in the REIT world.

Cohen & Steers Quality Income Realty Fund Sector Diversification as of March 31, 2014



SL: Then isn't it a good reason to stick with conventional REITs?

Yablon: Yes.

SL: We are interviewing two healthcare funds for the July/August issue of *The Scott Letter*. What REITs cover healthcare?

Yablon: Healthcare REITs invest in senior housing facilities, medical offices and skilled nursing facilities. Hospitals and lab space are a smaller part of the business.

SL: Have you heard about the bidding for California-based Griffen-American Healthcare REIT II by Chicago's Ventas and other healthcare REITs? It is said that the deal could be valued at nearly $7.3 billion. Since Ventas is one of your largest real estate holdings, how much could this impact your portfolio if the deal is completed?

Yablon: I expect this deal to be widely marketed and, as a result, the pricing might prove to be expensive. If Ventas acquired the portfolio, I would expect the company to remain disciplined on pricing, which could lead to earnings growth.

This merger comes at a time when a number of non-traded REITs are undergoing sales, mergers or public offerings so that their investors can cash out.

SL: Please tell us about the office segment.

Yablon: Office businesses will continue to perform extremely well, but we are underweight in the healthcare and triple net lease spaces as these sectors will be more impacted by a rising interest rate environment.

SL: Tell us about your largest holding, Simon Property Group.

Yablon: Simon is one of the largest mall companies at 9.2% of the portfolio (as of March 31, 2014). Probably the best mall and outlet operators in the U.S., they have recently expanded into Europe through an acquisition stake in Klepierre.

[**Editor's Note:** Klepierre owns and manages a portfolio of office properties in the business districts of central and western Paris. Most of their properties are located in other parts of France, Scandinavia and northern Italy. In these regions of high growth, the company is a "pure player in the shopping center segment" as 94.5% of its revenues are generated by its shopping centers. Klepierre's largest shareholders are Simon Property Group (28.9%) and BNP Paribas (21.3%) (Source: www.klepierre.com/en/who-we-are/strategy/).]

SL: Tell us about Prologis.

Yablon: Prologis is one of the largest global industrial companies. Their strategy is to own and develop high quality industrial assets located in major markets around the globe. They benefit from corporations modernizing their distribution networks, which has partially been shifted to e-commerce.

SL: Is HCP a healthcare company?

Yablon: It is. Most of the healthcare companies own a mixture of property types. There are a couple that specialize in one type, but the larger companies, like HCP and HCN, hold a mixture between senior housing facilities, assisted living and nursing facilities. Some of the REITs have hospitals, senior housing facilities, medical office buildings and small lab spaces.

SL: What about Equity Residential?

Yablon: They are one of the largest apartment owners in the U.S. and focus on upper income segments in urban centers. They have recycled their portfolio very aggressively over the last 10 years and have now created a high quality portfolio. Equity Residential is among the best operators in the apartment industry and have been excellent stewards of capital.

SL: How do they differ from Vornado Realty Trust?

Yablon: Vornado primarily owns high quality offices in New York and Washington, D.C. They also own some retail stores in New York City and shopping centers that they will be spinning off to a new company later in the year. They are keeping their NYC retail business within the company.

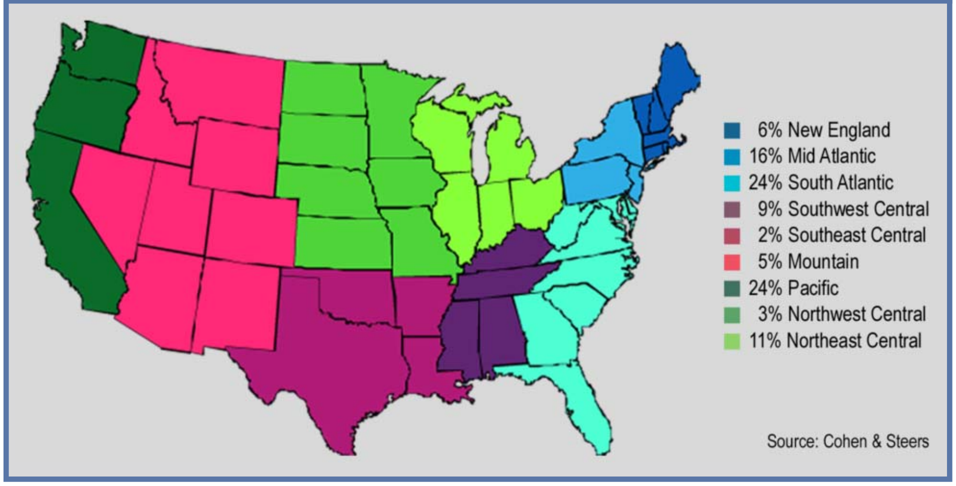
SL: Boston Properties?

Yablon: Boston Properties owns very high quality office properties in major cities around the country.

[**Editor's Note:** Boston Properties' website shows:

Boston Properties, Inc., a self-administered and self-managed real estate investment trust (REIT), is one of the largest owners, managers, and developers

Cohen & Steers Quality Income Realty Fund
Geographic Diversification as of March 31, 2014



of first-class office properties in the United States, with significant presence in four markets: Boston, New York, San Francisco and Washington, D.C. (Source: www.BostonProperties.com).]

SL: We've noticed that you have diversified by using preferred stocks and bonds in foreign banks, insurance companies and shopping centers. Would you comment why.

Yablon: Yes, on the equity side, we own REITs.

On the preferred side, Bill Scapell manages the preferred component of the Fund and invests globally. His mandate is to go wherever he can find value within the preferred securities market.

We are trying to stay true to the original mandate of remaining in the U.S., except for the preferred side of the Fund.

SL: In 1996, when I bought Closed-End Fund Advisors (then located in Santa Barbara, California), the portfolios were loaded with REITs. I followed the strategy but later decided that I would rather invest in REITs with Cohen & Steers instead.

Yablon: That is what we do. The reason that we have such a large global investment team is because we are sending our analysts out on the road with property managers and with both private and public owners of the real estate, to find out where the market values are really heading.

We think that we can create the most value in RQI by having a fundamental view of a particular market before other people know about it. You really need a large team and the resources to do that properly.

SL: That's because REITs are very different from closed-end funds. Do you have concluding remarks?

Yablon: From a real estate standpoint, we are actually at a good point in the economic cycle where demand growth is higher than supply growth. This creates a good environment for improving real estate fundamentals and growing real estate asset values.

That is why today is an attractive time to own real estate. We see double-digit growth and dividend growth both in 2014 and 2015.

SL: Thank you for your time. We have learned a lot about the REIT industry from this interview. ■

Cohen & Steers may be contacted by calling (212) 832-3232. Additional information is also available online at www.cohenandsteers.com.

Disclosure: Clients and employees of CEFA as well as its family members own shares of RQI at the time of this interview. We will wait three business days after publication before making any purchases or sales in the position.

Is America Littered with Dying Malls?

Cohen & Steers likes shopping centers in prospering larger cities, but what about the smaller malls that are struggling?

J.C. Penny and Sears Roebuck are prime examples of retail stores in struggling malls. *The Wall Street Journal* reported, "Nearly half of the 1,050 indoor and open air malls in the U.S. may be closing ..." (Source: "Struggling Malls Suffer When Sears, Penney Leave," May 12, 2014). These stores leave huge empty shells and acres of asphalt behind.

Sixty years ago, Victor Gruen, the father of America's enclosed malls, oversaw construction of Southdale Center in Edina, Minnesota, a climate-control place not just for shopping but also for people to gather. This concept became the prototype for the traditional mall.

In 1969, developers in Northwood, Ohio bragged about Woodville Mall's million square feet of enclosed space which included anchor tenants, Sears and J.C. Penny. Today, this is a "monument to big spending", now torn down as well as countless other malls.

In early 2014, Rick Caruso, CEO of Caruso Affiliated (a large privately held American real estate company) addressed the National Retail Federation and warned that "Within 10 to 15 years the typical U.S. mall, unless completely reinvented, will be a historical anachronism, no longer meeting the public's needs."

It is hard to envision today's malls becoming obsolete, but one needs to remember that Caruso's company is in the business of developing outdoor malls (Source: "Are Malls Over?" *The New Yorker,* March 11, 2014).

Nonetheless, as e-commerce becomes more popular, the future for small-city malls appears to be a disappearing part of the shopping mall industry. ■

Portfolio Managers' Review

Has this bull market run its course? We think not.

Although the U.S. stock markets had a weak first quarter, it regain ground in the second quarter. Yes, GDP contracted in the first quarter – its first decline in three years; however, many economists correctly saw the downturn to be short-lived (Source: Bloomberg News, May 29, 2014).

George Cole Scott talked to Dr. Gary Shilling, a columnist for Bloomberg, in late May, and Shilling said that he was not surprised by the current strength of the equity markets.

Our CEF Universe data showed that the average equity CEF rose +8.3%, taxable bond CEFs +5.2% and municipal bond CEFs +11.1% for a total return (year-to-date on a market price basis). CEF discounts also narrowed in May: equity CEFs to -7.15%, taxable bond CEFs to -4.75% and national muni CEFs to -4.97%. This means that (1) NAVs are not at highs for CEFs on average and (2) average market prices are at a 52-week 66% level (or about one-third off their highs). CEFs with higher distribution yields may include capital gains due to leverage (Source: CEFA's Universe Data, May 23, 2014).

Our Cohen & Steers interview describes part of CEFA's interest in diversifying client portfolios. By owning shares of RQI, our clients have both U.S. geographical and sector diversification (see charts on pages 4 and 5). So far in 2014, REIT indices have beaten the broader stock markets. As of April 30, 2014, the MSCI U.S. REIT index has returned 13.7% year-to-date.

CEFA recently purchased Prospect Capital (NYSE:PSEC) shares for clients. By selling shares of a global income fund whose yield was 3.78%, CEFA purchased PSEC shares which has a monthly yield of 13.65% (as of June 3, 2014).

According to our CEF Universe data of May 23, 2014, our equity CEFs average 7.6%, while our taxable bond CEFs average 6.7% and municipal CEFs average 6%. Eighty of the 597 traditional closed-end funds were trading above NAV with an average premium of +7.4%. Of 513 funds trading below NAV, the average discount was -7.9%. Closed-end funds market prices and their NAVs have grown higher to 75%, while trading volumes have returned to average levels.

Data from EPFR Global Company shows that mutual funds and ETFs added a net $13.2 billion to the emerging markets during April and May 2014, the biggest two-month rise since March 2013.

Due to low bond yields in the U.S. and Europe, we are are buying emerging markets funds. One of our largest holdings is Templeton Emerging Markets Fund (NYSE:EMF) which is well diversified in these markets.

Although we normally prefer to invest in global and regional funds, we made an exception to this rule with the Thai Fund, which has been trading near its 52-week low. We have been purchasing shares of this fund for our more risk-tolerant clients.

We also hold several emerging markets bond funds, including Templeton Emerging Markets Income Fund (NYSE: TEI), managed by Franklin/Templeton. As of June 1, 2014, TEI pays an annual dividend of 7.09%.

The next *Scott Letter* will be published in early August. If our readers wish to contact us, please call 1-800-356-3508 or email us at www.cefadvisors.com. ■

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