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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 news-letter 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 Editor

IN THIS ISSUE:

Dr. Mobius Hopes for the Health of this Planet that Pollution Can Be Minimized

Founded in 1947 by Rupert H. Johnson, Sr., the firm was named after Benjamin Franklin who is known for his frugality and prudence when it came to saving and investing. Succession fell to his son Charles B. Johnson in 1957, and he was later joined by his brother, Rupert Johnson, Jr., in 1965.

In 1971, the firm, Franklin Resources, Inc., went public and traded on the NYSE with the ticker BEN. Throughout the 70's and 80's, BEN increased its assets under management through its fixed income products and acquisitions.

Concerned about the firm's heavy emphasis on fixed income investments, BEN made strategic acquisitions to diversify its product offerings. One of these acquisitions was Templeton, Galbraith & Hansberger Ltd., a firm owned primarily by Sir John Templeton, his son Dr. John Templeton and John Galbraith. With this 1992 transaction, BEN acquired a strong portfolio of international equity funds as well as the expertise of emerging markets guru Mark Mobius.

Sir John Templeton 1912-2008

Dr. Mark Mobius

Today the Firm specializes in conservatively managed mutual funds and offers products under the Franklin (best known for bond funds), Templeton (international funds), Mutual Series (value funds) and Fiduciary brand names.

It continues to make strategic investments and acquisitions that further broaden and diversify its capabilities. Presently Franklin Templeton is one of the largest independent global asset management firms in the world with offices in 35 countries and clients in more than 150. (Source: www.franklintempleton.ca/en-ca/public/company/history.page)

As of the date of this writing, Franklin Templeton Investments offers seven closed-end funds. In this interview, we focus on the Templeton Emerging Markets Fund (NYSE:EMF), which seeks long-term capital appreciation with at least 80% of its assets in emerging market equity securities. As of the end of November 30, 2014, EMF total net assets were $340,439,986.

In preparing for the January 2002 *The Scott Letter,* I phoned John Templeton to ask him which of his many investment rules helped him the most. He remarked: "Buy low – at the point of maximum pessimism." Sir **John Templeton** devoted his fortune to the Templeton Foundation, which he founded in order to exemplify his philosophy to work on the "Big Questions" of science, religion and human purpose. He also told me that he was busy managing several Templeton foundations, publishing spiritual books and "had no time to think about retiring".

He was called "Sir John" by his friends having been knighted by Queen Elizabeth in 1987.

He also established the John Templeton Foundation that same year for his many philosophic accomplishments. This included the giving of the Templeton Prize (£1,000,000 British pounds) to an individual in recognition of exemplary achievement in work related to life's spiritual dimensions. (Source: www.templetonprize.org/sirjohntempleton.html

Sir John died in Nausau at the age of 95 in 2008.

Mark Mobius, Ph.D, executive chairman of Templeton Emerging Markets Group, has spent more than 40 years working in emerging

markets all over the world. Currently, he directs the Templeton research team which is based in 18 global emerging markets offices, and manages emerging markets portfolios with over $40 billion in assets (as of December 31, 2014). Mobius works with a team of analysts and Dennis Lim, Managing Director of the Templeton Emerging Markets Group.

We caught up with Mark in Singapore on December 12, 2014.

SL: Hello, Mark. Are you at your Singapore residence?

Mobius: Yes, I am in my apartment in Singapore. I just came back from Thailand, Hong Kong and China.

SL: Do you plan to write another book any time soon?

Mobius: I haven't written a biography lately, at least not yet … unless you count the Japanese manga comic, *Mark Mobius – An Illustrated Biography*.

SL: What other books have you published?

Mobius: I've had a number of books published since 1966, including: *The Little Book of Emerging Markets* and *Passport to Profits*. In a more educational series entitled *An Introduction to Core Concepts*, we have written about equities, mutual funds, foreign exchanges and bonds.

SL: Have you changed your weighting in the Templeton Frontier Markets Fund (NYSE:TFMAX) much, and how soon will investors be able to invest in it again?

Mobius: The market slowdown may provide us an opportunity to open it up again. We keep a low portfolio turnover in TFMAX.

SL: We have some emerging market positions, but our focus is on the EMF portfolio. What are the top portfolio weightings now?

Mobius: They remain basically the same – China, Thailand, Brazil, India and Hong Kong with few changes.

SL: Did you know that China has been working to have better relations with their neighbors, offering tens of billions of dollars in investment in Vietnam, for instance?

Mobius: Yes, this should be beneficial to the entire region.

SL: The recent havoc caused by the huge drop in the oil price raises many concerns. Have we reached the point of "massive pessimism"?

Mobius: No, because there still is a great deal of optimism. Pessimism exists only in certain sectors, such as the oil patch. We have not entered the age of multiple sentiments where investment decisions need to factor in many variables.

SL: That's reassuring. You recently wrote in your "Focus on Long-Term Fundamentals, Not Fears" blog posting that "investors do not like to make decisions in a rational manner and are loss-averse because their fears get in the way." Please explain.

Mobius: It basically refers to how sentiment sometimes prevents investors from making rational decisions. Cutting losses may be the best course of action, but no one likes to realize a loss, as one is always hoping that things are going to turn around. Sometimes that may not be the case.

SL: Good advice. Now I'd like to discuss a new topic: the economic implications of climate change. What are your views on this?

Mobius: I'm not too optimistic regarding the ability of humans to affect the evolution of climate since there are so many variables at work. However, I certainly respect the scientists who are working on it and hope that simply for the health of all living things on this planet, pollution can be minimized.

SL: Regarding this subject, *The Wall Street Journal* is holding a "Climate Change" conference in late March, which I am planning to attend in Santa Barbara. We will let readers know more about this important subject later.

During his visit to China last November, President Obama and his Chinese counterpart, Xi Jinping, agreed on the need to reduce carbon emissions. China agreed to reduce its levels of carbon emissions by 2030, including delivering 20% of its energy from renewables. In return, by 2030, the U.S. would cut carbon emissions by 30% from its 2005 level.

China has been one of the countries that have been resisting a clean-up of their environments, a clean-up that I think is necessary for our survival. We will see how well they respond when the vote comes up in Paris in December 2015.

More and more Americans now realize the urgency, as they are investing in renewable power sources like wind, solar and geothermal energy to reduce carbon emissions. For the health of our children and grandchildren, it is paramount that we no longer delay addressing this issue.

For Canada, a country that depends so much on natural resources, the economic impacts could be severe. As carbon dioxide concentrations increase, the oceans are becoming more acidic. The more acidic the oceans become, the less carbon dioxide may be absorbed.

The good news here is that the U.S. has closed down over 100 U.S. coal-fired plants and converted them to natural gas, but a lot more has to be done globally, especially in China and India.

Mobius: Some people consider coal to be polluting, but these countries are heavily dependent on coal. About 80% of China's electric power is coal-fired.

SL: How is China handling this health risk?

Mobius: They are building nuclear plants and solar/wind generation facilities. Their demand for power is so high that they have to go in every direction. However, they are not obligated to take even the simplest steps to reduce carbon emissions for the next 16 years as they continue building coal-generating plants at the rate of one a week.

Climate Change Conference
March 25-27, 2015
Santa Barbara, CA

CEFA will be attending ECO:nomics' climate change conference entitled "The Future of Business and the Environment" in Santa Barbara on March 25-27. Among the many speakers will be company representatives from the energy industry.

For details, visit economics.wsj.com/, e-mail ECOevent@WSJ.com or call (212) 416-2300.

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SL: Why are you are now spending so much of your time covering the Asian markets, and what is the most important thing going on in China now?

Mobius: My refocus on Asia is because of its high market growth and volatility. Merger of the "H" and the "A" share classes in China are now underway, but it hasn't been completed yet.

The Chinese are also moving into a very aggressive bull market, with lots of retail investors piling in.

[**Editor's Note:** A-shares are listed on the Shanghai Exchange available only to domestic investors and trade at huge premiums over their H-share counterparts, which are listed on the Hong Kong Exchange and are available to non-Chinese investors. The A-shares may trade at a premium of 80%-100% over the H-shares. (Source: www.wikinvest.com/wiki/A-Share_vs_H-Shares_in_China)]

SL: Why do these shares trade at such large premiums and who buys them?

Mobius: It is a matter of supply and demand. These are exciting times for China, and there is still a lot of value there. The turnover has just exceeded the volume of the New York Stock Exchange. The number of new accounts went through the roof as many mainland domestic investors have begun to invest outside of China.

SL: Why has China made adjustments in its bank rates that upset the U.S markets?

Mobius: It is really not as significant in China as it is for foreign markets. The currency has been steady and hasn't appreciated much. Their exports are in a good position. The U.S. would like to see a stronger currency, but that's not a big issue now.

SL: Could the markets collapse due to these speculative moves?

Mobius: Collapse? Unlikely. Some correction along the way? Yes, of course.

SL: Could China's hunger for minerals to build skyscrapers, cars and bridges be producing a surge in the production of key commodities?

Mobius: We have lightened up pretty much on mineral holdings in all our portfolios, especially in resource-rich countries like Indonesia, where minerals make up a disproportionate share of these economies. We had big nickel holdings in Russia but have less now.

SL: Is there any evidence for a commodities crash?

Mobius: Commodity prices are not going to crash, but they are not looking that great, so it is probably not a good idea to be overweight in commodities. There are some exceptions where the mineral prices have gone down so far that they present an incredible opportunity, particularly with some of the coal companies.

SL: What Chinese companies produce electric power?

Mobius: General Nuclear Shares (HK:CGN) debuted recently on the Hong Kong market and raised about $2 billion USD. Despite all of the problems, nuclear power is very popular in China.

SL: That's good. We note that you have a large holding in the luxury car maker, Brilliance China Automotive (HK:1114).

Mobius: That is one of our best choices.

[**Editor's Note:** Brilliance China Automotive is a manufacturing company headquartered in Shenyang, China. They design, develop and manufacture luxury cars, microvans and minibuses. They can manufacture as many as 650,000 vehicles a year, of which roughly 70% of production is consumer sales. (Source: en.wikipedia.org/wiki/Brilliance_Auto)]

SL: Driving cars that have no carbon emissions will be a wake-up call when their health risks increase. Have the Hong Kong demonstrations affected the economy much?

Mobius: There have been some interruptions but nothing dramatic. Visiting Chinese nationals have limited their shopping for luxury goods, but that has ended. There are some continuing concerns about the political environment in Hong Kong so they want the Chinese government to be more careful in their policies.

[**Editor's Note:** On December 26, 2014, the Hong Kong police again arrested 12 protestors blocking several roads at the site the protestors had occupied for more than two months before being dispersed. As a result, President Xi Jinping urged the former Portuguese colony of Macau to

Templeton Emerging Markets Fund
As of November 30, 2014

Ten Largest Positions

Company	% of Portfolio Net Assets
Brilliance China Automotive Holdings Ltd	10.6%
Kasikornbank PCL	5.0%
Dairy Farm International Holdings Ltd	4.4%
Tata Consultancy Services Ltd	4.1%
Astra International TBK PT	3.8%
Siam Commercial Bank PCL	3.8%
Banco Bradesco SA	3.3%
Akbank TAS	3.2%
Unilever PLC	3.2%
MCB Bank Ltd	3.1%

International Allocations

Country		% of Portfolio Net Assets
Asia		71.1%
China	22.7%	
Hong Kong	8.6%	
India	7.7%	
Indonesia	6.7%	
Pakistan	3.3%	
South Korea	4.6%	
Thailand	17.6%	
Europe		14.0%
Austria	0.9%	
Russia	4.7%	
Turkey	5.1%	
United Kingdom	3.3%	
Latin America		12.4%
Brazil	10.6%	
Peru	1.8%	
Mid-East/Africa		2.5%
Jordan	0.2%	
South Africa	2.4%	

Industry Allocations

Industry		% of Portfolio Net Assets
Consumer Discretionary		20.0%
Automobiles & Components	17.7%	
Consumer Durables & Apparel	2.3%	
Consumer Staples		8.4%
Food & Staples Retailing	4.6%	
Food Beverage & Tobacco	3.8%	
Energy		22.1%
Financials		28.7%
Banks	27.8%	
Real Estate	0.9%	
Industrials		4.2%
Capital Goods	3.1%	
Transportation	1.2%	
Information Technology		8.4%
Software & Services	6.0%	
Technology Hardware & Equipment	2.4%	
Materials		8.1%

Source: Franklin Templeton Investments

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guard against such interference as the democracy protest in Hong Kong. This was after Beijing accused foreign forces of fostering the pro-democracy Occupy movement. Beijing does not want the more liberal regions of Hong Kong and Macau to become hot beds of democracy movements that may threaten the ruling Communist party's grip on power. (Source: www.foxnews.com/world/2014/12/20/chinese-leader-cautions-against-external-forces-on-visit-to-former-portuguese/)]

SL: Do you have confidence that the new Thai government will survive?

Mobius: Yes, but we will eventually see an elected government with a new constitution to make sure that the general population will "rule the roost" as they want to have a government run by experienced people.

Life in Thailand goes on, and things are going well there. They are, however, having problems with the many Russian tourists who have money to spend, and Russia does not have a foreign exchange. That really hit the Thais.

SL: I had planned to visit Bangkok during my 1968 round-the-world trip, but Air India had a disagreement with the Thais. I missed my chance to visit this beautiful country.

What caused the massive drop in the oil price?

Mobius: Saudi Arabia is not willing to cut production. They like being the "big boy on the block", determining where oil can go, and they see the U.S. taking oil marketshare away from them. That is why you have so much volatility in oil prices.

Nigeria and Saudi Arabia have slowed down, but this is not alarming because these countries are going to be growing faster than the developed markets. We want to be exposed to that arena but see volatility in these markets from time to time.

SL: Saudi Arabia is the world's second largest oil exporter, but oil now drags the country's economic growth.

Mobius: We think that by this time next year you will see the oil price back to $80 or $90.

SL: That's optimistic; we have seen estimates of $70-$75 recently. As we were going to press, oil prices have recovered somewhat.

How long do you see continuing volatility in the global stock markets?

Mobius: I can't say when volatility in the emerging markets will end, but based on my decades of experience navigating the markets, it won't last forever. It will bring potential opportunities for the savvy investor who knows where to look.

SL: That is the "Templeton Way". A recent investment move we have made for our clients was to buy the energy fund, Petroleum & Resources (NYSE:PEO), managed by the same firm managing our largest holding, Adams Express (NYSE: ADX). PEO dropped dramatically on the news but has since recovered.

Is your Moscow office still open?

Mobius: Yes, but low oil prices have been disastrous for the Russians, as much of their budget comes from oil and their taxes are very high. They must make adjustments, but low oil prices may be a blessing in disguise as Putin says he will treat businesses a little more kindly and not crack down on the people as much as in the past. The ruble has performed very badly, but the government has not been too concerned. Oil prices are almost in a free fall, and there has been a big drop against the dollar.

SL: We haven't seen much cooperation from Putin. When I was in Moscow in 2012, there were demonstrations every day. Now inflation is high too, causing many problems for them.

Mobius: Russia has also banned a lot of food imports which makes for a most difficult situation. If you look at the inflation numbers in Russia, you will probably see that food is rated fairly high because of the food import ban.

SL: Isn't that a double whammy with the low oil prices?

Mobius: It definitely is. The inflation is now about 9% of Russia's consumer price index, and in 2009 it was as high as ~14% before coming down to ~12% and then 4%. Now it is up to about 9% and is headed higher. If inflation and unemployment pick up in Russia, that would be a very bad sign for Putin.

SL: Will Russia have another currency devaluation like the one that shocked the world stock markets in 1998, when the country defaulted on their bonds and devalued their currency by 75%?

Mobius: The weakening ruble, in my opinion, will not have a significant impact on emerging markets. There is no significant correlation since the Russian market is not a big component of the overall market capitalization of emerging markets. Also, the trade relations between Russia and emerging market countries is not a big game changer.

[**Editor's Note:** Vladimir Putin's iron grip on Russia could explain his increasingly belligerent stance toward the West as well as low oil prices. For every dollar off the price of a barrel of oil, the Russian government loses $1.7 billion in annual revenue as half of its revenue accrues from the oil and gas economy. With falling oil prices combined with the Ukraine crisis, international sanctions have opened up new, worrisome scenarios for Putin, Russia and the world order. (Source: www.thestreet.com/story/12957213/1/why-low-oil-prices-could-make-russias-putin-even-more-combative.html)]

SL: Two India closed-end funds have been making new highs since the election of Narendra Modi as their new Prime Minister. Do you think he can fulfill expectations?

Mobius: Yes, he has worked to get new state governors in place and, I believe, is doing the right thing. In India, things don't happen overnight. The fact that their stock prices are up so much makes it more difficult [for us] to find bargains. There will be adjustments as we move ahead.

We haven't added to the India portion of EMF portfolio, as we are waiting to see what changes are made first. We keep our portfolio turnover very low.

[**Editor's Note:** Prime Minister Modi has shown strong political leadership in making an agenda to create market-friendly reforms, including structural changes in the country's banking system, allowing more foreign investments and removing regulations that hinder industrialization. India is not overly dependent on commodities, which should help their

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citizens by offering more disposable income. The future of the country is bright. (Source: bencarlsonyahoofinance.tumblr.com/post/108919218175/the-most-exciting-stock-market-in-the-world)]

SL: The Trans-Pacific Partnership is currently an important issue. President Obama is pushing for it and has Republican support. This partnership includes Australia, Brunei, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the U.S. and Vietnam. It is hoped that an agreement can be completed soon, despite Democratic opposition.

Do you think China will agree to join this pact?

Mobius: The Chinese prefer to have a bilateral rather than a multilateral agreement. They are for free trade, but they don't like the U.S. and everybody else involved.

SL: They do, however, participate in the Association of Southeast Asian Nations ("ASEAN") agreements, so perhaps they will join the Partnership when they see the economic benefits.

Mobius: The ASEAN free trade area could potentially offer a market of great influence. As regional trade increases, ASEAN could help lessen dependence on both the United States and China. Individual ASEAN member markets look small and less liquid, but by coming together, the region could become a much larger market force and global power, too.

This is something China is keenly aware of, particularly in light of recent territorial disputes in the South China Sea.

SL: We think an agreement will be advantageous for both the U.S. and China.

Now, turning to fund matters, you once told us that a closed-end fund structure is better for the investor in the emerging markets because of the discount and a fund's ability to repurchase shares which would increase the net asset value for shareholders. Is Franklin/Templeton still resisting launching closed-end funds?

Mobius: Their concern is that a discount may force open-ending the fund.

SL: Really! We think that such a powerful and respected organization like Franklin Templeton has little to worry about there. However, the only closed-end funds they have are the ones you manage, the ones they bought from John Templeton.

Closed-end funds are a good vehicle for these markets. The problem is that too many investors see the discount as a negative, when that isn't true. The discount also gives the investor some protection in downmarkets.

All of this will be addressed in a book I will be preparing to write on closed-end funds. In order to really understand closed-end funds, investors must first see the value of buying the fund at a discount and what that could mean for better investment returns.

When your Vietnam Fund was in trouble a few years back, Franklin merged it into The Templeton Dragon Fund, which could have prevented action by the activists, as the smaller funds are more vulnerable to liquidation than the larger ones.

Here are some other advantages of CEFs:

1. The discount or premium of a closed-end fund is a barometer of its popularity. Where large redemptions happen with closed-end funds, you see the discounts to net asset values ("NAVs") widen. The discount is really a component of the extra risk taken by the investor, but it can also enhance shareholder return by allowing you to pay a lower price to compensate for the additional risk.
2. Value investor Benjamin Graham advised individuals to find shares of CEFs selling at attractive discounts. He added that "chances are that the investor will do better [with CEF's] than buying a group of open-end funds with similar portfolios."
3. Closed-end funds can increase their yields because, unlike mutual funds, they can leverage their payouts for higher distributions. Many closed-end funds, particularly bond funds, now pay monthly distributions.

You wrote in one of your recent blogs: "We believe companies with strong records of governance today may be better prepared for the future, and, thus, may provide a better investment case." (Source: mobius.blog.franklintempleton.com/2014/04/03/examing-companies-lens-esg/)

Have you continued to be involved with corporate governance issues in the emerging markets?

Mobius: We do get involved, but I haven't done that much lately. We are now better off focusing on the individual companies to try to get some indirect changes. We found that going aggressively after these companies doesn't work very well, so friendly persuasion is often the better way.

It is more of a concern to see what companies violate corporate standards and to get them out of the way. I think that an ounce of prevention is worth a pound of cure, so it is better to avoid those companies who are not going to adhere to corporate governance.

SL: Keep up this good work! Does that also apply to the frontier markets where there may be corporate governance issues?

Mobius: Yes, even more so. You must aggressively go after these companies, and it may be even more relevant for those markets. We have people everywhere looking at these companies.

We believe that companies with strong records of governance today may be better prepared for the future, thus providing a better investment case. A lot of companies do not like it and complain about it, but, at the end of the day, they comply.

SL: Mark, thank you so much for you time today. We can always count on you to keep us abreast of the emerging markets. ■

For more information about Franklin Templeton closed-end funds, please visit www.franklintempleton.com/funds/closed-end-funds.

Disclosures

Clients and employees of CEFA as well as its family members own shares of EMF at the time of this interview. We will wait three business days after publication before executing any buys or sells in EMF or TFMAX.

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Portfolio Managers' Review

The U.S. markets continued rising in February 2015, after a weak January. Oil prices plummeted during the month, while many markets have been volatile due to oil's supply-and-demand imbalances.

Mark Mobius sees oil prices back to $80 USD levels within the year, even after WTI crude prices dropped below $50 USD (the most since the 2007-2009 global financial crisis). In February, oil prices recovered some but not enough to help oil companies' fourth quarter results or near-term outlook.

For the first time in *The Scott Letter,* CEFA makes the case that climate change is real. It has become an important part of economic thought. As a result, your editor-in-chief is planning to attend the seventh ECO:nomics climate change conference in Santa Barbara, California in March.

Closed-End Fund Advisors was founded in Santa Barbara, CA in 1989, and George Cole Scott purchased the firm in 1996, later moving it to Richmond, VA.

Topics of the conference include how climate has affected various industry sectors. After this conference, we hope to better serve our clients by helping them understand the importance of sustainable investing. In this way, we can help mitigate the harmful effects that are happening to our planet.

Some climate change issues are difficult to understand, and it will take serious time and effort to solve. "The ECO:nomics 2015 program will focus on several big issues confronting business and the environment: where money for innovation is being invested and where it's being pulled; explore the latest discoveries in clean energy; see how disruption is shaking large chunks of the energy business; debate the future of the environmental movement; hear from global decision makers on where energy policy is headed next; and stress-test what's really meant by *sustainability.*" (Source: economics.wsj.com/program)

Since 2007, we have invested in environmentally sustainable funds managed by Brown Advisory in Baltimore. As they do not manage any closed-end funds, we have chosen one of their open-end funds: Brown Advisory Sustainable Growth Fund, which has had an excellent investment record since its inception on June 29, 2012. The Fund seeks long-term capital appreciation by investing in a concentrated portfolio of companies that, in the manager's view, effectively implement environmentally sustainable business strategies to drive their prospects for future earnings growth. (Source: brownadvisoryfunds.com/biawx.html)

As of February 20, 2015, our CEF Universe data shows closed-end equity funds' discounts slightly widening over the previous month with an average discount of -8.01%, indicating a market price yield of 8%. Taxable bond funds are at an average -6.7% discount to NAV, a slight narrowing over the previous month, to show an average yield of 7.7%. National municipal bond funds are currently at -6.3% discounts, indicating a tax-free yield of 5.8%. Business development companies are at an -7.2% discount and indicate a 9.9% yield.

2015 is a year in which we expect activist investors to become more active. We are also looking at two important things from CEF syndicates: (1) investment objectives that can do well in a rising interest rate environment and (2) provisions to help avoid discounts and potentially lessen friction on the starting NAV of an initial public offering.

We will continue to monitor the overall trends in the markets and use our expertise in CEFs to help clients maximize returns while seeking to protect and reduce our clients' overall investment risk. ■

George Cole Scott

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