CLOSED-END FUNDS

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Interest Rate Sensitivity of Leveraged Municipal Closed-end Funds

Leveraged Duration

Recently, some leading money managers who are recommending leveraged municipal closed-end funds have speculated about the performance of such funds in a rising interest rate environment. This is an important issue, as we believe the interest rate sensitivity of a leveraged municipal closed-end fund is a critical component of its overall risk profile. We thought we would use this opportunity to remind investors how to assess the interest rate risks associated with leveraged municipal closed-end funds.

We believe it is important to consider not only a fund's duration[1], but also the effect of leverage on that duration. If a fund (or more correctly the total assets of a fund) has an 8-year duration, we would estimate that the *leverage-adjusted duration* of such a fund (assuming a 35% leverage ratio) would be closer to 12.3 years. Theoretically, if interest rates were to rise by 100 basis points or 1%, a 12.3-year duration would result in a decline in the fund's net asset value of 12.3% — over 50% greater than what the unleveraged duration may anticipate.

Another key factor that some frequently underestimate is the effect of price change. Rising interest rates typically cause municipal closed-end funds to trade at widening discounts to their net asset values (NAVs)[2], further reducing the returns to investors. In some cases, declining prices have accounted for the lion's share of the negative total returns to investors (such as during the 1994 and 1999 period). Past performance is not an indicator of future performance.

This is not to say that investors should be selling or necessarily shying away from leveraged muni closed-end funds. Rather, this is simply a reminder of the importance of understanding fully the components of interest rate sensitivity in the funds, and helping you choose appropriate vehicles for your investment objective and tolerance for risk.

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[1] A fund's duration is a measure of its price sensitivity, expressed in years, to fluctuations in interest rates. Funds usually with durations of 1 to 3 years typically experience minimal interest rate risk; funds with durations of 4 to 7 years experience moderate interest rate risk; and bonds with a duration of more than 7 years are considered to have greater interest rate risk. Theoretically, the price of a bond or the net asset value of a fund with a duration of X years would decline/increase by X%, if rates rise/decline by 1% or 100 basis points.

[2] A closed-end fund has both a net asset value (NAV) and a price, and these two values may differ. A closed-end fund's NAV is the total value of the securities in the portfolio minus any liabilities, divided by the fund's number of common shares outstanding. The fund's price is the market value at which the fund trades on an exchange. Changes in investor demand for a particular closed-end fund may cause the fund to trade at a price that is greater (lower) than the NAV; in that case the fund is trading at a premium (discount) to its NAV. Since a fund's premium or discount to its NAV may narrow or widen, a closed-end fund's price return may differ from its NAV return.

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Income from municipal closed-end funds may be subject to state and local taxes and alternative minimum tax (AMT).

Leveraging a closed-end fund's portfolio enhances its yield, but it will also increase its net asset value volatility. Leverage will magnify the effect of changes in a fund's underlying assets on its net asset value.

Prices/yields/figures are as of 1/29/2004 unless indicated otherwise. All figures are subject to market fluctuation and change.

Investment return and principal value of the fund will fluctuate so that an investor's shares, when sold, may be worth more or less than their original cost. Brokerage commissions will reduce returns. Past performance is no guarantee of future results

Closed-end funds must distribute most realized gains to shareholders. Fund transactions will result in brokerage commissions and will generate tax consequences.

The investment discussed may not be suitable for all investors. Investors must make their own decisions based on their specific investment objectives and financial circumstances.

Investments in stock and bond funds are subject to risk, including market and interest rate fluctuations.

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