

## CEF Monthly: February 2014

# Deflating Expectations

The Indianapolis Colts aren't alone in their angst over deflation.

Plunging oil prices, fears of deflation, and the anemic recovery in Europe reached a tipping point in late January when European Central Bank president Mario Draghi announced a \$1.3 trillion stimulus program. The stimulus package was widely anticipated, but the magnitude caught some off guard. The news caused the euro to drop to its lowest level against the U.S. dollar in nearly 10 years and pushed global equity indexes lower. With interest rates already low across much of Europe, concerns over negative nominal interest rates increased. Note that the concern isn't over negative real interest rates, which take inflation expectations into account and do happen from time to time. The concern is over negative nominal interest rates, which essentially means investors are paying banks to hold their cash. In mid-December, Switzerland's nominal interest rates went negative, and in early February, negative nominal interest rates became a reality across a handful of European countries.

Switzerland's saga of negative interest rates, deflation, and currency pressures continued in January, causing the country to announce that it would unpeg its currency from the euro. This surprise move caused the Swiss franc to rise more than 30% against the euro on the day of the announcement. The Swiss Helvetia Fund (SWZ), a fund that invests primarily in the equities of Swiss companies, was largely unaffected by the news. The fund's discount widened from about 12% to 14.5% in the days following the announcement. The fund took a bigger hit on the mid-December newsexhi of negative nominal interest rates in the country.

For U.S. bond investors, however, some good news came from the struggles in the global market. Long-term bond yields fell sharply during January, pushing long-term bond prices higher. U.S. consumers benefited from falling gas prices, low inflation, an improving unemployment picture, and low mortgage rates. But it wasn't all rosy. Most large U.S. companies rely on foreign consumers to generate revenues, and the murky picture overseas caused the S&P 500 to drop nearly 3% last month.

### Best- and Worst-Performing CEF Categories

After almost three years of declining gold prices, the price of gold rose nearly 9% in January. Other precious metals, like silver and platinum, also saw higher prices last month, making the equity precious-metals Morningstar Category the top performer in January. The best-performing closed-end fund in January was ASA Gold and Precious Metals (ASA), which invests in the equities of energy and commodity firms. The fund gained more than 15% on net asset value and more than 17% on share price in January alone. This strong month doesn't make up for the fund's long negative streak, however. It's down 25% on both net asset value and share price over the trailing three years and down more than 11% for both measures over the five years ended Jan. 31.

The worst-performing group in January was the two-fund financials category. Both funds invest in the equities of financial institutions, including banks, insurance companies, and other related firms. Disappointing earnings from a number of prominent banks, including Bank of America and JPMorgan Chase, led the sector's decline. For example, a nearly 3% stake in JPMorgan Chase & Co (JPM), which dropped 12.5% in January, and a 1% stake in Bank of America (BAC), which lost more than 15% last month, hit John Hancock Financial Opportunities (BTO), the worst-performing CEF last month, hard.

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The table below lists the best- and worst-performing CEF categories in January, based on share price return.

**Exhibit 1**  
Best and Worst Category Share Price Returns  
Data as of 1/31/2015  
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 (%)
<b>Top Performing</b>								
Equity Precious Metals	13.78	10.12	13.78	10.12	-3.07	-1.90	-18.59	-17.44
Multialternative	9.06	3.17	9.06	3.17	5.43	2.57	3.12	1.91
India Equity	8.84	8.52	8.84	8.52	67.59	59.65	19.10	17.66
Muni Ohio	7.40	3.30	7.40	3.30	22.14	18.34	5.08	7.21
Commodities Precious Metals	6.92	5.67	6.92	5.67	-3.19	-2.85	-16.14	-15.11
Muni Minnesota	6.68	2.27	6.68	2.27	10.23	12.80	3.74	5.68
Muni California Long	5.34	2.81	5.34	2.81	21.00	17.29	7.01	8.29
Real Estate	5.19	6.04	5.19	6.04	30.23	32.91	16.58	17.60
Preferred Stock	5.15	1.50	5.15	1.50	21.08	15.79	10.63	13.21
Muni New Jersey	5.00	2.60	5.00	2.60	18.15	16.20	4.01	6.78
<b>Bottom Performing</b>								
Financial	-7.09	-4.75	-7.09	-4.75	1.28	-1.45	14.29	12.58
Latin America Stock	-4.95	-5.64	-4.95	-5.64	-9.44	-10.26	-9.12	-9.50
Small Blend	-4.52	-5.50	-4.52	-5.50	2.44	-1.60	14.38	11.93
Energy Limited Partnership	-4.37	-3.64	-4.37	-3.64	3.61	3.30	8.41	10.98
Mid-Cap Growth	-3.74	-3.23	-3.74	-3.23	3.26	4.42	11.35	10.70
Foreign Large Value	-3.22	-1.30	-3.22	-1.30	-5.29	-0.57	2.16	5.58
Large Value	-2.56	-3.11	-2.56	-3.11	11.56	8.85	13.86	12.71
Foreign Small/Mid Value	-2.02	-1.92	-2.02	-1.92	-7.88	-4.98		
Mid-Cap Blend	-1.97	-3.48	-1.97	-3.48	9.24	-0.34	11.66	6.89
Commodities Miscellaneous	-1.95	-2.14	-1.95	-2.14	-2.09	-12.23	-11.80	-11.33

### Most Expensive and Inexpensive CEFs

Exhibits 2-5 below list the most expensive and inexpensive closed-end funds based on three-year z-statistic as of February 11. 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

None of the taxable-bond CEFs look overvalued on a three-year statistical basis, though the high distribution rates of some funds continue to entice investors to pay top dollar. For example, the formerly Bill Gross-managed PIMCO High Income (PHK) continues to sell at a sky-high premium most likely due to its nearly 20% distribution rate at net asset value. Factoring in the premium, the distribution rate falls to 12% at share price, but that's still a fat yield compared with taxable-bond options. Despite the fund's strong track record, investors should [think twice](#) before buying any high-premium CEF.

As oil prices tanked, high-yield bond funds took a hit because energy companies make up a large part of the junk-bond universe. After months of falling share prices in this category, the average high-yield bond CEF's share price rose 0.42% in January and the average fund's net asset value was essentially flat. Whether we've reached a bottom is anyone's guess, but for those looking to add cheap exposure to junk bonds, two of the most undervalued taxable-bond CEFs invest in high-yield bonds.

**Exhibits 2-5****Most Expensive and Inexpensive<sup>1</sup>  
CEFs by broad category**

Data as of 2/11/2015

Source: Morningstar

Taxable Bond CEFs			Discount	Total Dist. Rate at	3-Yr z	1-Yr NAV Total	1-Yr Price Total	3-Yr NAV Total	3-Yr Price Total
Expensive Funds	Ticker	Morningstar Category	(%)	Price (%)	statistic	Return (%)	Return (%)	Return (%)	Return (%)
Doubleline Opportunistic Credit	DBL	Multisector Bond	10.12	7.77	1.22	14.33	23.68	9.95	9.35
Federated Enhanced Treasury Income	FTT	Short Government	-8.23	3.77	1.06	-0.90	3.67	-0.12	1.09
PIMCO High Income	PHK	Multisector Bond	62.45	11.99	0.94	9.09	14.05	18.95	11.72
MFS® InterMarket Income Trust	CMK	Corporate Bond	-7.93	4.59	0.77	2.64	7.26	4.49	5.17
Flah&Crum Pref Income Opps	PFO	Preferred Stock	7.01	7.05	0.63	16.75	26.57	14.95	10.99
Inexpensive Funds			Discount	Total Dist. Rate at	3-Yr z	1-Yr NAV Total	1-Yr Price Total	3-Yr NAV Total	3-Yr Price Total
Pioneer Diversified High Inc	HNW	High Yield Bond	-3.64	9.27	-2.13	0.03	-6.66	8.66	4.67
Credit Suisse High Yield Bond	DHY	High Yield Bond	-3.82	10.40	-2.10	-0.37	-2.27	10.06	6.82
Blackstone/GSO LS Credit Income	BGX	Bank Loan	-12.56	7.54	-1.86	-1.58	-8.35	5.52	1.48
Pioneer Floating Rate Trust	PHD	Bank Loan	-11.09	5.84	-1.82	1.62	-7.42	6.55	2.07
Templeton Emerging Markets Income	TEI	Emerging Markets Bond	-11.11	7.19	-1.71	-2.47	-7.64	2.67	-2.47

**Equity CEFs**

At first blush, the most overvalued equity CEFs look inconsistent with market trends--Eastern Europe is a mess and oil prices continue to slide--but it's likely that some CEF investors think we are at or near a turning point. The 25% share price decline of MS Eastern Europe (RNE) over the trailing 12 months looks terrible in absolute terms but doesn't look so bad compared with its 32% drop in net asset value. Over the past year, the share prices of BlackRock Energy & Resources (BGR) and Kayne Anderson Energy Development (KED) are in positive territory even as the net asset value returns remain negative.

Equity CEFs			Discount	Total Dist. Rate at	3-Yr z	1-Yr NAV Total	1-Yr Price Total	3-Yr NAV Total	3-Yr Price Total
Expensive Funds	Ticker	Morningstar Category	(%)	Price (%)	statistic	Return (%)	Return (%)	Return (%)	Return (%)
MS Eastern Europe	RNE	Miscellaneous Region	-2.48	3.52	4.32	-32.22	-25.26	-5.18	-2.23
BlackRock Energy & Resources	BGR	Equity Energy	6.78	7.30	3.95	-12.43	5.94	0.00	5.45
Petroleum & Resources	PEO	Equity Energy	-10.64	7.70	2.73	-7.82	-2.99	1.92	4.16
Herzfeld Caribbean Basin	CUBA	Mid-Cap Blend	13.21	0.12	2.65	-7.50	18.40	7.83	19.47
Kayne Anderson Energy Dev Co	KED	Energy Limited Partnership	22.67	6.25	2.57	-5.06	19.63	13.10	19.70
Inexpensive Funds			Discount	Total Dist. Rate at	3-Yr z	1-Yr NAV Total	1-Yr Price Total	3-Yr NAV Total	3-Yr Price Total
Cushing MLP Total Return Fund	SRV	Energy Limited Partnership	-11.71	20.47	-3.80	-20.34	-43.01	-4.14	-15.06
GDL Fund	GDL	Mid-Cap Growth	-15.82	6.23	-2.31	0.36	-0.64	3.16	3.33
Nuveen NASDAQ 100 Dynamic Overwrite	QQQX	Technology	-6.98	7.45	-2.25	15.63	15.45	17.07	17.38
Aberdeen Australia Equity	IAF	Miscellaneous Region	-7.94	12.64	-2.09	-0.44	-10.37	0.70	-4.01
Liberty All-Star Equity	USA	Large Blend	-13.28	6.88	-2.02	6.40	5.81	13.56	14.29

**Municipal CEFs**

Muni CEFs			Discount	Total Dist. Rate at	3-Yr z	1-Yr NAV Total	1-Yr Price Total	3-Yr NAV Total	3-Yr Price Total
Expensive Funds	Ticker	Morningstar Category	(%)	Price (%)	statistic	Return (%)	Return (%)	Return (%)	Return (%)
BlackRock MuniYield Arizona	MZA	Muni Single State Long	9.98	5.08	2.21	15.70	28.03	6.83	10.80
PIMCO CA Municipal Income	PCQ	Muni California Long	9.31	5.83	1.13	19.43	25.65	10.12	9.60
Pioneer Muni High Inc Adv	MAV	High Yield Muni	20.74	7.39	1.06	20.34	21.57	9.76	9.36
Nuveen CA Select Tax-Free	NXC	Muni California Long	0.45	4.40	0.97	13.15	17.86	6.72	9.07
Western Asset Muni Defined Opp	MTT	Muni National Long	3.05	4.24	0.92	10.10	17.04	5.84	6.70
Inexpensive Funds			Discount	Total Dist. Rate at	3-Yr z	1-Yr NAV Total	1-Yr Price Total	3-Yr NAV Total	3-Yr Price Total
Invesco Trust NY Inv Grade Muni	VTN	Muni New York Long	-9.79	5.86	-1.64	16.40	7.38	6.49	2.58
BlackRock Muni 2018 Term Trust	BPK	Muni National Interm	0.70	4.05	-1.45	5.25	3.59	4.91	3.13
PIMCO Municipal Income III	PMX	Muni National Long	1.17	6.65	-1.40	25.05	16.62	11.30	5.91
EV NY Municipal Income	EYV	Muni New York Long	-7.39	6.02	-1.31	17.25	15.63	7.84	3.93
Nuveen Minnesota Municipal	NMS	Muni Minnesota	-2.30	5.41	-1.28	12.96	4.85	6.24	2.10

Municipal CEFs remain attractive on an aftertax total return basis. A low supply and still high investor demand has kept the discounts and premiums of these funds near fair value. Only one muni fund appears

overvalued on a three-year statistical basis, BlackRock MuniYield AZ (MZA), and none appear undervalued.

### Other CEFs

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	(%)						
Gabelli Convertible & Income	GCV	Aggressive Allocation	7.53	9.13	3.83	1.71	16.17	10.49	15.17
Calamos Convertible & High Income	CHY	Convertibles	5.04	8.34	2.40	3.12	16.07	9.77	12.64
EV Tax Adv Global Div Opps	ETO	World Allocation	-0.73	8.84	1.87	6.66	14.41	13.75	18.72
AllianzGI Convertible & Inc II	NCZ	Convertibles	16.76	11.81	1.37	-0.46	-0.37	12.47	13.60
JH Tax-Advantaged Dividend Inc	HTD	Conservative Allocation	-6.55	6.50	1.16	24.54	30.98	16.09	16.07
Inexpensive Funds									
Comerstone Progressive Return	CFP	Tactical Allocation	-2.13	22.80	-1.78	14.72	-10.17	12.46	5.84
Advent Claymore Cnvt Secs&Inc II	AGC	Convertibles	-13.89	8.74	-1.68	-5.33	-7.67	7.76	5.25
Calamos Global Total Return	CGO	World Allocation	-5.10	9.08	-1.45	4.74	1.22	6.68	4.44
EV Tax Adv Global Dividend Inc	ETG	World Allocation	-8.42	7.51	-1.44	8.18	5.06	14.48	13.38
Delaware Inv Div & Income	DDF	Moderate Allocation	-10.07	6.30	-1.23	12.83	14.71	17.53	16.91

### News You Can Use

#### Fund Liquidations & Mergers

Deutsche High Income (KHI) announced it will present a plan to shareholders at a meeting this year to open-end the fund. Although the firm offered few details, shares of KHI have sold at a discount since May 31, 2013. Its three-year average discount as of Jan. 30 was nearly 3%, and its six-month average discount was more than 8%.

Nuveen Investment's board of directors announced a proposed merger of Nuveen NY Performance Plus Muni (NNP) and Nuveen NY Dividend Advantage Muni 2 (NXK) into Nuveen NY Dividend Advantage Muni (NAN). Shareholders will vote on the proposal at a shareholder meeting in the second quarter of 2015.

#### Strategy Changes

PIMCO Corporate & Income (PTY), PIMCO Corporate & Income Strategy (PCN), PIMCO Income Strategy (PFL), and PIMCO Income Strategy II (PFN) announced board approval to change to nonfundamental investment policies. By prospectus, PIMCO Corporate & Income and PIMCO Corporate & Income Strategy previously maintained an average credit quality of BBB and focused on investment-grade securities at the lower end of the credit spectrum and higher-quality junk bonds. PIMCO Income Strategy and PIMCO Income Strategy II previously did not invest more than 20% in securities rated CCC or below. Going forward, PIMCO has aligned the prospectus objectives to be the same and expanded the investment range. Each of the funds will typically limit investments in securities rated CCC or below to 20% of total assets, excluding mortgage- and asset-backed securities. The funds can invest, without limit, in mortgage- and asset-backed securities of any credit quality.

PIMCO pointed to a desire for additional flexibility to invest across the credit-quality spectrum and maintain income goals in light of currently low interest-rate spreads as reasons for the changes. What's more, the firm was looking for increased flexibility to invest in the below-investment-grade segment of the privately issued mortgage- and asset-backed markets.

The board of directors of Nuveen Preferred & Income (JPI) approved an increase to the maximum amount the fund can invest in junk-rated preferred securities to 50% from 40%.

Nuveen Tax-Advantaged Total Return (JTA) clarified and updated certain parts of its nonfundamental investment policies. As of Jan. 30, at least 60% of the fund's total assets will be invested in tax-advantaged income-producing equity securities, including DRD, or dividends received deduction, preferred securities; the fund can invest up to 70% of the total assets in non-U.S. issues of any currency; it can invest up to 20% of total assets in emerging-markets countries; and it can use derivatives both for hedging purposes and to enhance risk-adjusted returns, including writing (selling) covered options.

### Manager Changes

The board of directors of Adams Express (ADX) elected Mark Stoeckle, chief executive officer and lead portfolio manager, to the additional position of president. Stoeckle succeeds James Haynie, who was elected president of Petroleum & Resources Corporation (PEO). Haynie will continue to serve as a member of the ADX portfolio management team. In addition, D. Cotton Swindell will join Stoeckle and Haynie on the portfolio management team. Swindell was previously vice president of research and will continue to follow the industrials sector in his new position. Nancy Prue, co-portfolio manager, will be leaving the management team to assume the new role of director of shareholder communications.

Thomas Ray joined the management teams of Nuveen Flexible Investment Income (JPW), Nuveen Preferred Income Opportunity (JPC), Nuveen Tax-Advantaged Dividend Growth (JTD), and Nuveen Tax-Advantage Total Return (JTA) after previous comanager Mike Carne left the fund and the firm. Ray joins a team of managers on each fund.

Noah Wise replaced Janet Rilling as portfolio manager of Wells Fargo Advantage Multi-Security Income (ERC).

### Other Fund Announcements

PIMCO Corporate & Opportunity (PTY) announced a voluntary tender offer for 100% of its outstanding auction-rate preferred shares at a price of 87% of the full liquidation value and any unpaid dividends. In addition, each tendering ARPS holder will be entitled to one nontransferable contingent payment right. The contingent payment right allows the ARPS holder who participates in this tender offer to receive additional payment from the fund if it completes another tender offer within one year of this offer's expiration. The additional payment would be equal to the number of ARPS accepted for payment in this offer multiplied by the price differential per share between the price received by this offer and the price of a subsequent tender offer or voluntary redemption by the fund. This is a unique offering from PIMCO after it attempted to redeem the ARPS of PIMCO Income (PFL) and PIMCO Income II (PFN) at 90% of redemption value in October 2014. Only 35% of PFL's and 43% of PFN's ARPS were tendered.

Exhibit 6 below lists significant distribution changes announced during January.

#### Exhibit 6

Significant Distribution Changes announced in January, 2015

Source: Morningstar

Significant Distribution Changes			Current	Previous		
Fund Name	Ticker	Frequency	Amount (\$)	Amount (\$)	Change (%)	Pay Date
Salient Midstream & MLP	SMM	Special Non-Recurring	0.20	--	--	1/28
Liberty All-Star Equity	USA	Quarterly	0.10	0.09	11.11%	3/9
Diversified Real Asset Income	DRA	Monthly	0.12	0.11	0.08	2/2
MFS Intermediate High Income	CIF	Monthly	0.02	0.02	6.25%	1/30
Managed Duration Investment Grade Muni	MZF	Monthly	0.06	0.07	-0.05	1/30
BlackRock MuniHoldings Fund II	MUH	Monthly	0.08	0.08	-6.63%	2/2
Massachusetts Tax-Exempt	MHE	Monthly	0.06	0.06	-0.07	2/2
Lazard Global Total Return & Income	LGI	Monthly	0.09	0.10	-10.60%	1/23
Lazard World Dividend & Income	LOR	Monthly	0.08	0.09	-0.11	1/23
Invesco PA Value Muni	VPV	Monthly	0.07	0.08	-13.33%	1/30
MS Income Securities	ICB	Monthly	0.05	0.05	-0.14	1/30

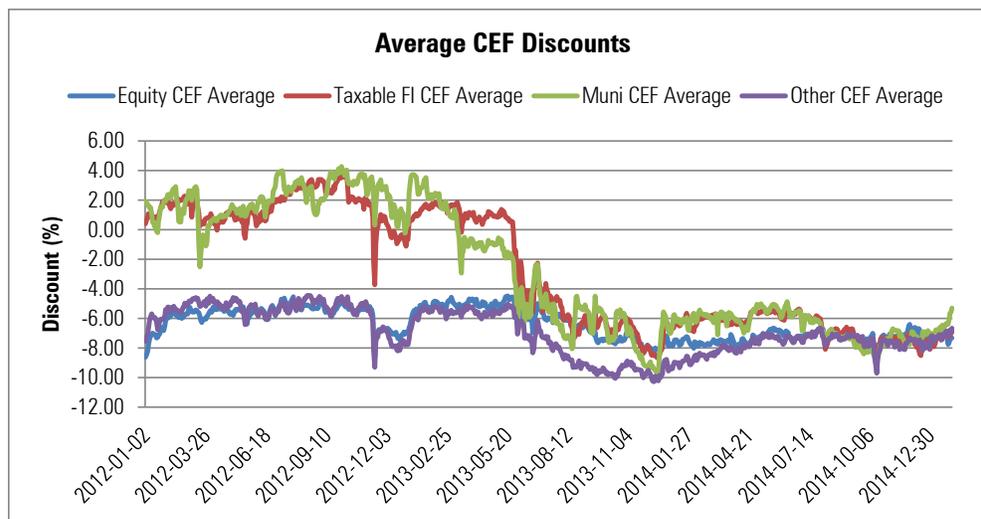
## Discount Trends

Each of the four categories of CEFs saw its average discount narrow in January. This is not uncommon and is often attributed to the “January effect,” which refers to the general increase in trading volume and share prices during January, following a drop in both during December because of tax-related selling. Although this market quirk is typically associated with small-cap stocks, CEFs have similarly low trading volumes, which can lead to a comparable phenomenon. Exhibit 7 below shows the average discounts for CEFs over the past three years.

### Exhibit 7

Historical Discount Data  
Data as of 1/31/2015

Source: Morningstar



## Conclusion

January was a rocky start to 2015, and there are plenty of reasons to expect continued volatility as the market awaits the Fed’s first interest-rate move and watches the economic drama play out in Europe. Both domestic and foreign investors will also be keeping a close eye on oil prices, though consumers are reaping the benefits of lower gas prices. The risks associated with investing in emerging markets and, in particular, those with significant reliance on oil, remain high.

While long-term investing should be the focus of the majority of any investor’s portfolio, setting aside a small portion to act on temporary market disruptions may be acceptable for certain investors. The discount and premium phenomenon of CEFs allows investors to pick up shares at deeply discounted prices. This is because the CEF market is largely retail and those investors tend to flee when things look shaky, often parting with shares at below-market prices. Those who understand the complexities of the CEF market and are willing to put a small part of their capital at risk may find some good deals. Trading costs should play a role in any decision to buy or sell, but most online brokerage platforms charge low trading fees, even for CEFs. In times of market stress and uncertainty, a clear head and a well-vetted watchlist can put savvy investors ahead of the pack.

*All performance data in the accompanying tables is as of the market close February 11, 2015. 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.*

<sup>1</sup> *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."*