CLOSED-END FUND review

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SECOND QUARTER 2015

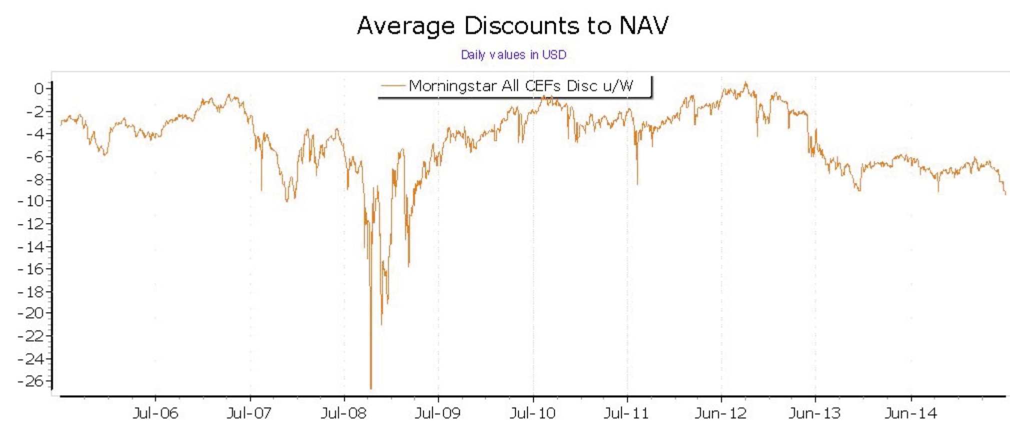
Second Quarter Overview

The second quarter was a difficult one for diversified closed-end fund (CEF) investors. According to Morningstar, the average CEF was lower by 3.70% on a share price total return basis. Most categories of the CEF marketplace experienced share price total return weakness during the second quarter and that is reflected in the fact that, according to Morningstar, all equity CEFs were lower by an average of 3.44%; all taxable fixed-income CEFs were down by an average of 3.40% and all municipal CEFs were lower by an average of 4.35%. While there are different reasons for the share price weakness depending on the specific category, in general the global increase in long-term interest rates during the quarter, coupled with volatile global equity markets (particularly during the last month of the second quarter), created a tough backdrop for many CEFs.

In my view, the main story during the quarter was not so much the share price total return weakness many CEFs experienced, but rather the meaningful discount widening and the degree that many categories had their respective share prices underperform underlying net asset values (NAVs). Indeed, while the average CEF had a 3.70% share price total return decline during the quarter, the average NAV was lower by much less (1.39%) on a total return basis (Morningstar). While it is not unusual for share prices to underperform underlying NAVs, the discount widening which occurred during the quarter, as well as both the absolute and relative level of current average discounts to NAV (compared to historical averages), is noteworthy (please see below for more on this topic).

Average Discounts to NAV Widen During Second Quarter

According to Morningstar, the average discount to NAV for all 561 CEFs in its database ended the quarter at 9.03%. This is over 200 basis points wider than where NAVs were when the first quarter ended and average discounts to NAV were 6.72%. The widening of discounts to NAV during the quarter to over 9% has pushed average discounts to levels which are meaningfully wider than historical averages. Indeed, the average discount to NAV one year ago ended 6/30/2014 was 6.04%; three years ago ended 6/30/2012 was 0.79%; five years ago ended 6/30/2010 was 1.89%; and ten years ago ended 6/30/2005 was 3.34% (Morningstar). In short, as the chart below illustrates, average discounts to NAV for all CEFs from 6/30/2005 through 6/30/2015 are currently as wide as they have been since the credit crisis during the second half of 2008 and beginning of 2009.



Source: Morningstar

While it is challenging to know exactly why discounts have widened so significantly recently, in my opinion, it is likely related to investor apprehension toward the CEF structure. Why? For one thing, the global increase in long-term interest rates during the quarter (for example, according to Bloomberg, the yield on the 10-YR U.S. Treasury increased from 1.93% to 2.34%). As well, the increased discussion of higher short-term rates (and therefore higher leverage cost) being discussed by several members of the federal reserve has spooked investors, in my

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opinion. Either way, while the recent weakness, as well as discount widening, has created short-term frustration for diversified CEF investors in my view, it has also created some very compelling long-term dollar cost averaging opportunities, along with compelling opportunities to initiate positions in favored categories (see below).

Use Recent Weakness and Discount Widening to Focus on Favored Categories

As discussed above, headed into the second half of 2015, average discounts to NAV for the CEF marketplace remain much wider than recent historical averages. I believe this has created some compelling opportunities for diversified CEF investors. However, even though average discounts to NAV for most categories are in the high single-digit or even in the low double-digit range, I still believe investors need to pick their spots carefully when deciding which CEFs and categories to focus on.

In my view, given First Trust Portfolios' macro outlook for continued "plow horse" (as our Economics Team calls it) growth in the U.S. economy, potential for mid single-digit growth in S&P 500® Index earnings in 2015 and double-digit earnings in 2016 and the potential for both short- and long-term interest rates to move higher this year, I continue to believe the core parts of an investor's CEF positions should include domestic equity CEFs, senior loan CEFs, limited duration multi-sector CEFs and non-leveraged municipal CEFs. I also continue to believe that convertible CEFs, Master Limited Partnership (MLP) CEFs and preferred securities CEFs that specifically have an emphasis on fixed-to-floating[1] rate preferreds are three categories that could be used as satellite positions.

[1] A fixed-to-floating rate security has a coupon rate that is fixed for a certain period of time (typically five, ten or thirty years from the time of issuance), after which the coupon resets at a floating rate based on a spread over the security's benchmark (typically 3-month LIBOR).

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