



Understanding the Advantages of Closed-End Funds



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A World of Investment Opportunity

Once investors understand the risks associated with closed-end fund investing, they also understand the opportunities to achieve superior performance.

Introduction

Closed-end funds (CEFs) are professionally managed investment companies that offer investors an array of benefits unique in the investment world. While often compared to traditional open-end mutual funds, closed-end funds have many distinguishing features. They offer investors numerous ways to generate capital growth and income through portfolio performance, dividends and distributions, and through trades in the marketplace at beneficial prices.

CEF shares are listed on securities exchanges and bought and sold in the open market. They typically trade in relation to, but independent of, their underlying net asset values (NAVs). Intra-day trading allows investors to purchase and sell shares of closed-end funds just like the shares of other publicly traded securities. In addition, when shares of closed-end funds trade at prices below their underlying NAVs (at a discount), investors have the



opportunity to enhance the return on their investment by making bargain purchases.

The history of closed-end funds began in 1893, more than 30 years before the first mutual fund was formed in the United States. Currently, there are more than 500 closed-end funds, some of which have management and performance histories that date back over half a century. Many investors hold CEFs for long periods of time, and it is not unusual for shares to be handed down from one generation to the next.

Closed-end funds are truly unique investments and provide investors an important way to achieve their long-term investment goals.

Investment Company Industry

Investment companies have been around for over 100 years; however, the foundation for their current popularity was laid with the passage of the Investment Company Act of 1940 (the 1940 Act). This legislation and subsequent amendments and related rules have provided a rigid, yet workable, framework for millions of individual investors to obtain professional management of a diversified portfolio of securities at a reasonable cost.

There are two principal types of investment companies: open-end and closed-end.



*There are two
types of
investment
companies,
open-end
and
closed-end.*

What is a Closed-End Fund?

The capital structure and number of shares are fixed, hence the term “closed-end.”

Open-end funds (more commonly known as mutual funds) continuously offer their shares to investors and prospective investors and stand ready to redeem their shares at all times. Transactions in shares of mutual funds are based on their net asset value (NAV), determined at the close of each business day. Sometimes the transaction price includes an adjustment for a sales, redemption or other charge. NAV is the value of the fund's assets less its liabilities divided by the number of the fund's outstanding shares. The invested capital in a mutual fund tends to fluctuate based on investor sentiment.

Closed-end funds have a fixed number of shares outstanding. Following an initial public offering, their shares are traded on an exchange between investors. Transactions in shares of closed-end funds are based on their market price as determined by the forces of supply and demand in the marketplace. Interestingly, the price of a CEF may be above (at a premium to) or below (at a discount to) its NAV. The transaction price will also include a customary brokerage charge. The invested capital in a closed-end fund is fixed and will change only at the direction of management. Capital can be increased through the issuance of shares in conjunction with a rights offering or through dividend and capital gain reinvestments of certain dividend payments. Capital can be reduced when shares of the fund are repurchased in conjunction with a stock repurchase program or tender offer.

Advantages of Funds

If you have had experience with mutual funds, several advantages of closed-end funds should be familiar to you. Let's cover those first. Then, we'll identify a few benefits of closed-end fund investing which aren't available in mutual funds.

Diversification—In closed-end funds, you participate in a portfolio that invests in many securities, and this helps to spread market risk. If any one security performs poorly, it shouldn't have a severe impact on your investment.

Professional Management—The portfolio manager or team selects securities and monitors them on a full-time basis. You can participate in closed-end funds without developing investment expertise or devoting hours of time to research on specific issues.

Clear Objectives—Most closed-end funds specialize in either stocks or fixed-income securities and pursue a consistent objective, such as capital appreciation or current income. Some funds are highly specialized, investing in a given region, country or specific type of security. You can select funds with management styles and objectives that match your needs.



If you have had experience with mutual funds, many of the advantages of closed-end funds should be familiar to you.

Convenience—You may buy or sell shares quickly and easily during the day in any quantity that your brokerage firm permits.

Liquidity—Whether your order is to buy or sell a few shares or several thousand, you should be able to execute your trade in active and competitive bidding.

Economy of Scale—The costs of operating a closed-end fund are divided pro rata among all shareholders. The major ongoing cost, a management fee paid to the investment advisor, is based on assets and is very competitive with the same expense in mutual funds.

Periodic Distributions—Your fund will make distributions according to a prescribed schedule. If you depend on your investments for current income, this will allow you to plan the timing of income. (The actual amounts of income distributed by closed-end funds vary with market conditions and fund performance.)

“Pass Through” Taxation—Like mutual funds, closed-end funds generally do not pay tax at the fund level on amounts distributed to investors. The taxation is said to “pass through” to the shareholders.

Available for Many Accounts—Like mutual funds, closed-end funds may be purchased in regular brokerage accounts (individual or joint-name), retirement plan accounts, trust accounts or custodial accounts.

Advantages of CEFs

Opportunity to Buy at a

Discount—When closed-end funds can be bought at a discount to net asset value, investors are buying a dollar's worth of assets for less than a dollar. This can be attractive for two reasons:

- In income-oriented funds, the yield will be higher when calculated on actual dollars invested at a discount, compared to NAV. To take an example, suppose a fund has a NAV of \$20 per share, market price of \$18 a share, and generates income of \$1 per year. The yield based on NAV is 5% (\$1 divided by \$20). If you bought a mutual fund at NAV, this is the yield you would receive. But in the closed-end fund, the yield based on actual dollars invested is 5.6% (\$1 divided by \$18).
- If during the holding period of your closed-end fund shares the discount narrows, the reduction in the discount gives a small boost to the fund's performance when you sell the shares. Using the same example in the paragraph above, suppose you bought the closed-end fund at a \$2 discount to NAV. Several years later, you sell it at a \$1 discount to NAV. Your capital gain would be the change in NAV over this period plus the \$1 reduction in the discount.



...now add the advantages of CEFs which aren't found in mutual funds:

-Opportunity to buy at a discount.

-Efficient portfolio management.

-Ability to control market price and timing.

-Leverage potential.



CEF managers don't have to sell or purchase portfolio securities during market swings. That enables them to remain singularly focused on their investment strategy.

Efficient Portfolio Management—

Unlike mutual fund managers who must worry about constant inflows and outflows of cash, closed-end fund managers are responsible for a stable pool of capital. Although fund shares trade actively, that doesn't affect the fund manager because no assets are flowing into or out of the portfolio. Therefore, closed-end fund managers can put capital to work in a long-term strategy, without worrying whether their fund will have enough liquidity to pay back investors who suddenly sell (redeem) shares. This can lead to superior investment results. It also makes the closed-end fund structure advantageous for investing in specialized areas such as less liquid securities or markets, venture capital opportunities, real estate, and private placements. Regardless of the trading volume or market price fluctuations in such areas, closed-end fund managers are never forced to sell securities in a declining market to meet redemptions. Conversely, in a bull market, closed-end fund managers aren't inundated with new cash they must invest at rising prices.

Ability to Control Market Price and Timing—Closed-end fund orders can be placed throughout the trading day, and limit prices can be specified. This is not possible in a mutual fund because all orders are placed at the close of business, based on the closing net asset value (plus any commissions that apply).

Integration With Brokerage Account—Closed-end funds are bought through brokerage accounts and can be integrated with other services provided by the account and servicing broker, such as margin, consolidated statements, a broker's guidance, and "sweeps" of idle cash.

Leverage Potential—Closed-end funds may issue senior securities (preferred stock or debentures) or borrow money to "leverage" their investment positions. This gives portfolio managers of closed-end funds in the fixed-income area in particular the opportunity to enhance yield and provide investors with superior performance. It also gives them more flexibility to take advantage of timely market opportunities. The use of leverage, of course, increases the likelihood of share price volatility and market risk. (Some closed-end funds do not leverage their portfolios by policy because they wish to avoid the increased level of risk for investors.)



You don't need to know all the nuances of closed-end funds to take advantage of them.



The expense ratios of closed-end funds are sometimes less than those of mutual funds.

Clear Commissions—You pay one commission to buy closed-end fund shares and another to sell them—and those are the only transaction-related costs. Closed-end funds generally do not impose “trail commissions” or 12b-1 fees which are assessed against the account annually, as many mutual funds do.

Lower Expense Ratios—Closed-end funds do not incur ongoing costs associated with distributing their shares as do many mutual funds; thus, the expense ratios of closed-end funds are sometimes less than those of mutual funds. Over time, a lower expense ratio provides a boost to investment performance.

No Minimums—Closed-end funds do not impose minimum amounts on purchases or sales, as most mutual funds do.

While many closed-end fund investors also invest in mutual funds, they work with their broker or financial advisor to seek out the best solution to achieve specific goals. Mutual funds fit the need in some cases, and in other cases closed-end funds can do the job as well or better.

Risk is the possibility or chance of loss. All investments involve risk—some more than others. Risk, however, is related to reward. Generally, investments with higher risk levels also offer higher reward prospects.

Investors should be aware of the risks associated with any investment they contemplate, especially shares of CEFs. The following is a summary of some of the risks to be considered. Additional information should be obtained from your broker or financial adviser and the fund before finalizing your investment decision.

Market Risk—Markets rise and fall based on the prices of individual securities. Investor sentiment, economic conditions, global events and many other factors contribute to the day-to-day changes and the overall trend of the markets. Equity securities and the stock markets tend to fluctuate more widely and rapidly than fixed-income securities and the bond markets. International markets present additional risk factors. The degree of fluctuation has risen dramatically in recent years; thus, markets have become more volatile. The prospect of a market decline, and its related impact on the prices of individual securities and fund shares, represents general market risk.

Issuer Risk—The general risk that an issuer of a security will not be able to meet operating expectations or will have some other difficulty which will cause the value of an investment to decline.



*All investments
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be fully aware of
the chance of loss.*

Credit Risk—The risk that an issuer will default on an obligation.

Interest Rate Risk—The risk that a rise in interest rates will cause the value of an investment to decline.

Prepayment Risk—The risk that a security will be prepaid (or called) prior to maturity and that the proceeds can be reinvested only in investments offering a less attractive yield.

Inflation Risk—The risk that inflation will result in the erosion of the value of an investment.

Liquidity Risk—The risk that the market cannot accommodate the size of an order to buy or sell a security within the desired timeframe.

Political risk—The risk that an investment in a foreign security or fund will be impacted adversely as the result of unfavorable political developments.

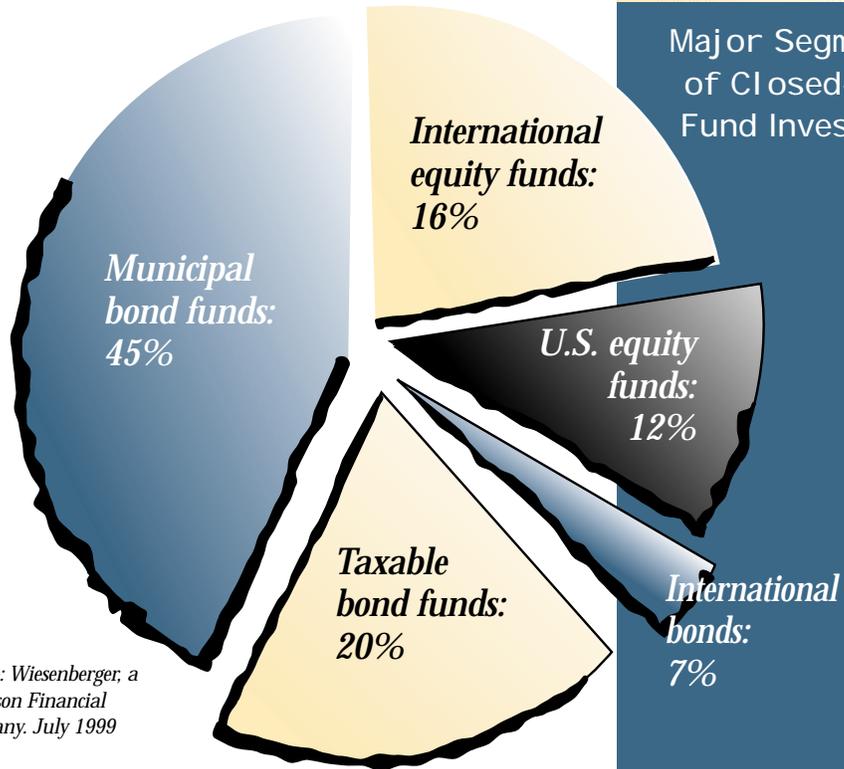
Currency Risk—The risk that a currency devaluation or exchange rate change will result in the decline in the value of an investment.

Leverage Risk—The risk that the cost to a fund of its leveraged capital, such as preferred stock or debt, will exceed the earnings on the related assets; also, the risk of higher share price volatility.

You probably know that some large mutual fund families offer dozens of “flavors” of funds,

Types of Closed-End funds

Major Segments of Closed-end Fund Investing



Source: Wiesenberger, a Thomson Financial Company. July 1999

each participating in different types of investments. Closed-end funds also offer a variety of flavors. As indicated in the chart above, bond funds account for just over two-thirds of the capital at work in closed-end funds. Below are some of the more popular categories of closed-end funds:

- **Municipal bond funds**—In terms of assets under management, this is the largest category of closed-end funds. Municipal bond funds seek to pay out income to investors which is tax-exempt for federal income tax purposes (and in some cases also for state or local income tax purposes). They invest in bonds issued by state and local



There are more than 500 closed-end funds, some of which have management and performance histories that date back over half a century.

governments and agencies. Professional managers monitor bond ratings and credit quality and usually seek to broadly diversify the portfolio and to avoid adverse events or defaults that might impact a given sector, region or issuer. Many municipal bond closed-end funds make use of leverage to enhance their return potential.

- **Taxable U.S. bond funds**—These CEFs focus on high-quality instruments including treasuries, government agencies and investment-grade corporate bonds, all of which generate interest income that is taxable by the federal government. Others may mix lower-grade “high yield bonds” into the portfolio, or even emphasize high yield bonds for their attractive rates of return (at somewhat higher risk levels).

- **Diversified U.S. equity funds**—This category, which focuses on common stocks traded on U.S. exchanges, comprises some of the oldest closed-end funds in the market. These funds typically build portfolios consisting of stocks issued by a broad mix of companies and diversified across many industries, geographic regions and economic sectors. Some diversified equity funds specialize in a particular asset class or investment style—such as large-cap, small-cap, growth or value. Diversified equity closed-end funds often pursue objectives similar to growth or growth and income mutual funds.

- **Sector and speciality funds**—These closed-end funds focus on stocks of a given industry such as banking, media, natural resources or health care, or on specialized securities such as preferred stocks or convertible securities. They can be a way to participate in the fortunes of an economic sector, industry group or specialized security, while reducing risk by investing in many different companies.

- **Global and international funds**—Closed-end funds offer counterparts to the mutual funds that build globally diversified portfolios of stocks or fixed-income instruments. Funds which mix U.S. and foreign securities are called “global” while those that focus on non-U.S. investments only are considered “international.” Some closed-end funds specialize in emerging market securities, which can be highly volatile and somewhat illiquid under adverse market conditions. Since closed-end funds are not forced to sell from their portfolios to meet redemptions, they may offer special advantages over mutual funds in such markets and may offer access to markets that are difficult for mutual funds to invest in, given their liquidity considerations.

- **Single country funds**—One area in which closed-end funds have grown is “single-country” investing. Currently there are over 80 single-country funds specializing in stocks traded in countries involving Korea, India, Mexico, Spain and Germany among others. The closed-end fund structure gives the portfolio manager freedom to devise a long-term strategy and hold positions through periodic declines which may impact stocks in these markets. The goal of most single-country funds is to produce superior capital appreciation over holding periods of several years.

Buying and Selling Closed-End Funds



The procedure for buying CEFs is the same as buying a stock and can take just minutes.

In general, you will need to set up a brokerage account to buy closed-end funds. Some funds offer a direct purchase plan where an investor can purchase shares from a transfer agent without going through a broker. Most investors place their instructions with the assistance of a securities broker, or financial advisor, who transmits instructions to the exchange on which the closed-end fund trades. The broker also may offer guidance on how the fund fits into your overall planning. You can buy or sell closed-end funds through all types of brokerage firms, including full-service brokers, discount brokers and on-line (Internet) brokers. In each case, you pay your brokerage firm a commission for the services provided.

The procedures for buying or selling closed-end funds are the same as for buying or selling stocks. Your broker can quote you the current market price of the shares, determined by competitive bidding. You then decide whether you want to pay the prevailing price by submitting a market order or set your own price through a limit order.

The process, from the time you place the order until the confirmation comes back, can take just minutes. This is a major difference between transactions in closed-end fund shares and mutual fund shares:

- With closed-end funds, you can control the timing of your orders. Through limit orders, you can also control the exact price you pay.
- With mutual funds, you can't control the timing. All orders received during a business day are filled only at the end of that same day, and all transactions are based on the closing net asset value per share.



Unlike mutual funds, CEFs offer investors control over the exact timing of buy/sell orders.

Net Asset Value



Many closed-end funds trade at a discount to NAV. This means investors can often buy a dollar's worth of securities for perhaps 95 cents or less.

Net asset value (NAV), which is the value of all fund assets (less liabilities) divided by the number of shares outstanding, is very important in an open-end mutual fund because it is the price upon which all share purchases and redemptions are calculated. For purchases of mutual funds with front-end sales loads, known as “load funds,” a brokerage charge generally is added to NAV to determine the purchase price.

Conversely, closed-end fund shares are bought and sold at “market prices” determined by competitive bidding on exchanges and not at NAV. Let’s assume that the market price is \$18 per share and that NAV is \$20. In this case, the closed-end fund sells at a discount of \$2 per share. On a percentage basis, the fund sells at a discount of 10% (\$2 divided by \$20). If the market price is above NAV, say \$21 in this case, then the closed-end fund sells at a premium of 5%.

For a variety of reasons discussed later in this guide, many closed-end funds trade at a discount to NAV. This means investors can often buy a dollar’s worth of securities for perhaps 95 cents or less. Even when the brokerage commission is added to the purchase price, the investor may be purchasing an interest in underlying securities with a value in excess of the fund’s market price, thanks to the discount.

Like mutual funds, closed-end funds pay out their earnings to shareholders in two ways:

- Income dividends pass through to shareholders the interest or dividends collected by the fund, net of expenses. Fixed income closed-end funds typically pay out income dividends monthly or quarterly, while equity funds pay out income dividends quarterly, semi-annually or annually. Income dividends generally are taxable to shareholders as ordinary income, provided shares are held in taxable accounts. Income dividends paid by municipal bond funds are, of course, exempt from certain taxes.
- Capital gains distributions pass through to shareholders the “realized” capital gains of the fund, net of realized capital losses. Most closed-end funds make capital gains distributions once each year, toward the end of the calendar year. The portion of a capital gains distribution reported by the fund as “short-term” generally is taxed to shareholders as ordinary income (in taxable accounts). The portion reported as “long-term” is taxed to shareholders at a maximum federal income tax rate of 20%, under current law.

By reinvesting distributions rather than taking them in cash, the shareholder is able to compound the return as invested capital.

Performance



It's important to note that the best measure of a closed-end fund's total return is based on the combination of the change in its actual market price over the periods measured, plus the affects of any fund distributions.

It is important to note that the best measure of a closed-end fund's total return to an investor is based on the combination of the change in its actual market price over the periods measured, plus the affect of fund distributions, whether reinvested or paid in cash. This return is what an investor in the fund's shares earns. On the other hand, when assessing the performance of a fund manager, the fund's total return based on its NAV is more useful—because the manager's decisions impact NAV directly while influencing the premium or discount only indirectly.

Performance information is available from periodic reports issued by closed-end funds, reports by services which follow and rate individual funds, and reports issued by analysts who focus on the closed-end fund industry. Newspapers and other financial publications are also a good source of information on funds.



Ideally, there would be no difference between a closed-end fund's share price in the market and its net asset value per share. Thus, there would be no discounts or premiums. However, prices are established by competitive markets which reflect "real world" buying demand and selling supply of shares. In turn, these are influenced by investors' perceptions, fears and needs for specific types of investments. Other factors which have been suggested as having an impact on discounts and premiums include: the fund's relative performance, yield, the use of a managed distribution program (guaranteed annual payout of 8%-10%), name recognition of the fund's manager, a significant amount of illiquid holdings in the fund's portfolio and a sizeable amount of unrealized appreciation.

What do discounts and premiums mean to a typical closed-end fund investor? Perhaps not very much. The price of a closed-end fund usually tracks the fund's NAV; thus, in the long run, the price performance will be similar to the NAV performance of each respective closed-end fund unless there has been a dramatic change in the fund's discount/premium during the specific measurement period.



*Prices are
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competitive markets
which reflect
"real world"
buying and
selling forces.*



The advantage of buying a closed-end fund at discount can continue to reward investors for many years.

While discounts persist, investors are able to purchase additional shares in the market and put more than a dollar of net assets to work for every dollar invested. Some brokers urge buying shares when discounts widen, because this makes the shares even more of a bargain.

Some investors think the benefit of buying closed-end fund shares at a discount occurs only at the time of purchase. However, the advantage can continue to reward investors for many years, as shown in the following comparison of two hypothetical funds with identical performance and net asset values of \$10 a share (chart on page 24). Fund A is a mutual fund and Fund B is a closed-end fund selling at a 20% discount to NAV (\$8 per share).

(A discount of 20% is used in this example to dramatize the impact of the discount over a long period of time and is not meant to be illustrative of typical discount rates.)

A hypothetical investment of \$10,000 in Fund A buys 1,000 shares. (Commissions are ignored.) The same hypothetical investment buys 1,250 shares of Fund B at a cost of \$10,000. These shares represent net asset value of \$12,500.

Let's assume that both funds return identical performance over 20 years, as follows:

- A 10% annualized rate of return calculated on NAV, of which 3% is income dividends and 7% is capital gains. Both dividends and gains are calculated based on NAV at the start of each year.
- The income dividends are taken in cash and the capital gains are reinvested into new shares. (Taxes are ignored in this example, as if the investments are held in retirement plans.)

The table on page 24 shows the rate of income and cumulative income that an investor would receive in both funds over 20 years. To summarize:

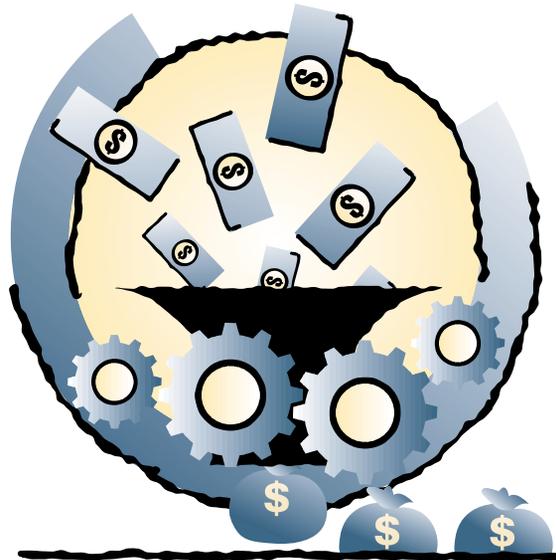
- The dividend yield begins at 3.0% in the first year for Fund A, and at 3.75% for Fund B. It is higher in Fund B because it is calculated based on a larger amount of net assets at work (\$12,500 in Fund B vs. \$10,000 in Fund A. $3\% \text{ of } \$12,500 = \375 . The $\$375$ of income dividends divided by an investment of $\$10,000 = 3.75\%$).
- The annual income yield of Fund A, the mutual fund, gradually increases to 10.8% of the original investment over 20 years. The total income generated over 20 years is \$12,299.



Many individual investors use closed-end funds as core investments to reach their long-term investment goals.

- The annual income yield of Fund B, the closed-end fund, gradually increases to 13.6% of the original investment over 20 years. The total income generated over 20 years is \$15,373.

Notice that if an investor sells both funds at the end of 20 years, and the closed-end fund is still at a 20% discount, the investor will realize the same principal in each case. However, over time the investor pockets more than \$3,000 of additional current income from the closed-end fund, thanks to the discount.



The Long-Term Benefit of the Discount in a Closed-End Fund

Years	Mutual Fund (FUND A) (Open-end)			Closed-End Fund (FUND B) (Assumes 20% discount)		
	NAV at Start of Year	Annual Income	Income Yield	NAV at Start of Year	Annual Income	Income Yield
1	10,000	300	3.0%	12,500	375	3.8%
2	10,700	321	3.2%	13,375	401	4.0%
3	11,449	343	3.4%	14,311	429	4.3%
4	12,250	368	3.7%	15,313	459	4.6%
5	13,108	393	3.9%	16,385	492	4.9%
6	14,026	421	4.2%	17,532	526	5.3%
7	15,007	450	4.5%	18,759	563	5.6%
8	16,058	482	4.8%	20,072	602	6.0%
9	17,182	515	5.2%	21,477	644	6.4%
10	18,385	552	5.5%	22,981	689	6.9%
11	19,672	590	5.9%	24,589	738	7.4%
12	21,049	631	6.3%	26,311	789	7.9%
13	22,522	676	6.8%	28,152	845	8.4%
14	24,098	723	7.2%	30,123	904	9.0%
15	25,785	774	7.7%	32,232	967	9.7%
16	27,590	828	8.3%	34,488	1,035	10.3%
17	29,522	886	8.9%	36,902	1,107	11.1%
18	31,588	948	9.5%	39,485	1,185	11.8%
19	33,799	1,014	10.1%	42,249	1,267	12.7%
20	36,165	<u>1,085</u>	10.8%	45,207	<u>1,356</u>	13.6%
	\$12,299			\$15,373		

Sources of Financial Information



Visit the Closed-End Fund Association's website at www.closed-endfunds.com for comprehensive information on performance, company news and other data.

The market prices of most closed-end funds are reported in the financial pages of daily newspapers. They are shown in the stock exchange (i.e., NYSE, AMEX, or NASDAQ) listing for each respective fund. Like stocks, each closed-end fund has an identifying ticker symbol which can be useful in locating quotes and trading data.

For investors who wish to obtain the NAV of their funds, most closed-end funds offer a toll-free number and updates on NAV either daily or weekly. At the end of every week, closed-end fund NAVs are published in *Barron's*, the *Wall Street Journal* and newspapers in major metropolitan areas. *Forbes* also publishes an annual ranking of closed-end fund performance each year.

The National Association of Securities Dealers (NASD) collects and disseminates NAVs of closed-end funds on a daily basis through most electronic quotation services. Additional sources for statistical data include Lipper, Morningstar and Wiesenberger, a Thomson Financial Company. There are also brokerage and advisory firms who specialize in CEFs and offer a wide range of services.

Finally, the Closed-End Fund Association hosts a free-access website which provides daily NAVs and performance histories for all reporting closed-end funds.

Is a closed-end fund “closed” to new investors?

There is often confusion between closed-end funds and open-end funds that are “closed.” CEFs have fixed amounts of capital and shares but are open to new investors through customary securities trading procedures. Conversely, open-end funds that are “closed” do not allow new investors into the funds.

How many stocks might an equity closed-end fund own?

The number can range from a few stocks up to hundreds, depending on the quantity of assets and the diversification or concentration of the portfolio holdings. Funds which hold 30 or fewer stocks are sometimes called “focus funds,” because they seek to generate superior performance from their very best stock selections. While such a strategy can be rewarding for investors at times, it also may involve greater risk than investing in a portfolio which is diversified among one hundred or more stocks.

Can a closed-end fund “go broke?”

It is very unlikely. Keep in mind that the fund is an investment company that is prohibited by law from engaging in active business enterprise, other than of an investment nature. The fund can't go broke because it moves into an unproductive line of business, or if all its markets and customers disappear. Assuming the fund's fiduciaries do their job in safeguarding assets, the only way a closed-end fund can go broke would be for all its portfolio holdings to become worthless—an extremely remote possibility.

Can you make money buying closed-end fund shares by purchasing when discounts are “deep” and then selling when discounts narrow?

Perhaps. But short-term trading of these shares can be very risky. For starters, your commissions will reduce any returns you earn. Also, the factors which produce discounts in closed-end fund shares can take time to change. You may find that you bought a fund for the wrong reason—because it sells at a deep discount—rather than because it meets your investment objective.

For investing in a highly specialized industry or global region, wouldn't a mutual fund offer greater diversification and therefore less risk than a closed-end fund?

Probably not. The mutual fund and closed-end fund may be managed in much the same manner when markets are normal. The advantage can swing to closed-end funds, however, when specialized markets go through rough times. If securities prices decline, fund investors may want out. In closed-end funds, an investor flight can cause the price of shares to decline, but it won't have an impact on the portfolio manager's strategy. The manager can ride out the downturn without selling portfolio securities, if he or she chooses. In mutual funds, however, this isn't always possible. The manager may be forced to sell securities in falling markets to meet redemption demand, and those sales could put additional downward pressure on market prices.

What is a rights offering?

This is a plan through which current shareholders of the fund are given the "right" to purchase additional shares in proportion to their current holdings, at a stated price. The offering price is often below the market price (and NAV) which is an inducement for shareholders to exercise their rights. However, this can also

result in dilution of the fund's NAV. It is one way that an established fund may increase the amount of capital at work in the fund, since the shares purchased in a rights offering are newly issued. Shareholders who take advantage of the offering by exercising their rights will maintain their percentage ownership in the fund (the ratio of shares they own to all shares available). In addition, in a transferrable rights offering, shareholders have the opportunity to benefit from the sale of their rights.

What is an automatic dividend reinvestment plan?

This is a plan through which all income dividends or capital gains distributions issued by the fund, or both, are automatically reinvested in new shares. In some closed-end funds, this is the "default" choice, which goes into effect unless the shareholder specifically notifies the fund that dividends are to be paid in cash.

Closed-End
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