Closed-End Fund Review

Jeff Margolin, Vice President
Closed-End Fund Analyst

FIRST Trust ADVISORS L.P.

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2007 Review

2007 was a challenging year for closed-end fund investors, particularly for new closed-end fund investors not accustomed to a lot of volatility from their income producing investments. Longer-term investors in closed-end funds know that funds do go through these periods when discounts widen to extreme levels and share prices decline more than underlying net asset values (NAVs) as was the case with many funds in 2007. Longer-term investors in closed-end funds are also aware that historically funds do bounce back from these extreme discounts and oftentimes when discounts are this wide it represents a compelling investment opportunity.

It is also important to put the volatility in closed-end funds this year in perspective and recognize it follows an exceptionally strong period of performance in 2006 when most of the major categories of funds were up double digits. Furthermore, throughout the volatility this year the overwhelming majority of closed-end funds continued to distribute very attractive income (which is often a key reason investors buy closed-end funds).

Much of the weakness occurred in the second half of the year after a large number of closed-end fund initial public offerings (IPOs) flooded the market and concerns about the sub-prime mortgage market led to a dramatic increase in borrowing cost for leveraged funds (approximately 70% of all closed-end funds employ the use of leverage); investors panicked, selling closed-end funds almost regardless of what the underlying asset class was or how the underlying NAV was performing. As expected (see commentary for Third Quarter 2007) many funds were also negatively impacted by tax-loss selling in the fourth quarter, which helped to contribute to discounts increasing to an average of 10% at year's-end. In fact, the average discount of 10% is more than double the 10-year average discount of 4% for closed-end funds and illustrates, in my opinion, why the share price pressure many funds had in the last half of the year was an overreaction and why there are many very attractive opportunities available for investors. As of December 31, 2007, 92% of all closed-end funds were trading at a discount to NAV and only 8% were at a premium. To compare that to earlier in the year, nearly 40% of all funds were trading at a premium to NAV in May.

For the year, 17 of the major categories of closed-end funds posted a lower market price total return and 3 were positive. Based on market price total return, below are the best and worst performers for 2007:

<u>Best Performers</u>

International Equity Funds	Up 20.60%
Sector-Specific Equity Funds	Up 11.90%
U.S. Government Funds	Up 7.88%

<u>Bottom Performers</u>

REIT Funds	Down 27.70%
Preferred Funds	Down 19.97%
Growth & Income Funds	Down 15.57%

Outlook for 2008

As I have discussed in previous commentaries, historically the fourth quarter is the most volatile for closed-end funds because of tax-loss selling. As well, discounts tend to widen towards the end of the year (as was the case in 2007). The first quarter tends to be the best quarter of the year as investors go bargain shopping for funds that have been a victim of tax-loss selling and are now trading at compelling valuations. With many of the major closed-end fund categories now trading at average discounts of 8%-12%, I believe investors should take advantage of the wide discounts and attractive yields many funds provide.

I believe we could potentially see a rally in many funds during the first quarter of 2008. Here are my reasons:

1. Tax-loss selling is over: A lot of the selling pressure many funds had the past few months has been a result of tax-loss selling which is a short-term, technical phenomenon that causes share prices to decline and discounts to widen at the end of the year. When the New Year begins, closed-end funds no longer have this added selling pressure and that is part of the reason funds tend to perform better in the first quarter.
2. Bargain shopping/wide discounts: 2008 will start with some of the most attractive discounts and opportunities for closed-end fund investors relative to anytime in the past

eight years, in my opinion. I believe this will attract investors who want to take advantage of these opportunities. It is not unusual for discounts to be cut by a third for some funds in the first quarter as investors go bargain shopping after the usual, seasonal weakness which occurs in the fourth quarter. This is precisely what occurred in the first quarter of 2006 after a difficult tax-loss season at the end of 2005 when discounts widened to an average of 7% (only now discounts are 10% on average).

3. Lower borrowing costs for leveraged funds: Part of the reason many funds got hit so hard this summer was because leverage costs increased so dramatically and in such a short period of time when there was a lot of uncertainty in the credit markets due to the sub-prime concerns. However, now that the Federal Open Market Committee (FOMC) has cut the federal funds rate 100 basis points since September (from 5.25% to 4.25%) we are starting to see borrowing costs come down for leveraged funds. While leverage costs have not declined as much as I would have expected considering all of the reductions the FOMC has made in the federal funds rate, they are slowly starting to come down and I expect them to decline even further next quarter. A decline in borrowing costs helps the environment for leveraged funds as it increases the spread between what the fund is borrowing at and what it may be able to re-invest at.

4. Fewer closed-end fund IPOs: 2007 was almost a record year for the amount of money raised in new funds. Approximately $28 billion was raised this year. The record was set in 2003 when $29 billion was raised. While I expect there will still be new issues next quarter and next year, I also expect less money to be raised in these new issues (at least in the first half of the year) which should help the secondary market for closed-end funds as investors focus on all the opportunities that exist in the secondary market as opposed to the primary market. This is similar to what happened at the beginning of 2006 when only 3 closed-end funds came public in the first quarter after a lot of funds were brought public in 2005.

5. Institutional investors: I expect that even some small institutional investors will be buyers of closed-end funds early in 2008 as they also know about the solid performance many funds historically exhibit at the beginning of the year. Hedge funds and other types of institutional investors love to take advantage of inefficiencies in the marketplace and I expect them to take advantage of these very wide discounts which could help the performance of funds in early 2008.

While 2007 was a volatile year for many closed-end funds, it is important to remember that closed-end funds began trading in this country in 1893 and that historically they have provided long-term investors with solid total returns despite going through difficult periods such as the last half of 2007. In fact, all 20 of the major categories of closed-end funds I monitor have a positive average annualized market price total return over the past 5 years. I believe that investors who ride out these difficult periods, collect the dividends and buy more shares as discounts widen out, will ultimately be rewarded. 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.