

CEF Monthly: October 2014

No Reprieve for Energy CEFs in October

As oil prices continued to tank, commodity and energy funds took a nose dive.

Oil prices continued their descent in October, leading some to question the future health of the country's largest oil producers. Consumers of oil and gas, however, have benefited from this steady decline in prices. Airlines, for example, have fared extremely well this year, in part because of low fuel costs. Despite the hit that oil and gas firms and energy and related mutual funds took last month, the broader equity market did quite well. The S&P 500 Index gained 2.4% in October and was up nearly 11% for the year to date.

During October, the Federal Reserve officially wound down its bond-buying program, though it's still reinvesting the cash flows received from the mortgages on its books. The Fed communicated this plan clearly and well in advance of the announcement, so the move was mostly a nonevent. Making headlines this month in the bond market, however, was the swift decline in the 10-year U.S. Treasury yield on Oct. 15. The bond's yield started the day at about 2.20% and quickly dropped to 1.87%; just as quickly, though, the bond's yield rebounded, closing the day at about 2.10%. This rapid decline coincided with increased trading volume, and some market pundits are comparing it to the "Flash Crash" of May 2010. Whatever the reason, it highlights concerns that many fund managers have about the lack of liquidity and the impact of high-frequency traders in the bond market.

Best- and Worst-Performing CEF Categories

The table below lists the best- and worst- performing closed-end fund categories during the month of October based on share price.

Exhibit 1
Best and Worst Category Share Price Returns
Data as of 10/31/2014
Source: Morningstar

Best and Worst Categories by Share Price								
Morningstar Category	1-Mo Price Total Return (%)	1-Mo NAV Total Return (%)	YTD Price Total Return (%)	YTD NAV Total Return (%)	1-Yr Price Total Return (%)	1-Yr NAV Total Return (%)	3-Yr Price Total Return (%)	3-Yr NAV Total Return (%)
Top Performing								
Real Estate	7.27	8.10	24.24	26.08	16.91	20.45	16.31	16.76
Health	6.88	6.06	17.11	19.76	29.10	28.23	33.34	30.37
Communications	5.14	3.65	-3.52	-4.14	1.04	0.64	4.62	4.98
Conservative Allocation	4.55	3.63	20.50	16.09	20.49	15.70	15.31	14.13
Small Blend	3.76	4.69	1.10	-0.69	9.44	5.46	18.99	15.94
Global Real Estate	3.54	3.55	10.19	9.18	6.44	6.79	14.13	12.61
Muni California Long	2.64	1.21	18.31	17.71	15.93	16.94	8.38	10.17
Utilities	2.53	3.58	17.13	15.72	17.63	16.81	11.93	15.86
Preferred Stock	2.53	1.15	17.48	16.34	17.05	16.09	11.26	13.84
Mid-Cap Growth	2.44	3.09	1.31	2.93	7.23	7.33	14.00	12.32
Bottom Performing								
Equity Precious Metals	-8.82	-9.60	-10.70	-7.62	-21.00	-17.72	-22.12	-20.59
Equity Energy	-5.19	-7.16	3.21	-1.77	5.00	0.09	6.23	4.89
Natural Resources	-4.88	-6.00	-0.43	-4.69	-4.53	-4.52	-2.91	-2.28
Commodities Broad Basket	-3.67	-0.62	-15.30	-5.62	-21.86	-7.98	-6.74	-1.72
Commodities Precious Metals	-3.01	-2.80	-5.21	-6.67	-13.86	-14.04	-19.08	-17.26
Energy Limited Partnership	-2.50	-4.20	13.86	15.03	15.38	19.68	16.62	18.43
Mid-Cap Blend	-2.23	1.09	2.24	2.62	5.52	7.79	10.36	10.00
Short Government	-1.99	-1.69	6.39	0.01	4.35	-0.54	1.39	-0.43
Muni Minnesota	-1.91	0.84	9.33	12.85	8.67	12.13	4.40	7.38
Foreign Large Value	-1.50	-0.45	3.35	-0.20	5.44	0.19	7.00	8.10

Topping the best-performing list last month were sector funds--real estate, health (health-care and science-related funds fall into this category), and communications. A recovering housing market has benefited real estate funds this year, and a sharp drop in mortgage rates in mid-October provided another boost. Real estate funds (closed-end, open-end, and ETF) tend to have higher payouts than other equity funds, adding to the appeal for income-starved investors. The average real estate CEF paid a 6.5% distribution rate at net asset value (7.2% at share price) at the end of October compared with an average of 5.8% at NAV (6.2% at share price) for the average equity CEF.

It should be no surprise that the five worst-performing categories, which include precious metals, energy, natural resources, and commodities funds, invest heavily in commodities and resources. Those categories saw NAV deterioration along with share price depreciation.

Most Expensive and Inexpensive CEFs

Last month's gap in returns across categories caused a divergence of valuations within the CEF universe. The four tables below list the five most inexpensive and expensive CEFs by broad category (taxable-bond, equity, municipal, and other).

The z-statistic measures how many standard deviations a fund's discount/premium is from its three-year average discount/premium. For instance, in these tables, a fund with a z-score of negative 2 would be two standard deviations below its three-year average discount/premium. Funds with the lowest z-scores are classified as Relatively Inexpensive, while those with the highest z-scores are Relatively Expensive. We consider funds with a z-score of negative 2 or lower to be "statistically undervalued" and those with a z-score of 2 or higher to be "statistically overvalued." That said, the z-statistic does have its [flaws](#).

Taxable Bond CEFs

The wariness in the bond market around the timing and magnitude of the Fed's expected hike of short-term interest rates has led to middling returns for many taxable-bond CEFs in recent months. Meanwhile, credit has taken a bit of a stumble in the second half of the year. For the year to date, the average high-yield bond fund gained 5.3% in NAV and 5.2% in share price through October, compared with an average gain of 20% and 10% in NAV during 2012 and 2013. Within the category there have been some clear favorites among investors. Pioneer High Income (PHT), for example, has seen its premium widen immensely, likely because of the fund's peer-beating 12% distribution rate at NAV. The fund's whopping 33% premium knocks that distribution rate down to 9% at share price, but that's still among the highest of its peers. Pioneer High Income's three-year z-statistic of 2.07 as of Nov. 12 was well above the z-statistics of its peers (the average was negative 0.93).

Exhibits 2-5

Most Expensive and Inexpensive¹
CEFs by broad category
Data as of 11/12/2014

Source: Morningstar

Taxable Bond CEFs			Total Dist.	1-Yr NAV	1-Yr Price	3-Yr NAV	3-Yr Price		
Expensive Funds	Ticker	Morningstar Category	Discount (%)	Rate at Price (%)	3-Yr z statistic	Total Return (%)	Total Return (%)	Total Return (%)	Total Return (%)
Pioneer High Income Trust	PHT	High Yield Bond	33.74	9.18	2.07	4.16	11.24	12.75	11.56
Oxford Lane Capital Corp	OXLC	Bank Loan	5.60	14.63	1.26	5.65	20.12	13.56	20.65
Guggenheim Strategic Opp Fund	GOF	Multisector Bond	9.61	10.03	0.90	9.52	6.47	13.41	12.00
Federated Enhanced Treasury In	FTT	Short Government	-8.58	3.75	0.80	-0.54	4.35	-0.43	1.39
AllianceBernstein Income Fund	ACG	Long-Term Bond	-9.09	5.46	0.56	6.03	13.88	5.50	7.09
Inexpensive Funds									
Pioneer Floating Rate Trust	PHD	Bank Loan	-10.44	5.74	-2.30	4.40	-1.86	7.81	3.55
Blackstone/GSO LS Credit Inc.	BGX	Bank Loan	-11.67	7.19	-2.10	3.64	-2.91	7.75	3.22
First Trust Senior FR Inc II	FCT	Bank Loan	-10.53	6.24	-2.07	3.58	-3.18	7.66	5.70
Templeton Emerging Mkts Income	TEI	Emerging Markets Bond	-10.33	6.4	-2.00	3.03	-5.07	6.12	2.77
Invesco Dynamic Cred Opps	VTA	Bank Loan	-12.11	7.61	-1.95	6.51	0.87	11.07	10.97

Despite concerns and uncertainty around rising interest rates, four bank-loan funds appeared undervalued, and most funds in the category were selling at double-digit discounts. The category has

experienced a significant discount-widening since the start of the year, but those cheap valuations haven't enticed too many investors to jump in, and a handful of funds appear undervalued.

Equity CEFs

As a whole, the equity market has done quite well this year--the S&P 500 Index gained nearly 11% for the year to date through October--but certain sectors and individual stocks have posted incredible returns. Airlines have been particularly strong performers. Southwest Airlines (LUV), for example, gained more than 100% for the year to date and was the best-performing stock in the S&P 500 Index as of mid-November. Technology and health-care stocks, including Google (GOOG), Apple (AAPL), Microsoft (MSFT), Gilead (GILD), and a plethora of small bio-tech stocks, helped the returns of many of the best-performing CEFs for the year to date.

The four funds that appeared overvalued as of Nov. 12 invested in some of those strong-performing names. For example, Nuveen Equity Premium Advantage (JLA) replicates the returns of the S&P 500 Index and the Nasdaq 100 Index. That fund had a small allocation not only to Southwest but also to other airlines that have benefited from industry consolidation and low oil prices. The fund also had a 9% allocation to Apple and a 3% weight to Gilead. Strong returns and the fund's nearly 8% distribution rate attracted investors, narrowing its discount from more than 10% at the start of 2014.

Equity CEFs			Total Dist.			1-Yr NAV	1-Yr Price	3-Yr NAV	3-Yr Price
Expensive Funds	Ticker	Morningstar Category	Discount (%)	Rate at Price (%)	3-Yr z statistic	Total Return (%)	Total Return (%)	Total Return (%)	Total Return (%)
BlackRock Health Sciences	BME	Health	6.17	4.64	2.60	28.25	37.36	25.96	28.56
Nuveen Equity Prem Advantage	JLA	Large Growth	-4.65	7.66	2.13	8.95	18.28	11.22	15.87
Columbia Seligman Premium Tech Gr	STK	Technology	5.36	10.31	2.12	24.33	32.01	10.52	12.80
Cohen & Steers Gbl Inc Builder	INB	World Stock	3.09	9.08	2.11	9.77	25.36	13.70	22.41
NASDAQ Premium Income & Growth	QQQX	Technology	3.71	6.51	1.94	20.69	24.51	19.23	22.93
Inexpensive Funds			Total Dist.			1-Yr NAV	1-Yr Price	3-Yr NAV	3-Yr Price
Herzfeld Caribbean Basin	CUBA	Mid-Cap Blend	-16.84	0.13	-3.00	5.60	-3.35	12.42	9.63
Comerstone Strategic Value	CLM	Large Blend	-2.39	22.7	-2.44	16.43	-8.72	16.15	1.20
ClearBridge Energy MLP	CEM	Energy Limited Partnership	-7.99	5.91	-2.41	18.17	8.17	18.83	15.39
Central GoldTrust	GTU	Equity Precious Metals	-10.56	0	-2.01	-12.23	-15.65	-12.34	-15.92
Aberdeen Chile Fund	CH	Miscellaneous Region	-9.57	12.95	-1.93	-15.38	-29.05	-8.81	-11.97

Municipal CEFs

Municipal-bond funds have the benefit of tax-free distributions, and in the current low-yield environment, that advantage is meaningful. During the height of the bond bull market, muni CEFs traded at large premiums, only to collapse after news of trouble in Detroit and Puerto Rico spooked investors. The average discount for muni funds has been steadily falling since late 2012, despite assurances that a rush of municipalities declaring bankruptcy is unlikely. Uncertainty within the retail market and the long durations of most municipal CEFs are keeping a lid on valuations for now.

Muni CEFs			Total Dist.			1-Yr NAV	1-Yr Price	3-Yr NAV	3-Yr Price
Expensive Funds	Ticker	Morningstar Category	Discount (%)	Rate at Price (%)	3-Yr z statistic	Total Return (%)	Total Return (%)	Total Return (%)	Total Return (%)
BlackRock MuniYield Arizona	MZA	Muni Single State Long	6.85	5.3	1.76	15.28	25.95	8.58	11.84
Pioneer Muni High Inc Adv	MAV	High Yield Muni	21.79	7.42	1.43	16.27	20.98	9.75	12.48
Nuveen CA Select Tax-Free	NXC	Muni California Long	0.12	4.44	1.04	12.16	25.84	8.00	12.38
Nuveen CA Muni Value	NCA	Muni California Long	-0.45	4.5	0.75	12.57	20.46	7.76	10.83
BlackRock Municipal Income II	BLE	Muni National Long	2.00	6.24	0.50	19.71	18.18	10.27	9.88
Inexpensive Funds			Total Dist.			1-Yr NAV	1-Yr Price	3-Yr NAV	3-Yr Price
Invesco Trust NY Inv Gra Mn	VTN	Muni New York Long	-10.21	5.97	-2.27	14.47	4.59	8.11	3.58
Nuveen Minnesota Municipal Income	NMS	Muni Minnesota	-3.47	5.51	-1.85	13.08	5.10	8.29	1.98
PIMCO CA Municipal Income II	PCK	Muni California Long	9.27	6.75	-1.84	22.64	5.54	14.27	8.39
PIMCO Municipal Income III	PMX	Muni National Long	1.60	6.83	-1.65	21.54	10.92	12.45	7.77
BlackRock MuniVest Fund II	MVT	Muni National Long	-3.57	6.46	-1.62	19.21	10.91	10.78	7.97

Other CEFs

As investors look to diversify away from bonds but still want high income generation, convertibles funds have become more popular, narrowing the average discount significantly from 8.0% at the start of the year to 4.7% at the end of October. Calamos Convertible & High Income (CHY) invests in both convertible securities and high-yield bonds, and its three-year z-statistic is the highest in the CEF universe.

Other CEFs			Discount (%)	Total Dist. Rate at Price (%)	3-Yr z statistic	1-Yr NAV Total Return (%)	1-Yr Price Total Return (%)	3-Yr NAV Total Return (%)	3-Yr Price Total Return (%)
Expensive Funds	Ticker	Morningstar Category							
Calamos Convertible & High	CHY	Convertibles	4.13	8.2	2.71	10.95	22.17	12.30	15.67
EV Tax Adv Global Div Opps	ETO	World Allocation	-1.45	8.39	2.36	10.47	17.63	16.04	21.73
Calamos Convertible Opps & Inc	CHI	Convertibles	2.86	8.35	1.67	10.90	13.96	12.58	14.06
Dividend and Income Fund	DNI	Tactical Allocation	-6.97	10.11	1.46	11.65	20.54	9.86	15.62
AllianzGI Convertible & Inc II	NCZ	Convertibles	16.54	11.31	1.38	6.01	14.76	15.71	15.94
Inexpensive Funds									
Comerstone Progressive Return	CFP	Tactical Allocation	-2.93	23.85	-2.21	15.36	-4.20	15.18	5.17
Central Fund of Canada	CEF	Canada Commodity	-10.60	0.09	-2.09	-18.71	-21.86	-16.75	-19.84
Tortoise Power & Energy Infra	TPZ	Tactical Allocation	-12.66	5.48	-1.59	17.27	19.18	13.17	11.49
Nuveen Diversified Commodity	CFD	Commodities Miscellaneous	-16.97	12.05	-1.58	-7.16	-8.50	-6.20	-7.93
LMP Capital & Income	SCD	Aggressive Allocation	-11.55	6.56	-1.44	16.64	16.62	19.63	20.23

News You Can Use

Two new funds launched in October, bringing the number of IPOs this year to eight and the total net proceeds to just under \$4.5 billion. A few more funds may make it to market by the end of the year, but 2014 is likely to be among the slowest years for fund launches in more than a decade. The table below lists IPOs for each calendar year, starting in 2000, ranked by net proceeds (2014 IPO data is through October 31).

Exhibit 6

CEF IPOs

Data through 10/31/2014

Source: Morningstar

CEF IPOs by Calendar Year		
	No. IPOs	Net Proceeds (\$M)
2000	0	0.00
2008	1	114.36
2009	13	2,221.00
YTD 2014	8	4,473.00
2001	23	5,030.07
2011	18	5,659.62
2010	20	8,417.91
2006	17	9,783.13
2012	25	11,767.88
2002	58	13,501.28
2013	24	13,613.24
2005	31	16,047.48
2004	39	19,201.09
2003	39	23,685.11
2007	32	24,400.12

Fund Mergers & Launches

On Oct. 8, Eagle Point Credit Company (ECC), raised \$127 million in net proceeds. The fund will invest in the equity and junior debt tranches of collateralized loan obligations.

On Oct. 29, BlackRock launched a new technology CEF, BlackRock Science and Technology (BST), raising \$357 million in net proceeds. The fund will invest in both high-growth and high-dividend-paying

technology and science stocks domestically and internationally. The fund will also write call options on a portion of the underlying portfolio to generate additional income for distribution.

Nuveen Investments continued its merger trend with the announced union of four New Jersey funds. Shareholders approved the merger of Nuveen New Jersey Investment Quality Muni NQJ, Nuveen New Jersey Premium Income Muni NNJ, and Nuveen New Jersey Dividend Advantage Muni 2 NUJ into Nuveen New Jersey Dividend Advantage Muni (NXJ) in mid-October. In connection with the merger, three of the funds announced special distributions. See the distribution table below for more details and other significant distribution changes announced in October.

Exhibit 7

Significant Distribution Changes Announced During Oct. 2014

Source: Morningstar

Significant Distribution Changes						
Fund Name	Ticker	Frequency	Current Amount (\$)	Previous Amount (\$)	Change (%)	Pay Date
Nuveen NJ Dividend Adv Muni 2	NUJ	non-recurring	0.078	--	--	12/1
Nuveen NJ Dividend Advantage Muni	NXJ	non-recurring	0.063	--	--	12/1
Nuveen NJ Investment Quality Muni	NQJ	non-recurring	0.143	--	--	12/1
Nuveen NJ Premium Income Muni	NNJ	non-recurring	0.141	--	--	12/1
Ellsworth Fund	ECF	non-recurring	0.350	--	--	11/26
First Trust Energy Infrastructure	FIF	non-recurring	1.430	--	--	11/17
BlackRock Income Opportunity	BNA	non-recurring	0.165	--	--	10/31
BlackRock Core Bond	BHK	non-recurring	0.170	--	--	10/31
Neuberger Berman Real Estate	NRO	monthly	0.030	0.020	50.0%	11/28
Nuveen Select Quality Muni	NQS	monthly	0.820	0.067	23.3%	12/1
Eaton Vance Tax Adv Global Div Opps	ETO	monthly	0.180	0.150	20.0%	10/31
Liberty All-Star Equity	USA	quarterly	0.090	0.100	-10.0%	1/2

Reverse Stock Split

In an effort to raise the share prices of Cornerstone Strategic Value (CLM), Cornerstone Total Return (CRF), and Cornerstone Progressive Return (CFP), the funds' board approved reverse stock splits. The splits will be one-for-four and are expected to be effective on Dec. 31, 2014. It is Morningstar's opinion that these funds are not suitable for investors. The excessively high distribution rates are propped up by return of capital, and the funds typically sell at high premiums. This combination causes the fund's underlying NAVs and share prices to deteriorate, leading to actions such as this reverse stock split to artificially raise the funds' share prices.

Name & Policy Changes

H&Q Healthcare Investors (HQH) and H&Q Life Sciences Investors (HQL) changed their names to Tekla Healthcare Investors and Tekla Life Sciences Investors, respectively. The funds' managers, process, advisor, and tickers remain the same.

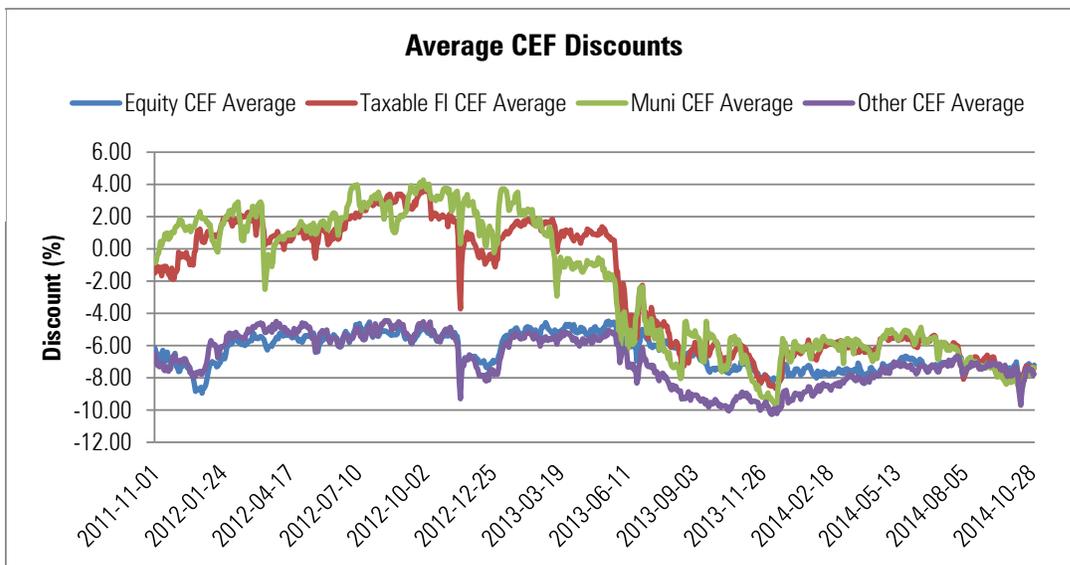
LMP Capital and Income (SCD) announced that its board of directors approved a change to its investment policy guidelines. The fund can now invest, without limit, in both energy and nonenergy master limited partnerships. The fund does have certain restrictions around the maximum allocation to certain types of MLPs. Read more [here](#).

Discount Trends

CEF discounts continued to converge in October. For each of the broad categories, the average discount was about 7.5% at month-end versus 8% for equity CEFs, about 7% for taxable-bond and muni CEFs, and more than 9% for "other" CEFs at the start of the year. Historically, equity funds sell at wider discounts because of the lower distribution rates compared with bond funds. But the large and persistent disparity between the high premiums of bond funds and wide discounts of equity funds following the crisis was unusual. That trend seems to be normalizing, though the average discount of bond funds remains wider

than it's historically been. That said, the taxable-bond group's average discount did narrow a bit this month.

Exhibit 8
 Historical Discount Data
 Data as of 10/31/2014
 Source: Morningstar



As 2014 draws to a close, investors should be preparing to evaluate their portfolios and are likely making buy and sell decisions based on taxes. Because CEFs are a generally retail-oriented product, the end of the year typically brings tax-loss selling, which can cause funds to sell at cheap valuations. To take advantage of this yearly "sale," investors should begin making a watchlist now. Morningstar's CEF [QuickRank](#) tool can help by sorting CEFs by category, discount/premium, and performance over various time periods.

All performance data in the accompanying tables is as of the market close November 12, 2014. In some limited cases, funds do not disclose their daily NAV values, and in such cases their estimated NAV (based on the performance of their most recently published holdings) is used.

¹*The funds listed in the Most Expensive & Inexpensive table are ranked using three-year z-scores. This statistic measures how many standard deviations a fund's discount/premium is from its three-year average discount/premium. For instance, in these tables, a fund with a z-score of*

-2 would be two standard deviations below its three-year average discount/premium. Over a long period of time, a fund would be expected, statistically speaking, to have a z-score of -2 or lower only 2.14% of the time. Funds with the lowest z-scores are considered to be relatively cheap, while those with the highest z-scores are considered to be relatively expensive. We consider funds with a z-score of -2 or lower to be "statistically undervalued" and those with a z-score of +2 or higher to be "statistically overvalued."