CLOSED-END FUND review

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Overview of 2015

2015 was a challenging year for diversified closed-end fund (CEF) investors, with the average CEF lower by -5.71%. It was a particularly difficult year for equity CEFs, which were lower on average by -17.99% and taxable fixed-income CEFs, which were lower on average by -3.23%. Municipal CEFs were a bright spot in 2015, rising 7.68% for the year. (Source: Morningstar)

I believe many factors contributed to the difficult year for diversified CEF investors, including: the first negative price return year for the S&P 500 Index since 2008; a significant decline in oil prices, which put particular pressure on master limited partnership ("MLP") CEFs, as well as credit-sensitive funds, including high-yield bond CEFs; and investor apprehension toward the CEF structure for much of 2015, ahead of the Federal Reserve's ("Fed") first increase in the federal funds rate since 2006. The Fed eventually did raise the federal funds rate on December 16, 2015. Volatility in the equity markets (particularly during the second half of the year) and a "risk off" investor mentality on the part of retail investors also likely contributed to the difficult year, as well as widening of discounts among many CEFs.

While 2015 was a hard year for many categories of the CEF marketplace, as 2016 commences, I believe valuations (as well as distribution rates) for several categories remain compelling. Indeed, as of 12/31/15, the average CEF was at a wide -7.86% discount to its net asset value (NAV) and the average share price distribution rate was 7.70%, (Morningstar). Bear in mind, three years ago (12/31/2012), the average discount to NAV was only 2.77% and five years ago (12/31/2010) the average discount to NAV was 3.21% (Morningstar). I don't know exactly when discounts will begin to narrow from current levels of approximately 8% to levels which are closer to the long-term average of 3-4%. However, historically when average discounts to NAV are as wide as they are for as long as they have been and distributions are as high as they currently are, it creates very compelling long-term total return opportunities for CEF investors.

In my view, investors who ride out the volatile periods, add to positions in favored categories (see below), let the power of compounding work in their favor and wait for the unusually wide discounts to NAVs in the secondary market narrow closer to long-term averages, ultimately should be rewarded. Below I highlight three categories within the CEF marketplace I believe investors should focus on and make up the core of a diversified CEF portfolio.

U.S. Domestic Equity CEFs

The first negative price return year for the S&P 500 Index since 2008 created a challenging backdrop for equity CEFs which invest primarily in U.S. equities. However, with discounts to NAV (gathered from Morningstar) averaging 8.08% as of 12/31/2015 (versus 6.46% on 12/31/2012 and 4.82% on 12/31/2010) and very compelling average share price distribution rates of 10.13% as of 12/31/2015 (versus 7.71% on 12/31/2012 and 7.02% on 12/31/2010), I believe investors inclined to take equity risk should take advantage of the compelling valuations and distribution rates available among U.S. domestic equity CEFs.

Moreover, our Economics Team continues to forecast more "Plow Horse" (as they describe it) U.S. economic growth. According to Bloomberg, as of 12/31/2015, consensus EPS (earnings per share) estimates for the S&P 500 Index are forecasted to grow 8.62% in 2016 and 12.64% in 2017. This could create a positive backdrop for U.S. domestic equity CEFs in 2016.

Non-Levered Municipal CEFs

Last year, in my CEF commentary pieces, I wrote how I preferred non-levered municipal CEFs over levered municipal CEFs. While non-levered municipal CEFs had a good year in 2015, rising 5.40% on a share price total return basis (Morningstar), they underperformed the average leveraged municipal CEFs, which were higher by 7.80% on a share price total return basis in 2015.

I continue to like the underlying asset class of municipal bonds and believe municipal bonds provide important balance in a diversified portfolio, as well as compelling taxable equivalent yields. However, despite the

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underperformance relative to leveraged municipal CEFs in 2015, with the Fed having begun the process of raising the federal funds rate, I continue to favor non-leveraged municipal CEFs over leveraged municipal CEFs.

Senior Loan CEFs

Despite very compelling fundamentals for the underlying asset class of senior loans (the default rate on senior loans stood at 1.19% in December, according to S&P Capital IQ, and remains well below the historical average of 2.79% since December 2002), and very compelling valuations for the underlying asset class (the S&P/LSTA U.S. Leveraged Loan 100 Price Index ended the year well below par at 87.70), the average senior loan CEF had a disappointing 2015, with a negative share price total return of -4.72% (Morningstar).

With the Fed on hold for most of 2015, investors clearly were not interested in the floating-rate nature of senior loans and were not interested in reducing duration risk in their portfolios. However, now that the Fed has finally begun the process of raising the federal funds rate, I believe as 2016 progresses, investors will indeed become more concerned about duration risk among their fixed-income oriented CEFs and will increasingly look to senior loan CEFs as a way to still earn a compelling income stream (as of 12/31/2015 the average senior loan CEF had a share price distribution rate of 8.61%, according to Morningstar), while reducing duration risk. Furthermore, not only are the fundamentals and valuations of the underlying asset class of senior loans compelling, but the valuations of the Morningstar universe of 27 senior loan CEFs also remains attractive. Indeed, as of 12/31/2015, the average senior loan CEF was trading at a 9.1% discount to its NAV. Keep in mind three years ago (12/31/2012), the average senior loan CEF was a premium to its NAV of 0.76% and five years ago (12/31/2010), the average senior loan CEF was also at a premium to NAV of 0.16% (Morningstar). In other words, I believe there is ample room for discounts to narrow should investors look to reduce durations and add exposure to a floating-rate asset class in 2016.

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