CLOSED-END FUND review

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2016 Overview

2016 was a very solid year for diversified closed-end fund (CEF) investors with the average fund up 8.59% on a share price total return basis according to Morningstar. Unlike 2015 when most of the gains were limited to municipal CEFs, the gains in 2016 were broad—with many categories posting meaningful total return gains. All equity CEFs were up on average 9.78% and all taxable fixed-income CEFs were up on average 16.68%. Municipal CEFs were only up on average 0.64%. As both LIBOR (London Interbank Offered Rate) and long-term interest rates trended higher the last six months of the year, municipal CEFs struggled and were lower by 10.19% during the last half of 2016 (Morningstar). After lagging in 2015, shorter-duration, credit-sensitive categories really shined in 2016. Indeed, senior loan CEFs were up on average 23.92%, high-yield CEFs were up on average 18.79% and limited duration CEFs were up on average 15.87% on a share price total return basis (Morningstar).

As 2017 commences, the good news from my perspective is that even after a very solid year for many categories of the CEF marketplace, there remain several pockets of opportunities and value that I think CEF investors should focus on (see below). Average discounts to net asset value (NAV) remain wide by historical standards. Indeed, according to Morningstar the average fund was trading at a 6.34% discount to its NAV as of 12/31/2016 and only narrowed slightly from the average discount of 7.86% on 12/31/15.

Three Favored Categories; One Caution Area

I believe the best approach to investing in CEFs is to start with a macro view of the economy, interest rates/bond markets and equity markets. After the "top down" or "macro view" has been formulated, a CEF investor can then focus on the categories they believe are best positioned to perform well given their macro view. After the categories have been selected, that's when I believe a CEF investor should get much more granular and dive into several key factors about an individual fund. These include valuation, distribution sustainability, leverage structure, portfolio manager track record, etc.

Given First Trust's macro view for 2017 (as outlined by our Economics Team in this report (http://www.ftportfolios.com/Blogs/EconBlog/2016/12/27/2017-dow-23,750,-sp-2700) of real GDP (gross domestic product) growth of 2.6%, an increase in the CPI (consumer price index) to the 2.5% to 3.0% range, three or four rate hikes, 10-yr Treasury to finish the year at 3.25% and the S&P 500 Index to finish the year at 2700, my favored categories focus on equities and shorter duration fixed-income categories.

With average discounts to NAV still wide at 11.69% (Morningstar as of 12/31/16) for U.S. general equity CEFs, growing S&P 500 Index earnings per share forecasts and our Economics Team's forecast for higher U.S. equity prices, **U.S. Equity Income CEFs** still remain a favored category and still represent value and provide high income with growth potential, in my opinion.

Among taxable fixed-income CEFs, I still favor **Senior Loan CEFs**. Despite being up on average 23.92% in 2016 on a share price total return basis (Morningstar), the underlying asset class still has solid fundamentals (i.e. defaults below historical averages). I believe there still exists the potential for distributions to move higher later in 2017 should LIBOR continue to trend up. As well, the historical steady price of senior loans during periods of rising rates continues to make senior loan CEFs the most attractive fixed-income category this year, in my view. To be clear, while senior loan CEFs remain my favorite fixed-income CEF category for 2017, I am not expecting to earn the 20% plus total returns earned in 2016 and expect more of the total return to come from income and less from capital appreciation.

While U.S. equity income CEFs are my favorite equity income category within the CEF marketplace this year, I also believe investors should have exposure to **Global Equity CEFs**. While valuation is only one of several factors investors should look at when investing in CEFs, at the present time, the valuation (aka, discount to NAV) of the

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average global equity CEF is very attractive in my view and for deep value investors warrants a close look. Indeed, according to Morningstar, the average global equity CEF was at a very wide 12.65% discount to NAV as of 12/31/16. There are several reasons discounts to NAV among global equity CEFs remain very wide but one reason is the underperformance out of equity markets in Europe last year. However, at the present time, many blue-chip European equities are trading at more inexpensive multiples than their S&P 500 Index brethren and any upside surprise out of Europe could help the performance of several global equity income CEFs. Anytime you add global equity funds to your portfolio you also add other types of risk, including currency risk, local political risk, etc. However, at this point in time, given the very wide discounts in global equity income CEFs, attractive valuations in Europe and high distribution income stream, I think it is worth taking these potential risks and including global equity CEFs as part of a diversified CEF portfolio.

Finally, while average discounts to NAV remain decent at 4.20% (Morningstar as of 12/31/16) and yields also remain attractive, I remain cautious about being too over-exposed to long duration, leveraged municipal CEFs, in light of the potential for the Federal Reserve to raise rates three to four times this year (as our Economics Team is forecasting) and with the potential for long-term rates to continue to trend higher. If both short- and long-term interest rates do indeed continue to trend up in 2017 (as they did during the back half of 2016), it could continue to create rough seas for levered municipal CEFs and I think it is important CEF investors remain vigilant about the duration risk in levered municipal CEFs. I prefer more of an investor's municipal bond exposure to be in non-levered municipal CEFs, non-levered municipal ETFs (exchange-traded funds) and portfolios of individual municipal bonds as a way to slightly reduce duration risk relative to levered municipal CEFs.

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