CLOSED-END FUND review

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THIRD QUARTER 2011

Overview of Third Quarter

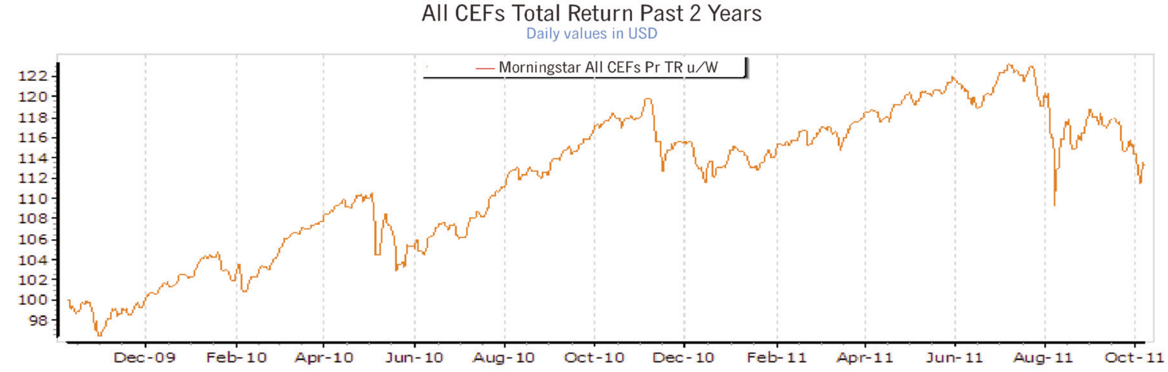
The third quarter was volatile and difficult for closed-end fund (CEF) investors. Indeed, the average fund was lower by 6.14% during the quarter, on a share price total return basis (according to Morningstar). Many equity-oriented and credit-sensitive funds, such as high-yield and senior loan funds, were down even more than that. In fact, according to Morningstar, the average equity fund was lower by 17.79%, high-yield funds were lower by 7.22% and senior loan funds were lower by 13.99%. The real bright spot for the quarter—and for the year—remains municipal funds, which were up 5.34% for the quarter and are up 12.45% year-to-date (as of 9/30/11). As I stated in a report dated 8/12/11, entitled "Municipal CEFs- A Big Beneficiary of the FOMC's Announcement", I believe municipal CEFs remain a compelling category of the CEF marketplace for income-oriented investors as many municipal funds continue to benefit from low leverage cost. This is enabling the average leveraged municipal fund to yield 6.60% (as of 9/30/11). Furthermore, defaults on municipal bonds remain exceptionally low and yields on municipal bonds remain compelling on a historical basis relative to U.S. Treasuries.

During the third quarter, companies reported very solid second quarter earnings, with earnings up in the mid-teens for the Standard & Poors 500 (S&P 500) Index, and several pieces of economic data were quite strong: Retail Sales up 0.5% on 8/12/11; Durable Goods up 4.0% on 8/12/11; Institute for Supply Management (ISM) Manufacturing at 50.6 on 9/1/11; and Leading Economic Indicators up 0.3% on 9/22/11. Yet, even though defaults remained very low for high-yield bonds and senior loans (more on that below), investors were clearly more focused on concerns about the Eurozone and soverign debt issues impacting Europe and European banks. The concern about Europe led to a meaningful sell-off in equities with the S&P 500 lower by 14% during the quarter. Furthermore, high-yield corporate bonds, as measured by the Barclays Capital High Yield Very Liquid Bond Index, were lower by 8.29% during the quarter. The palpable risk averse mentality among investors, which led to this weakness in equities and credit-sensitive securities, also led to a dramatic flight to safety and rally in U.S. Treasuries. Indeed, despite having its debt downgraded by S&P to AA+ from AAA on Friday August 5, 2011, U.S. Treasuries staged an enormous rally in the quarter with the yield on the 10-year Treasury dropping to 1.92% on 9/30/11 from 3.16% on 6/30/11.

Some Perspective

Despite a very challenging quarter for investors in equity-oriented and credit-sensitive CEFs, it is important for investors not to lose perspective and to realize it was just one bad quarter after several very good quarters. Even after the difficult third quarter, according to Morningstar, the average CEF is only down 0.4% as of 9/30/11. Indeed, as the chart below clearly shows, the trend the past two years has been quite good for CEFs and a period of volatility and weakness is not out of the ordinary after two very good years. In fact, the First Trust CEF Composite Total Return Index (UPCEFT) is up 36.19% from July 3, 2009 through September 30, 2011.

All CEFs Total Return Past 2 Years



Source: Morningstar

Moreover, I believe there is a disconnect growing between the underlying strength in corporate America and in the U.S. economy, and how equity and credit-sensitive securities are currently priced. Based on earnings growth for the S&P 500 (which is still forecasted to be in the mid-teens for 2011, according to S&P) the low valuations based on historical metrics for the S&P 500, the record amount of cash on the balance sheets of corporate America, as well as several recent positive data points on the U.S. economy (see above) and extremely low defaults for corporate bonds and senior loans, I believe there remains very good value and opportunities to be had for patient long-term investors. I think it is a mistake to sell into

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the recent weakness. For example, while both senior loan and high-yield funds had a challenging quarter, I believe the fundamentals remain quite solid for both of these asset classes. Indeed, Moody's reported that the global speculative-grade default rate stood at 1.8% in September, no change from August, according to *The Wall Street Journal*. The rate was 4.0% a year ago. Moody's is forecasting a default rate of 1.4% for December 2011. The U.S. speculative-grade default rate stood at 2.0% in September, down from 2.1% in August. The rate was 4.0% a year ago. The default rate on senior loans stood at 0.90% in September, down from 1.05% in August, according to Standard & Poor's LCD. At this pace, the default rate could fall to 0.23% by year-end. Bear in mind, the historical default rate for senior loans is 3.4%.

At the end of the third quarter, the average senior loan fund traded at a 6.02% discount to NAV and yielded 7.21%. With a default rate below 1% and the average price of a senior loan at 89 cents on the dollar (according to Bloomberg as of 9/30/11), I believe there remains good value and yields in the senior loan space. Furthermore, investors are earning these yields with very low duration risk.

Outlook and Potential Fourth Quarter Tax-Loss Selling

As we enter the fourth quarter, I continue to advocate that CEF investors build diversified portfolios across several categories including equity-oriented, senior loan, high-yield, limited duration and municipal funds. As stated above, I believe there remains compelling value and opportunities in both equity and credit-sensitive funds. While the third quarter was challenging, based on the positive fundamentals, yields and discounts to net asset value (NAV), I believe investors with the appropriate risk tolerance should take advantage of these opportunities.

It is also prudent for CEF investors to be prepared for some enhanced volatility in CEFs associated with tax-loss selling during the fourth quarter. With several funds lower for the year, we could experience tax-loss volatility in the latter part of the quarter. Having some cash on hand to be able to take advantage of this potential volatility could serve investors well. (Tax-loss weakness historically tends to be short-lived as investors at the beginning of the first quarter look to buy funds which might have been weak at the end of the fourth quarter.) As always, due to the fact that CEFs 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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