



Closed-End Fund Review

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FIRST QUARTER 2008

First Quarter Review

It was another challenging quarter for closed-end fund investors. Indeed, it was a challenging quarter for most equity and debt (with the exception of U.S. Treasuries) investors as well. With over 45% of all closed-end funds classified as equity funds or equity-oriented funds versus only 20% seven years ago, the net asset values (NAVs) and share prices of many closed-end funds are more correlated to the broad equity markets than they ever have been. Therefore, with the Standard & Poor's 500 Index lower by 10% in the first quarter of 2008 and with many broad European and Asian indices also down by over 10%, it is not surprising that many equity-oriented funds had a difficult first quarter. Many equity income funds or tax-advantaged equity income funds were hit particularly hard in the quarter due to having overweight exposure to financial services companies.

According to data compiled by Lipper, 38 of the 39 categories of closed-end funds were lower in the quarter. The three best-performing categories on a share price basis were:

U.S. Government Funds	+3.39%
Global Income Funds	-0.07%
Latin American Equity Funds	-0.07%

The three worst-performing categories on a share price basis were:

Miscellaneous Country/Region Funds	-18.06%
Emerging Market Funds	-13.86%
Pacific Ex-Japan Funds	-11.95%

Other notable categories included:

Growth Funds	-11.40%
Leveraged High Yield Funds	-8.73%
Loan Participation Funds	-8.45%
Leveraged National Municipal Funds	-3.81%

It was also a difficult quarter for debt investors, which negatively impacted the performance of many debt-oriented closed-end funds. Concerns about further write downs at broker dealers, disruptions in the auction rate preferred

securities (ARPS) market (see below) and the collapse of Bear Sterns caused debt investors to be extremely risk averse. In fact, U.S. Treasury Bills reached a 50-year low in yield during the quarter as investors sold credit sensitive securities in a "flight to quality." There is a record \$3.51 trillion in U.S. money market mutual funds. Even high quality municipal bonds were punished in the first quarter and February was the worst month of performance for individual municipal bonds in over ten years. Municipal bonds were hurt by forced selling by hedge funds and by concerns regarding the financial strength of the municipal bond insurers even though more than half of all municipal bonds carry a rating of AA or higher without the backing of a municipal bond insurer. Needless to say, it was a tough quarter for debt investors and closed-end funds, many of which take on credit risk to attain a high yield and were negatively impacted by the flight to quality we saw in the quarter.

Auction Rate Preferred Securities (ARPS)

Of the 660 closed-end funds in the marketplace, approximately 315 borrow via the auction rate preferred securities market. ARPS are issued by closed-end funds as a form of leverage. They are perpetual securities that re-set their interest rate every 7 or 28 days. Closed-end funds have been issuing ARPS as a form of leverage for 20 years and throughout that time there have been very few failed auctions—until mid-February when we started to see an unprecedented number of them.

Traditionally, the organizer (broker-dealer) of the ARPS process brings together buyers and sellers. When there have not been enough buyers for a specific ARPS, the broker-dealer organizing the process would purchase the excess securities to assure there was enough demand and make it a successful auction. However, in February most auctions for ARPS issued by closed-end funds did not produce enough buyers for the numbers of shareholders who wanted to sell their ARPS and the broker-dealers which had historically stepped in to buy the excess inventory failed to do so, resulting in failed auctions and illiquidity.

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It is important to note that a failed auction is not a default but rather the ARPS shareholder is unable to redeem their ARPS and instead earns the "fail rate" or "max rate" which is specified in the prospectus and is usually a designated margin over a specified index. Moreover, the assets backing an ARPS issued by a closed-end fund are collateralized at a rate of at least 200% (as required by the Investment Company Act of 1940). The unprecedented and surprising number of failed auctions has created some uneasiness among ARPS shareholders, many of whom have been unable to redeem their ARPS, as well as the common shareholders of closed-end funds who have been unsure what impact these failed auctions have on their fund.

The "fail rate" or "max rate" that most closed-end funds have had to pay to ARPS shareholders are only slightly higher than if the auctions had been successful, and due to the aggressive easing by the Federal Reserve, borrowing cost for most funds which use ARPS are lower now than they were 3 or 6 months ago. In other words, the large number of failed auctions has not resulted in significantly higher borrowing costs for most funds and therefore, in most cases, funds are still earning a nice spread between what they are paying ARPS shareholders and what they can re-invest at.

While many ARPS shareholders have been frustrated with the lack of liquidity in these securities, over the past several days in early April, many issuers of closed-end funds have announced initial plans to redeem some ARPS and replace them with an alternative form of leverage. The process of replacing ARPS with another source of borrowing (if ultimately that is what a Board of Directors of a fund decides to do) and bringing liquidity back to the market has started. This process is also one that could potentially take several more months as the Board of Directors of each fund has to carefully consider how their actions impact both common and preferred shareholders.

Lastly, some broker-dealers have recently announced that as a result of the illiquidity in the ARPS market, they will begin to value ARPS below par on their client statements. It is important to be cognizant of the fact that the markdown of the price of ARPS does not impact the common shares of a closed-end fund. Furthermore, these markdowns do not impact the net assets of a closed-end fund or impact how the NAV of a fund is calculated.

Outlook for rest of 2008

At the beginning of the year in the "Outlook for 2008" section of my commentary, I detailed an optimistic outlook for the first quarter and for 2008 as it relates to the performance of closed-end funds. While the first quarter did not meet my expectations, many of the positive conditions I discussed earlier in the year are still very much present now, which is why I continue to believe the rest of 2008 will see better performance for many closed-end funds relative to the past 6 months or so. Furthermore, I believe that during these periods of enhanced volatility, investors should ride out the volatility, continue to earn the very high income many funds distribute, and dollar cost average, if possible, to take advantage of lower prices.

Some of the positive factors which could improve performance for many closed-end funds this year include lower borrowing costs due to aggressive easing by the Federal Reserve; a dramatic slowdown in the CEF IPO market which places more emphasis on the opportunities that exist in the secondary market; and wide discounts which could attract more buyers to closed-end funds who want to take advantage of these historically attractive valuations. Perhaps the wild card in all of this is the performance of the equity markets. As I stated in the first paragraph, many closed-end funds such as covered call funds, convertible funds, dividend capture funds and equity funds generally trade in sympathy with the broad equity markets. Therefore, if equity markets stabilize or have a sustained rally this year, it would go a long way to help the overall performance of many closed-end funds. As always, due to the fact that closed-end funds can exhibit periods of high volatility, investors are encouraged to maintain a long-term time horizon and exposure to different types of funds.

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