Closed-End Fund Review

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THIRD QUARTER 2006

Third Quarter 2006 Results

Closed-end funds exhibited very solid performance in the third quarter with 20 out of the 21 categories we monitor posting a positive total return. The year-to-date statistics are even better with all 21 categories up for the year. We attribute the strong showing to three primary factors:

Federal Open Market Committee (FOMC) is likely closer to the end than the beginning of its tightening cycle: After 17 straight increases in the Federal Funds rate, the FOMC has now held steady at 5.25% at its last two meetings August 8th and September 20th. This "pause" has convinced many closed-end fund investors that despite the possibility that the FOMC might increase short-term rates again, it appears that the Fed is likely closer to the end of its tightening cycle than the beginning. This has encouraged investors to feel more comfortable with leveraged funds as it means that borrowing costs will be more stable.

Slow Initial Public Offering (IPO) market for closed-end funds: The IPO market for closed-end funds continues to slow with only 4 new funds brought to market in the third quarter. This compares to the 8 funds brought public in the third quarter of 2005. I believe this phenomenon helps existing closed-end funds as it re-focuses attention to the many opportunities that exist in the secondary market.

Few other attractive yield-oriented investments: Even with the 17 increases in the Fed Funds rate, yields on most money market funds and certificate of deposits (CDs) remain below 5%. Furthermore, yields on long-term U.S. Treasuries also remain relatively low with the yield on the 10-year U.S. Treasury Note ending the quarter at just 4.63%. Lastly, even with all of the dividend increases we have seen this year by companies in the S&P 500 Index, the dividend yield is still only approximately 1.85%. Therefore, many yield-oriented investors have increasingly been turning to closed-end funds as a way to increase yield within their portfolios.

We break the universe of over 600 funds into 21 separate categories. Based on market price total return, below are the best and worst performers for the third quarter:

<u>Best Performers</u>

Real Estate Investment Trust (REITs)	up 15.92%
Growth & Income	up 11.13%
Preferreds	up 10.14%

<u>Worst Performers</u>

Covered Call Funds	down 0.59%
Senior Loans	up 3.5%
Sector Specific Funds	up 5.16%

Market Commentary

The fourth quarter of 2005 was the worst fourth quarter for closed-end funds since the last three months of 1994 and 1999. Closed-end funds sold off primarily as a result of year-end, tax-loss selling. Tax-loss selling is when investors sell securities to realize losses in order to offset gains within their portfolios. Despite the very solid rebound in closed-end funds thus far in 2006, many investors still have vivid memories of the volatility experienced at the end of last year. The question on the mind of many closed-end fund investors is whether or not this year's fourth quarter tax-loss selling will be as bad as last year's and take away a lot of the gains we have achieved in the first nine months of the year.

It is my contention that the short-answer is "No." This year's fourth quarter tax-loss selling season will likely not be as bad as last year's was for the closed-end fund marketplace. Why? I don't think it will be as bad as last year simply because closed-end funds have performed much better thus far year-to-date and there are fewer losses for investors to take. However, there will likely be some tax-loss selling and enhanced volatility for closed-end funds in the fourth quarter (there almost always is) and investors need to be prepared for this enhanced volatility that we could potentially see over the next few months. Investors might also take profits in closed-end funds in the fourth quarter which could also lead to some short-term downside volatility.

I believe if we do have volatility this fourth quarter, it will provide another good opportunity to buy closed-end funds and take advantage of the seasonal trading weakness which is usually temporary. Investors who panicked and sold during last year's fourth quarter have missed out on some very good returns this year among many closed-end funds. The investors who were contrarians and realized that the tax-loss selling was just a temporary phenomenon and bought closed-end funds in the fourth quarter are sitting on some very solid gains. We would once again encourage investors to be contrarians and buy closed-end funds if we have a lot of weakness in the fourth quarter as a result of year-end selling.

Lastly, 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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