CLOSED-END FUND review

FOURTH QUARTER 2009

Jeff Margolin

Senior Vice President, Closed-End Fund Analyst

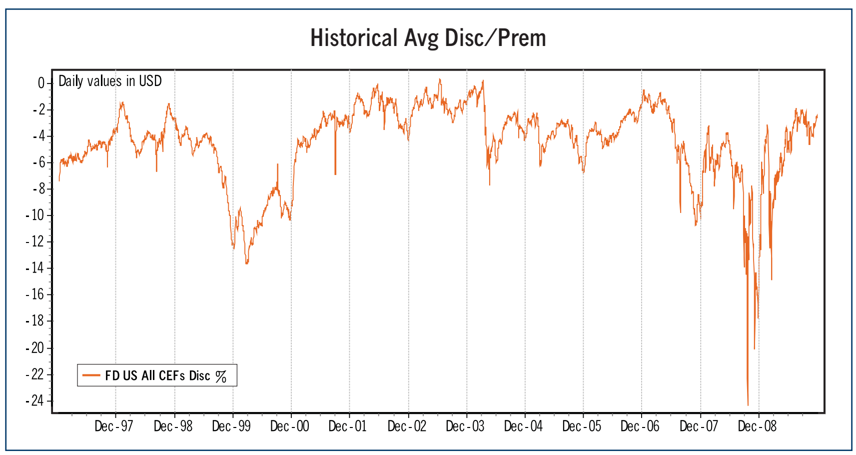
Overview of 2009

2009 was simply a great year for the closed-end fund marketplace. The average closed-end fund was up a remarkable 51.15% on a share price total return basis (according to FundData). Every category tracked by FundData was up for the year. In fact, in my approximately 15 years of working in the financial services industry, 2009 was by far the best year closed-end funds have ever had. The rally was broad and deep. There were 3 key conditions which contributed to 2009 being such an amazing year for many closed-end funds including:

1. Average double digit discounts to net asset values (NAVs) of over 11% for closed-end funds to start the year.
2. Enormous value in the underlying asset classes many closed-end funds focus on due to the panic which engulfed the financial markets in the fall and winter of 2008.
3. Steady improvement in the global equity and credit markets throughout 2009.

In my opinion, it was precisely these 3 key conditions which helped many closed-end funds to post total returns in excess of 50% during the year. As 2010 commences, I continue to be optimistic that as long as the global financial markets continue to improve, 2010 could also be a solid year for many closed-end funds. However, I do not expect most closed-end funds to have the same kind of total returns they had in 2009 and I think it is crucial that closed-end fund investors lower their expectations relative to last year. There are simply not broad-based double digit discounts to NAV available anymore and many key asset classes including equities, senior loans, municipal bonds and corporate bonds have already rallied sharply off their lows from the beginning of 2009. I believe in 2010 the majority of the total return which closed-end funds provide will be from income and not capital appreciation as experienced so dramatically last year.

I think it is more important than ever for closed-end fund investors to focus on funds which are invested in underlying asset classes which are positioned to perform well in 2010. I believe investors can still make money in closed-end funds this year even though discounts are not nearly as wide as they were a year ago, as long as the underlying asset class the fund invests in performs well. However, in most cases, closed-end fund investors will not be able to count on an extra boost from returns due to discounts contracting. As 2010 starts, the average discount to NAV was only 2.77%, according to FundData. This number is inline with the 5-year average discount to NAV of 3.22%.



Source: Fundamental Data Ltd, a Morningstar company (www.FundData.com)

Opportunities for Closed-End Fund Investors in 2010

At the beginning of 2009, closed-end fund investors could have bought funds in every category across the board and they would have made money. I do not believe it will be that easy in 2010 and closed-end fund investors need to be pickier and focus on funds where the underlying asset class remains compelling. I believe the four areas of the closed-end fund marketplace which continue to have the potential to deliver solid total returns for investors this year, albeit far less than last year, include senior loan funds, equity income-oriented funds, municipal funds and investment-grade corporate and multi-sector bond funds. The one common thread between all four of these categories is that all four asset classes remain attractive, in my opinion. I believe if investors stay diversified across these four closed-end fund categories, they can achieve a blended yield in the 6%-8% range and the potential for modest capital appreciation (particularly in the senior loan and equity income funds). On the following page is a summary of each category and why I find it compelling at this time.

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Senior Loan Funds: With the likelihood that short-term interest rates will move higher this year, I think it is crucial for investors to have protection against rising interest rates and exposure to floating rate funds. Senior loan funds provide this protection as the income on a senior loan re-sets every 60-90 days based on where short-term rates are. As short-term rates move higher, so should the interest on the loans in the senior loan funds (albeit with a short lag) and therefore so should the dividends the funds pay. Also, senior loans are still very attractive considering the S&P/LSTA U.S. Leveraged Loan 100 Index was at 87.68 on 12/31/09, which is still considerably below par (100). I believe as the economy and credit markets continue to improve in 2010, prices on senior loans will trend higher and could reach the mid to high 90s by the end of the year, providing modest capital appreciation for the NAVs of the senior loan funds. Furthermore, as of 1/4/10, the average senior loan closed-end fund was trading at a discount to NAV of 3.85% versus a five-year average premium to NAV of 0.48%. This represents a good value relative to where they historically trade. I would not at all be surprised if many senior loan funds began trading at premiums to their NAVs this year. I would expect them to remain at premiums for an extended period of time or at least until the Fed is done raising rates as investors remain attracted to the potential for rising dividends as short-term rates move higher.

Municipal Funds: Regular readers of my commentary are well aware of the fact that throughout all of 2009, I was very bullish on the municipal closed-end fund category and while the average municipal closed-end fund was up 44.93% on a share price total return basis, according to FundData in 2009, it is still a category I like as 2010 gets underway. However, I think it is important for me to state that I do not expect the tremendous capital appreciation in municipal closed-end funds for 2010, but rather believe most of the return will come from the very high and attractive dividends municipal funds currently offer.

2010 will likely be a tug of war year for the municipal funds. On the negative side, investors will worry about the threat of higher interest rates and the negative implications this could have on municipal funds. On the positive side, investors will be attracted to the extremely attractive tax-free yields currently available in municipal closed-end funds. Indeed, the average municipal fund yields 6.45% as of 1/4/10, according to FundData. Municipal closed-end funds continue to benefit from the exceptionally steep municipal yield curve which is enabling municipal funds to still meaningfully over-earn their monthly dividends. Our analysis of the municipal closed-end fund category indicates that many municipal funds are over-earning their dividends by over 10% and have 1 to 3 months of undistributed net investment income (UNII) balances available. I believe dividends are very secure for 2010 and could potentially move higher again in the first half of the year. The likelihood of high and stable monthly tax-free dividends will keep investors attracted to municipal closed-end funds. I also believe municipal closed-end funds will benefit from the threat of higher Federal taxes after 2010 and many states have already increased taxes. Furthermore, the continued issuance of taxable Build America Bonds (BABs) in 2010 by states instead of more traditional tax-free municipal bonds should limit the supply of new municipal bonds and help the secondary market for municipal bonds as demand remains high but supply decreases.

Equity Income Funds: Equity income-oriented closed-end funds are another category within the closed-end fund marketplace I think remain attractive for 2010. Equity income closed-end funds not only provide investors with attractive income but they also provide investors with capital appreciation potential. With First Trust Chief Economist Brian Wesbury continuing to call for a V-shaped recovery coupled with anticipated higher equity prices in 2010, I believe equity income funds should perform well as the economy continues to improve. Furthermore, there are still attractive discounts to net asset value among equity closed-end funds. Indeed, according to FundData, the average discount among all equity funds is 3.28% as of 1/4/10.

Investment-Grade Corporate and Multi-Sector Bond Funds: I find many of the investment-grade corporate and multi-sector bond funds particularly compelling now because many of them have short- to intermediate-term durations and therefore generally hold up better relative to longer duration taxable fixed-income funds when interest rates move higher. Furthermore, many investors are looking for an attractive income stream but don't want a large amount of credit risk associated with below investment-grade funds. Investment-grade corporate and multi-sector bond funds provide investors with an attractive income stream but these funds have investment-grade average credit ratings of BBB or higher. Lastly, while discounts have narrowed among the investment-grade corporate and multi-sector bond funds, they are still attractive. In fact, the average discount (according to FundData) among multi-sector bond funds is 5.06%, as of 1/4/10.

Conclusion

2009 was a year characterized by remarkable total returns for closed-end funds and after the first week of March, exceptionally low downside volatility. I do not expect 2010 to offer the same type of total returns and low volatility for closed-end fund investors that 2009 offered. However, I do believe if investors focus on the four categories discussed in this commentary, 2010 has the potential to be a year of solid, high single-digit total returns. As always, 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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