CLOSED-END FUND review

FIRST QUARTER 2009

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Overview

After a gut wrenching and historically volatile last 6 months of 2008, many closed-end fund categories stabilized and performed better in the first quarter of this year. Although there were still a few categories which were under a lot of pressure in the first quarter such as real estate funds, value-oriented equity funds and preferred stock funds, most categories at least stabilized in the quarter and did not see double-digit declines. In fact, of the 34 Lipper categories, 18 were positive for the quarter and 16 posted negative share price total returns. Only 4 categories posted negative total returns greater than 10%. The bulk of the categories which were positive for the quarter were fixed-income oriented as investors sought to take advantage of the attractive yields and opportunities in fixed-income funds which had been beaten down so badly during the dramatic flight to U.S. Treasuries and cash which occurred in the last half of 2008.

The best-performing categories were all leveraged municipal income closed-end funds, which was one of the categories I highlighted in my commentary at the beginning of 2009 as being very compelling. Indeed, 9 of the 10 top-performing categories in the first quarter were all leveraged municipal income funds. Despite the very solid first quarter for municipal funds, which were generally up 8-10%, I continue to believe municipal closed-end funds remain attractive. (See below for more on municipal closed-end funds.)

For the quarter, the three worst-performing categories on a share price total return basis were:

Real Estate Funds	-29.27%
Value Equity Funds	-15.43%
Preferred Stock Funds	-15.34%

The three best-performing categories on a share price total return basis were:

Pennsylvania Municipal Leveraged Funds	10.94%
New Jersey Municipal Leveraged Funds	10.40%
National Municipal Leveraged Funds	9.92%

Plethora of Dividend Increases for Municipal Funds

At the beginning of the 2009, I highlighted municipal funds as being particularly compelling due to the fact that municipal bonds represented exceptional value relative to U.S. Treasuries and because the yield curve was very steep for municipal bonds. This kind of environment enables municipal closed-end funds to borrow at very low interest rates and then re-invest in longer-term municipal bonds. The steep yield curve which municipal funds were benefiting from was ripe for an environment where dividends could be increased and that is what occurred in the first quarter of 2009. Dozens of municipal closed-end funds from several different fund families increased their dividends in the quarter. Indeed, as borrowing costs continued to decline in the quarter with municipal funds able to borrow at 0.75% in many cases, many funds began to significantly over-earn their monthly dividends, which is why many municipal funds raised dividends in March.

Even though municipal funds have had a very nice run the past four months, I continue to believe the fundamental story remains very much intact for these funds and that they are still very compelling.

1. There are attractive yields in municipal bonds relative to U.S. Treasuries
2. The steep yield curve has enabled most muni funds to over-earn their dividends
3. These funds have high credit quality characteristics

Lastly, many state legislatures have either raised or are considering raising state income taxes for their residents including New York, New Jersey, Maryland, California, Delaware and Wisconsin. These higher state income taxes make state-specific funds (in states which have them) even more attractive than they already are.

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Very Successful California Municipal Bond Offering

In my travels across the country, an issue which is frequently brought up by advisors is the health of California municipal bonds. The first point I make is to remind advisors that the California municipal market consists of a very broad group of issuers from local municipalities throughout the state, many of which are managed more conservatively than the overall state of California. When people discuss the "California municipal market" they are often referring to California state general-obligation bonds, but the California municipal market is much broader than that.

Given that there is so much interest in the health of California general-obligation bonds due to the fact they are represented in many national municipal closed-end funds as well as California state specific ones, I think it is important to mention that at the end of the month of March, the state of California had a very successful bond offering. Indeed, according to Bloomberg it was the biggest U.S. tax-exempt bond issue in almost five years at $6.54 billion. There was enormous demand for this issue and I believe it shows a lot of confidence in the state of California. More importantly, it clearly shows that the general-obligation bonds of California (which are rated A by S&P) are not at all trading like distressed securities. In fact, the yields offered on these bonds ranged from 3.2% on the notes due in 2013 to 6.1% for the bonds which mature in 2038. While these yields are slightly higher than comparable general-obligation bonds issued by other higher-rated states than California, they in no way suggest that the market is worried about actual defaults in California general-obligation bonds. If that were the case, yields would be significantly higher than what California had to offer. Furthermore, California state general-obligation bonds are secured by full taxing authority of the state and repayment of their debt service falls second only to education expenditures. I believe March's very successful offering shows that California general-obligation bonds are healthy and not distressed. This should help quell some of the fears investors have about the California municipal bond market.

Outlook for the Remainder of 2009

As the second quarter begins, it appears as if the worst of the financial meltdown which rattled global financial markets beginning in mid-September of 2008 is behind us. If this is indeed the case, many closed-end funds should continue to perform well during the rest of the year and volatility should decrease. As I have stated before, stability in the broad equity and credit markets will go a long way in helping to lessen the volatility in the closed-end fund marketplace. Initial signs of this stability are beginning to appear, which is part of the reason performance among many categories of closed-end funds has improved of late. Average discounts to net asset value (NAV) in closed-end funds (which reached an astronomical 25% last fall) are now down to 8%. This figure is still double the 10-year historical average of 4% and therefore signals there are still attractive opportunities in many categories including municipal funds, equity-oriented funds (including covered call funds), limited duration funds and investment-grade corporate bond 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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