CLOSED-END FUND SPECIAL REPORT

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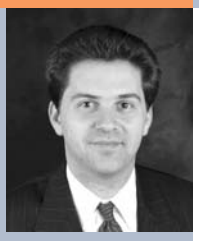

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Mid-quarter CEF Update: Focus on Income, Less On Capital Appreciation

Senior loan funds, limited duration funds and high yield funds have delivered very solid performance of the underlying asset classes in the past two years. Senior loans and high yield bonds are both, on average, trading close to par. Discounts to NAV have narrowed considerably in these three areas and we believe that most of the potential total return provided by these funds over the next year will likely come from income distributions and not significant capital appreciation as was the case the past two years. Consider the S&P/LSTA U.S. Leveraged Loan 100 Index, which closed on Friday at 96.30. While this index is still at an average discount to par (100), it has been steadily narrowing recently.

Below is a very brief synopsis of the key closed-end fund (CEF) categories I favor and recommend investors build diversified portfolios around. Additionally, I have provided the YTD share price total return numbers, according to Morningstar, as of February 11, 2011. **I believe it is imperative for investors who build diversified portfolios across these categories to expect most of the potential total return to come from income and not capital appreciation.**

Equity CEFs: The average equity CEF is up 2.43% YTD. I believe this category continues to offer attractive income as well as the potential for meaningful capital appreciation and remains one of the only broad categories within the CEF marketplace where investors can still buy funds at mid- to-high single digit discounts to NAV. Furthermore, the underlying asset class of equities remains very compelling for investors looking for income, but also the potential for capital appreciation due to attractive equity valuations, an improving corporate earnings picture and continued improvement in the broad economy.

Convertible CEFs: Convertible funds are up 4.50% YTD, on average. These are not pure play equity funds, but rather hybrids between equity and fixed income. I find this category compelling now because convertibles historically not only provide solid income, but also are much less interest rate sensitive relative to pure corporate bonds because they can be converted into the common stock of the underlying issuer.

High Yield CEFs: The average high yield CEF is up 5.39% YTD. Spreads have narrowed in high yield bonds and many high yield CEFs are only trading at small discounts to NAV or premiums. Investors looking for income should have exposure to high yields, in my opinion, because, as an asset class, high yield bonds are historically more credit sensitive than interest rate sensitive and credit conditions continue to improve in high yield bonds. Moody's recently reported that the global speculative-grade default rate stood at 2.8% in January, down from 3.2% in December. The rate stood at 12.6% a year ago. Moody's is now forecasting a default rate of 1.5% by January 2012. The U.S. speculative-grade default rate stood at 3.0% in January, down from 3.4% in December. The rate stood at 13.7% a year ago.

Limited Duration CEFs: The average limited duration CEF is up 1.24% YTD. I continue to favor this category for investors looking to shorten duration in their portfolios and still generate an attractive income stream. Many of the underlying asset classes that limited duration CEFs generally focus on, including senior loans, high yield and MBS, have seen their prices move closer to par. Thus, I believe most of the potential total return from limited duration CEFs will come from income and not capital appreciation.

Municipal CEFs: The average municipal CEF is down 0.87% YTD. Municipal CEFs have begun to stabilize and steadily trend higher the past four weeks. After suffering from what I believe are overstated concerns about credit conditions in municipal bonds, the asset class has started to perform better as investors begin to take advantage of the very attractive yields available in high quality municipal bonds relative to investment grade corporate bonds and U.S. Treasuries. I believe that municipal bonds do indeed represent good value and the very steep municipal yield curve is enabling the average leveraged, national municipal CEF to yield 7.29%. I believe leveraged municipal funds are the one area within fixed income where investors are being rewarded for the duration risk they are taking. Investors who want exposure to municipal bonds but don't want the enhanced volatility associated with leveraged municipal CEFs, should consider diversifying into non-leveraged municipal CEFs.

Senior Loan CEFs: The average senior loan CEF is up 5.78% YTD. Senior loan CEFs have very limited duration risk, yield an average of 6.14% and the default rate continues to decline among senior loans (it was only 2.18% in January, according to Standard & Poor's). I continue to believe that senior loan CEFs are compelling for investors looking for income from an asset class which historically performs well as interest rates trend higher. Many senior loans have moved closer to par and the average senior loan CEF is trading at a slight premium to NAV of 2.29%.

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