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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

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The Royce Funds: A Wealth of Experience

With approximately $30 billion in total assets under management, Royce & Associates, investment adviser to The Royce Funds, is committed to using a disciplined approach to select micro-cap and small-cap companies.

The Firm's founder, Chuck Royce, enjoys one of the longest tenures of any investment mutual fund manager. His investment staff includes more than 30 investment professionals.

The size and diversity of the small-cap universe make it a unique and fertile area for investment. For more than 40 years, it has been The Royce Funds' primary area of focus. Over that time, this universe has evolved into an established asset class used by a wide range of investors, including institutions, consultants, advisors and individuals.

Chuck Royce

Today, there are numerous small-cap and micro-cap indexes and ETFs. Importantly, the continuous regeneration of the asset class, through the entrance of new companies, spin-offs and IPOs, makes it an evergreen source of investment opportunities. This is why Royce has elected to focus on the small- company universe and believes it is ideally suited for a variety of distinct offerings. (Source: www.roycefunds.com/about/)

U.S. Small-Cap Market Cycle and Risk Adjusted Performance

The Royce Funds believe strongly in the idea that a long-term investment perspective is crucial for determining the success of a particular investment approach. While flourishing in an up-market is wonderful, surviving a bear market by losing less (or not at all) is at least as good.

However, the true test of a portfolio's mettle is performance over full market cycle periods, which include both up and down market periods. (Source: www.roycefunds.com/insights/2015/04/1q15-market-cycle-risk-adjusted-performance)

The U.S. Economy

Royce portfolio managers thought an extension of the bull market that began off the March 9, 2009 bottom was likely, though they were expecting both lower returns and increased volatility.

As it happens, this call was nearly accurate: the economy did pick up speed in the second half of 2014 while large-cap stocks roared on. Historically more turbulent, small-caps (along with most energy stocks) could not keep up.

Of course, equity markets simply do not stay undisturbed for long, so this increased volatility was not a surprise. Yet, its highly selective reach was puzzling, even allowing for the historically higher volatility exhibited by smaller companies. Shortly after the Russell 2000 Index established a year-to-date high on July 3, 2014 (a high that would last into late December), small-cap prices began to fall. They slid most precipitously in July and September and rallied to varying degrees in August, October, November, and December.

We are looking for a similar buying opportunity on market weakness.

Royce & Associates, LLC manages open-end mutual funds, annuity portfolios and three closed-end funds. These closed-end funds are: (1) Royce Value Trust (NYSE:RVT) which invests primarily in small-cap securities; (2) Royce Micro-Cap Trust which invests primarily in micro-cap securities, and (3) Royce Global Value Trust which invests in both U.S. and non-U.S. small-cap securities. (Source: www.roycefunds.com/insights/2015/02/great-expectations-small-cap-active-management)

This interview will cover the Royce Value Trust and the Royce Micro-Cap Trust.

Royce Value Trust

Royce Value Trust was one of the first closed-end small-cap funds launched in November 1986 by Chuck Royce. Its average weekly trading volume through the end of March 2015 was 838,800 shares. The Fund's officers, employees and their families owned more than 346,700 of the Fund's outstanding common stock at the end of the first quarter of 2015. The Fund's operating expenses (excluding advisory fee) relative to average net assets were 0.15% for 2014.

[**Editor's Note**: We applaud this inside ownership for both RVT and RMT which is rarely done in closed-end funds.]

During the first quarter of 2015, Royce Value Trust's diversified portfolio of small-cap stocks was up 1.0% on an NAV basis and 2.0% on a market price basis. These results trailed each of its unleveraged small-cap benchmarks, the Russell 2000 (which gained 4.3%) and the S&P Small-Cap 600 (which advanced 4.0%).

Seven of the Fund's 10 equity sectors posted net gains, led by industrials and healthcare. Consumer staples also made a respectable contribution followed by information technology and consumer discretionary. utilities and telecommunication services finished the quarter just slightly in the black.

The leading detractors were energy, materials and financials. Net gains at the industry level were dominated by the professional services group (industrials), followed by life sciences tools and services (healthcare) and building products (industrials).

On an NAV and market price basis, RVT outperformed the Russell 2000 in its 15-year, 20-year, 25-year and since inception (November 26, 1986) periods as of March 31, 2015. RVT's average total return since its inception was 10.7% as of March 31, 2015. (Source: www.roycefunds.com/funds/royce-value-trust/xrvtx)

Royce Value Trust and Royce Micro-Cap Trust distribute capital gains on a quarterly basis.

Royce Micro-Cap Trust

Royce Micro-Cap Trust is the only closed-end fund focusing on micro-cap securities.

The Fund has an average weekly trading volume of more than 487,500 shares. The Fund's officers, employees and their families own more than 1,350,300 shares (approximately 4%) of the Fund's outstanding common stock. Operating expenses (excluding advisory fees relative to average net assets) were 0.25% for 2014.

Royce Micro-Cap Trust, a diversified portfolio of micro-cap stocks, posted negative returns for the first quarter. The Fund fell 0.8% on an NAV basis and was down 0.6% on a market price basis, compared to gains of 4.3% for its unleveraged benchmark, the Russell 2000, and an increase of 3.1% for the unleveraged Russell Micro-Cap Index.

Five of the portfolio's 10 equity sectors made positive contributions for the quarter. Healthcare led by a wide margin, followed by information technology and consumer staples, while industrials and utilities posted more modest positive results.

RMT's worst performers for the same period were consumer discretionary, energy, financials and materials, while telecommunication services registered a small net loss.

At the industry group level, software (information technology), biotechnology (healthcare), building products (industrials) and pharmaceuticals (healthcare) made the largest positive impact.

The leading detractor was energy equipment and services (energy), followed by three groups from the consumer discretionary sector – household durables, diversified consumer services and media.

RMT outpaced the Russell 2000 on an NAV basis for its 15-year, 20-year and since inception (December 14, 1993) periods as of March 31, 2015. The Fund also beat its benchmark on a market price basis for the 3-year, 5-year, 15-year, 20-year, and since inception periods.

RMT also beat the Russell Micro-Cap Index on an NAV basis for its 10-year period as of March 31, 2015 and on a market price basis for its 5-year period. The Fund was even with the Micro-Cap Index on a market price basis for its 10-year period. (**Note**: Returns for the Russell Micro-Cap Index only go back to 2000.)

As of March 31, 2015, RMT's average annual NAV total return since its inception was 11.3%. (Source: www.roycefunds.com/funds/royce-micro-cap-trust/xotcx)

The Scott Letter interviewed Steve Lipper and Lauren Romeo via phone on June 2, 2015.

Steve Lipper

Steve Lipper is Principal and Portfolio Manager at Royce & Associates. Prior to joining the firm in 2014, Steve worked for Lord Abbett & Co. LLC from 2004-2014, serving most recently as a member of its Investment Committee where he was responsible for overseeing the Asset Allocation Strategy Funds.

Prior to that, Steve served as Client Portfolio Manager for Lord Abbett, functioning as a liaison between the Mid-Cap Value, Small-Cap Value and Capital Structure portfolio management teams and consultants.

From 2001-2004, Steve was Executive Vice President, Private Client Services at Reuters, after working in various roles at Lipper Analytical Services, a firm founded by his father, A. Michael Lipper, from 1989-2001.

Lauren Romeo

Lauren Romeo, CFA is a Portfolio Manager at Royce & Associates. Prior to joining Royce & Associates in 2003, she was a Portfolio Manager at Dalton Greiner, Hartman & Maher (2001-2003), an analyst with Legg Mason Funds Management (2000-2001), and an analyst with T. Rowe Price Group (1996-2000).

Lauren holds a bachelor's degree from the University of Notre Dame and a MBA from the Wharton School of Business at the University of Pennsylvania. She is a CFA Charter holder.

According to Lauren, "Investment success is often a function of the intersection of preparation and opportunity."

Source: www.roycefunds.com/people/

SL: Hello, Steve and Lauren. Thank you for some of your valuable time today. Do you use ETFs in your portfolio management as many funds do?

Lipper: We didn't have any investments in ETFs in our closed-end funds at the end of March. They're not an area of investment focus for us.

SL: That's good. We see the index funds may have some good holdings, but they also hold a lot of junk.

Lipper: We agree. Let me give you two specifics around that assertion. We see the percentage of companies that are having losses right now is nearly 30% of the companies in the index, near a non-recession high. You would expect that these numbers would go up in a recession, but there are so many small-caps that are losing money today.

We think that the underperformance of many quality small-caps is one measure of this crazy upside down world. Companies that have the lowest return on invested capital today have been leading and those that have the highest level of profitability sell at half the multiple of those that sell at low profitability.

SL: Really! Please tell us the differences in your outlook between small-cap and large-cap stocks?

Lipper: Both small-cap and large-cap stocks have delivered above their historic average returns over the last couple of years. As a result, we expect in the next 3-5 years that large-cap stocks will have below historic average returns, probably in the single-digit area.

We expect small-cap stocks will beat large cap-stocks due to higher earnings growth.

SL: Why is that?

Lipper: Small-caps have historically grown faster, in part because it is easier to grow on a smaller base.

SL: How long have you been investing in the global markets?

Lipper: We have been investing in the international markets since you visited us in the 1990s. Royce Pennsylvania Mutual Fund has held non-U.S. stocks for more than 20 years. Chuck Royce has managed it since 1972, assisted by Jay Kaplan since 2003 and Lauren Romeo since 2006.

SL: Yes, I remember that Fund and its good performance. It is one of your largest funds with assets of $5.19 billion as of March 31, 2015.

Lipper: We first began our international efforts nearly 20 years ago. We introduced dedicated international funds in 2006. We have a London office with dedicated investment professionals, along with a team based in New York.

SL: That's fascinating. Only a few closed-end funds have taken that step. Where are the best values that you find today?

Romeo: We continue to find companies in the more economically sensitive sectors, such as industrials and consumer discretionary. More recently, we have found more opportunities in the financial area, such as the asset management industry. The financials are our third largest weighting (about 16%).

SL: Many other closed-end funds have large weightings in the financial sector.

Romeo: The managers of other larger funds have a heavy weighting in banks and real estate investment trusts, which are about 15%-16% of the Russell 2000. We don't have significant investments in those areas in part because the companies tend to have too much leverage, and we've found more attractive valuations in other areas.

A good example is Genworth Canada, the second largest residential mortgage default insurance provider in Canada with a marketshare of roughly 30%. It has a history of astute underwriting and low loss levels and remains solidly capitalized with excess reserves.

The stock price declined earlier this year, reflecting investor concerns that the plunge in the price of oil would negatively impact employment in Canada's oil-driven regional economies. This might lead to higher unemployment and mortgage defaults.

Given our view that if such a scenario does occur, Genworth's loss rates would not likely exceed the high end of normal expectations and its solid balance sheet could absorb higher losses.

We took advantage of the opportunity to add to our position at lower prices. We believe the stock offers a compelling risk reward, trading below tangible book value while offering a dividend yield of more than 5%.

SL: Good! But, how much have the oil and gas price declines affected your energy companies?

Romeo: They have in the near term. However, our holdings are concentrated in energy services providers as opposed to exploration and production companies.

We believe long-term it will continue to offer key technologies that drive more efficient drilling. Helmerich & Payne, which provides the most technologically advanced drilling rigs, is an example. They tend to gain share even in weaker markets as exploration and production companies upgrade their rig fleets in order to maintain attractive drilling project returns on investment in periods of lower oil prices.

SL: We have little experience in micro-cap investing. What growth do you expect going forward for this Fund?

Lipper: If you look at performance, micro-caps as an asset class have lagged recently. The more stable pool of capital in a closed-end fund offers great advantages over open-end mutual funds considering the more limited liquidity of micro-cap stocks. This gives us some additional flexibility.

SL: You are happy with what you have?

Lipper: We are.

SL: We plan on starting to invest in the Royce Funds when the price is right, starting with Royce Value Trust.

Lipper: Great!

SL: How much of the assets of RVT are in foreign stocks now?

Romeo: About 14%.

Lipper: RVT, at one point in the last three years, had close to 30% exposure to international holdings. We decided to bring it back to its roots, reducing the number of international holdings. This move created Royce Global Value Trust.

SL: The top performing sectors in the funds have outperformed by a wide margin, but are these value stocks?

Romeo: We believe they are. We look for companies that have strong financial characteristics [i.e., high returns on capital and low financial leverage] that reflect the

existence of a sustainable competitive advantage or favorable industry structure.

Stocks of these types of smaller-cap companies have underperformed in recent years relative to non-earning, low return on capital and/or more highly leveraged companies over the past several years.

The result is one can construct a portfolio of companies that have much higher ROICs than those in the Russell 2000. However, they have an overall valuation equal to or less than the Russell index.

The technology sector is about 19% in RVT. We hold a large number of electrical and electronic equipment stocks, a category populated with companies that are leaders in industrial automation, such as IPG Photonics, the marketshare leader in fiber lasers. Fiber lasers are increasingly used in welding and cutting applications.

SL: Do you have any plans to increase your holdings in the fast-growing health-care sector?

Lipper: We tend to be contrarian on healthcare. It is a popularity thing that is not an attractive area for us. Technology is a little different as it is pretty widespread. We found that "tangible technology" companies are attractive now as businesses will increase their capital spending for technological benefits.

SL: We respect your judgement, but your views on healthcare surprise us. That may be because of their high multiples, powered by large-cap companies. Have you always been value investors?

Lipper: Yes, for all of these three closed-end funds, as well as in many of our open-end mutual funds.

SL: Share repurchasing is a subject that is of great interest to us for the benefit of closed-end fund shareholders. Chuck wrote about it in your First Quarter 2015 Report. We hope that Chuck will follow through with repurchasing shares soon, particularly since discounts are so deep now. I will explain the advantages of share repurchases to our readers in my Portfolio Review that follows this interview.

Lipper: We currently have a planned distribution policy, which the Fund's board has endorsed as a good deal for our shareholders.

SL: Most of the better funds now have planned distributions and use some leverage to increase their size.

Lipper: Leverage is anything from zero to as high as 16% for RVT and RMT. We will use leverage opportunistically.

In 2012, we saw good reasons to increase the level. Over the long term, you will probably expect an average of several percentage points of leverage because the closed-end structure gives us the opportunity.

SL: I remember speaking to Chuck in the 1990s about how he used moderate leverage to increase return without taking too much risk.

Lipper: Our leverage is lower now than in prior years. We think that is appropriate because of the higher valuations.

SL: That makes sense as many investors seem to be concerned about the high valuations. Our view is that there are always undervalued opportunities if you look hard enough for them.

What leverage do you use now?

Lipper: RVT was 0% at the end of March, and RMT was 2%.

SL: We respect your caution regarding leverage. Do you use any other indexes besides the Russell 2000?

Lipper: The Russell 2000 is the index for the small-cap asset class that we use for both RVT and RMT. Royce Global Value Trust uses the benchmark Russell Global ex-U.S. Small-Cap Index.

SL: Thank you for a good rundown on two of your portfolios. We would like to ask you about Royce Global Value Trust at a later date. Do you have any final comments?

Romeo: After five years of higher-than-usual returns, we see U.S. equity results moving closer to their longer-term averages. We also expect more economically sensitive companies will be rewarded, while more interest rate sensitive stocks look more likely to lag.

Lipper: Given both their greater potential for earnings growth and currently reasonable valuations, we think U.S. small-caps offer attractive risk/return profiles. This should bode well for RVT, RMT and many of our open-end mutual funds.

SL: Thank you for your time today. For more information, contact The Royce Funds via phone 800-221-4268 or visit their website, www.roycefunds.com. ■

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

Royce Value Trust and Royce Micro-Cap Trust: Average Annual NAV Total Returns (%)
Through March 31, 2015

	Royce Value Trust	Royce Micro-Cap Trust	Russell 2000	Russell Global Micro-Cap
1st Quarter 2015	0.96	-0.80	4.32	3.14
1-Year	1.22	1.37	8.21	3.79
3-Year	11.40	16.08	16.27	17.37
5-Year	11.26	13.84	14.57	14.69
10-Year	7.42	8.26	8.82	7.11
15-Year	8.95	10.29	7.19	Not Available
20-Year	10.60	11.55	9.62	Not Available
25-Year	10.92	Not Available	10.03	Not Available
Since Inception	10.68	11.32	Not Available	Not Available
Inception Date	November 26, 1986	December 14, 1993	Not Available	Not Available

Source: The Royce Funds

Portfolio Managers' Review

The economic recovery is entering its sixth year of expansion, and corporate profit margins are at multi-year highs.

However, it's unrealistic to expect that companies will be able to sustain the pace of earnings growth that they've generated over the past five years. The valuations on U.S. stocks are up, and the outlook for earnings growth is shifting, according to press reports.

The Fed is considering a slight rise in rates soon, which could increase financing charges for U.S. companies. This shows that the U.S. economy is doing well enough to absorb the impact.

In the closed-end fund world, we are finding that decent discounts are deeper than normal. The Royce Funds use a formula for making regular pay-outs to shareholders. We usually reinvest in additional shares of the distributions for possible faster growth.

In our experience, many closed-end funds find it is advantageous to repurchase their shares for the benefit of shareholders. The best time to do so is when the discounts widen to 8% or more.

According to *Barron's* and *The Wall Street Journal,* the discounts for Royce Value Trust on June 26, 2015 was -13.1%, for Royce Micro-Cap Trust, -14.0% and for Royce Global Value Trust, -15.1 %. With the discount on the average fund at 10%, the discounts on the three Royce Funds are about 3%-5% deeper. This creates a compelling opportunity for share repurchases by Royce.

Chuck Royce wrote in his 2015 First Quarter Report about share repurchases for each of his three closed-end funds:

"Royce Value Trust may repurchase up to 5% of the issued and outstanding shares of its common stock during the year ending December 31, 2015. Any such repurchases would take place at the then prevailing prices in the open market or in other transactions. Common stock repurchases would be affected at a price per share that is less than the share's then current net asset value."

We have always urged closed-end funds to repurchase their shares on a regular basis. The benefits are numerous.

Repurchases increase the liquidity of the fund's shares in the marketplace. When a closed-end fund repurchases its shares, it creates a new demand, and the benefit is magnified by the purchase. It also moderates growth in the outstanding shares, while increasing the fund's net asset value of the outstanding shares. Finally, repurchasing reduces the impact on shareholders who do not take the capital gains in additional shares.

Chuck Royce has always put the best interests of his clients' first, so we wouldn't be surprised if a repurchase plan is close to becoming a reality for his closed-end funds. He has always been is a smart investor with a brilliant long-term record. He has always been ahead of the curve in addressing the small-cap universe. His firm has been investing in closed-end and mutual funds since 1972.

CEFA clients, George Cole Scott and his family hold shares in Royce Value Trust and Royce Global Value Trust. We are also considering purchasing Royce Micro-Cap Trust for our clients at a later date. Each of these funds are near their 52-week lows and are trading well below the average discount of other closed-end funds.

Chuck Royce wrote recently that nothing "looks likely to derail the market's steady climb."

The next *Scott Letter* will be John Cole Scott's interview of Advent Claymore Convertible SE Closed-End Fund. It is scheduled to be released for the July/August edition. ■

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