Closed-End Fund Review

Jeff Margolin, Vice President
Closed-End Fund Analyst

FIRST TRUST ADVISORS L.P.

FIRST QUARTER 2006

First Quarter 2006 Results

What a difference a change in the calendar year can make. The fourth quarter of 2005 was characterized by substantial downward volatility in the market price of most closed-end funds, primarily as a result of year-end tax-loss selling. Fears of further increases in short-term interest rates (and therefore higher leverage costs) also hurt funds at the end of last year. I think it is fair to say that the fourth quarter lived up to its reputation as historically the most volatile for closed-end funds due to tax-related selling and portfolio repositioning that often occurs at the end of the year. Fortunately, the first quarter lived up to its reputation for being the best time of the year for closed-end funds.

Many funds entered 2006 trading at deep discounts relative to historical norms and with very attractive yields. Investors used the weakness that occurred at the end of 2005 to go bargain shopping and purchase closed-end funds at deep discounts in the first quarter. We break the universe of over 600 closed-end funds into 21 separate categories and 20 out of the 21 categories posted a positive market price total return in the first quarter. The only category to have a negative return was government funds, which were down 0.77%. This was not too surprising considering that Treasuries have been under pressure for most of the year. 19 of 21 categories had a positive net asset value (NAV) total return.

Based on market price total return, below are the best and worst performers for the first quarter:

Best Performers	
REIT funds	up 13.58%
International equity funds	up 12.24%
Senior loan funds	up 7.87%
Worst Performers	
Government funds	down 0.77%
Other state municipal funds*	up 1.63%
Mortgage funds	up 1.68%

*Includes single state municipal funds excluding California and New York

The solid rebound in senior loan funds was welcome news to holders of these funds because last year was such a difficult and frustrating year despite a positive environment for senior loans. Discounts among the senior loan funds narrowed significantly in the first quarter, ending at an average discount of 5.7% versus a discount of 10% at the end of 2005.

We believe the irrational weakness that we saw in the fourth quarter, coupled with the subsequent rebound in many funds this year, is a healthy reminder that often times the best time to be buying closed-end funds is in the middle of a seasonal occurrence such as tax-loss selling. Investors who were buying funds and not selling them at the end of 2005 are now sitting on very attractive gains whereas the investors who sold at the end of the year have missed out on those gains. Furthermore, we would encourage investors to consider not only the market price performance of their funds but also the NAV performance. While market prices were going lower for most of the fourth quarter of last year (17 of the 21 categories had a negative market price total return), NAV prices were stable to rising for most funds. In fact, 16 out of 21 categories had a positive NAV total return performance in the fourth quarter which was an excellent indicator that the selling pressure was being overdone and that investors should be taking advantage of the weakness and widening discounts to purchase funds, not sell them.

We believe another positive factor for closed-end funds during the first quarter has been the slow down in the number of new issues coming to market. In 2005 there were 47 new closed-end funds brought public or about 4 a month. In the first quarter of this year there were only 3 new funds (or 1 a month). We believe the slowdown in the IPO market creates more focus and more demand for closed-end funds in the secondary market and can help the performance of existing funds. We believe this phenomenon was evident in the first quarter of 2006.

Dividend Income Equity Funds

Over the past few years there has been renewed interest in closed-end funds that focus on dividend-paying stocks. We believe there are two primary reasons for the renewed interest in these funds. First, as the first wave of baby boomers begins to retire and other baby boomers start to think about their retirement plans they begin looking for funds that offer a predictable income stream but also the opportunity for growth. Americans are living longer and can often have a retirement that lasts 20-30 years. Therefore, people not only need regular income from their investments but also need growth to keep up with inflation.

Second, we believe there is renewed interest in dividend income equity funds related to the Jobs and Growth Tax Relief Reconciliation Act of 2003 which lowered the top tax rate on qualified dividend income to 15% in 2003 through 2008 from rates of up to 38.6%. This legislation has greatly improved the tax advantages of owning dividend income equity funds. Furthermore, we believe investors recognize the importance of dividends. To understand the power of dividends, consider U.S. stock returns over many decades. According to Ibbotson Associates, dividends have provided approximately 43% of the 10.36% average annual total return on the S&P 500 Index from January 1926 through December 2005. Lastly, corporations are not obligated to share their earnings with stockholders, so in our opinion dividends may be viewed as a sign of a company's - profitability as well as management's assessment of the future.

We believe dividend income equity funds represent one of the most attractive sectors of the closed-end fund marketplace for long-term, growth and income investors. In fact, a basket of 12 dividend income equity funds that we track ended the first quarter at an average discount to NAV of 11.7%. Furthermore, the average yield of these 12 equity income funds was 6.23%, much of which should qualify for the 15% tax rate. While the 15% tax rate on qualified dividends is scheduled to end at the end of 2008, there is a reasonable possibility that the tax law will be extended through 2010 or even made permanent at some point, which we believe could help the performance of these dividend income equity closed-end funds.

Final Thoughts

While closed-end funds have started the year with very solid performance, we caution investors that we believe it is unlikely we'll see these types of returns every quarter of the year. There are some head winds on the horizon that could put some near-term pressure on the closed-end fund marketplace, namely, rising short-term interest rates.

The Federal Open Market Committee (FOMC) has now raised short-term interest rates 15 times since 2004 from 1.00% to 4.75% which greatly impacts the leverage costs of many leveraged funds and therefore puts pressure on dividends (and often ultimately the market price of funds). Senior loan funds, non-leveraged funds and funds that have locked in their leverage costs are less negatively impacted by rising short-term rates. With it becoming increasingly likely that the FOMC is going to continue to increase short-term interest rates, leveraged funds could continue to feel the sting of these increases and that could potentially put pressure on many leveraged funds. Fortunately, it is likely that the FOMC is closer to the end of its tightening cycle than the beginning. This could help the performance of closed-end funds in the last half of the year as investors will be relieved that the Fed is done and that borrowing cost will, at the very least, be stable. 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.

All opinions expressed constitute judgments as of the date of release, and are subject to change without notice. There can be no assurance any forecasts will be achieved. The information is taken from sources that we believe to be reliable but we do not guarantee its accuracy or completeness.

First Trust Advisors L.P. • 1-630-915-6784
www.ftadvisors.com • www.ftportfolios.com

APRIL 2006