

CEF Monthly: March 2014

February Marked a Divergence of CEF Returns

Europe's QE and a strong U.S. dollar provided a lift for the Eurozone and Japan but negative headline news pushed the municipal market lower.

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Despite a tough road ahead, the eurozone fared relatively well last month. Greece's potential exit from the eurozone, though a hot topic, didn't dim the mostly encouraging news out of Europe. On the heels of the European Central Bank's announcement of its next round of quantitative easing, the region reported better-than-expected fourth quarter GDP growth, with a strengthening U.S. dollar (and weakening Euro) helping many European companies post strong earnings results. SPDR EURO STOXX 50 (FEZ), which tracks the 50 largest eurozone stocks, gained 6.7% in February versus a 5.7% gain for SPDR S&P 500 (SPY). Japanese stocks also benefited from the stronger dollar as well as lower oil prices—iShares Japan Large-Cap (ITF) gained over 6% last month—but concerns over deflation and additional monetary policy measures are likely to keep a lid on near-term results.

Domestically, the stock market continued its uptrend as unemployment ticked lower, though wage growth remained stalled. The strengthening U.S. dollar is likely to thwart at least some future economic growth, however, and investors are watching closely for any signs of weakness.

The municipal market took a hit on a few negative headlines last month. First, a New Jersey judge ruled that the state was required to pay an additional \$1.6 billion in pension funding during fiscal 2015. Second, the pressure remains on Illinois after the governor's proposed budget left the state \$6.6 billion in the hole. Finally, at the end of February, Moody's downgraded Chicago's debt rating to two notches above junk. The S&P Municipal Bond Index lost nearly 1% and the average national municipal CEF lost 1.6% on NAV and 2.3% on share price last month.

Long-term Treasury yields ended February marginally lower than the beginning of the month, though short-term rates remained relatively unchanged. Fed watching continues to be a full time job for some market commentators, who attempt to forecast whether Fed Chairwoman, Janet Yellen, will raise short-term rates in June as previously telegraphed, or hold off until September or even longer. A view that is becoming more popular is that concerns over deflation may prevent the Fed from raising short-term rates at all this year. Predicting the path of interest rates is not easy to do and, while some managers have taken a stance on rates this year, many remain duration neutral relative to benchmarks, focusing on credit quality or sector bets to boost comparative results.

A slight rebound in oil prices pushed the average junk bond fund higher last month, erasing some of the negative returns accumulated in the fourth quarter of 2014. The average high-yield bond closed-end fund (CEF) gained 2.6% on share price last month, the best single month return since February of last year. The gain, though promising, wasn't enough to land the group among the Best Performing CEF Categories in February.

Best- and Worst-Performing CEF Categories

As happens from time to time, the best performing CEF category in February (Foreign Large Blend) contains only one fund, BlackRock International Growth & Income (BGY). As of Dec. 2014, the fund had a 14% stake in Japan a 36% stake in Europe, with a big overweight to Switzerland (11% versus 7% for the MSCI ACWI ex USA Index). In addition to strong performance out of the equity markets in Europe and

Japan, Swiss equities rebounded last month after posting a near 2% loss for calendar year 2014. This fund also implements a covered call strategy, overwriting a portion of its portfolio in order to generate income to distribute to shareholders.

Although Japanese equities as a whole did well last month, large-cap stocks as measured by iShares Japan Large-Cap (ITF) outperformed small-cap stocks as measured by iShares MSCI Japan Small-Cap (SCJ) by nearly 300 basis points. The two CEFs investing in Japanese equities take different approaches: Japan Smaller Capitalization (JOF) focuses on small cap stocks while Aberdeen Japan Equity (JEQ) focuses on larger-capitalization names. JEQ gained nearly 9% on share price last month and 6% on NAV while JOF gained about 7% on share price and just 2% on NAV.

The table below lists the month's Best and Worst performers by Morningstar Category.

Exhibit 1
Best and worst share price returns
by Morningstar Category
Data as of 2/28/2015
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 (%)
Top Performing								
Foreign Large Blend	7.95	4.81	9.88	3.98	-3.53	-8.47	5.07	4.77
Mid-Cap Blend	7.69	5.76	5.62	2.07	14.52	1.48	13.22	7.96
Japan Stock	7.60	4.33	10.88	8.79	13.72	15.22	10.92	10.83
Financial	6.84	6.66	-0.74	1.61	5.21	1.98	14.84	13.86
Large Blend	5.83	5.14	3.90	2.10	10.87	10.88	14.54	14.07
World Stock	5.81	4.88	5.85	3.22	7.68	4.52	9.96	9.82
Mid-Cap Growth	5.60	5.91	1.60	2.45	1.92	5.35	11.63	11.61
Small Blend	5.47	5.29	0.71	-0.50	2.68	-0.54	14.87	12.73
Equity Energy	4.89	4.37	4.50	-1.64	-13.37	-19.89	-5.78	-7.23
Large Growth	4.73	4.89	2.73	2.95	9.87	8.41	15.25	13.05
Bottom Performing								
Equity Precious Metals	-4.62	-2.71	8.57	7.19	-15.15	-11.76	-19.17	-18.16
Muni Ohio	-3.03	-1.87	4.06	1.37	15.58	13.75	4.20	6.52
Commodities Precious Metals	-2.81	-2.61	3.75	2.78	-12.28	-11.71	-17.88	-16.68
Muni California Long	-2.62	-1.50	2.59	1.26	15.25	12.98	5.66	7.58
Real Estate	-2.33	-2.39	2.73	3.49	21.43	23.42	14.35	16.32
Muni National Long	-2.25	-1.64	2.53	1.22	14.27	13.61	4.48	6.99
Multialternative	-1.81	-1.37	7.09	1.76	4.83	1.68	2.18	1.70
Muni Pennsylvania	-1.61	-1.42	2.82	1.06	13.43	11.98	2.74	5.59
Intermediate Government	-1.53	-0.37	-2.78	-0.43	3.28	2.00	1.60	1.83
Long-Term Bond	-1.53	-1.73	2.45	1.04	16.84	14.12	7.37	8.01

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, 2015. 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."

Taxable Bond CEFs

Despite a bounce back in the high-yield market, two high-yield funds look undervalued on a three-year basis: Pioneer Diversified High Income (HNW) and Credit Suisse High Yield Bond (DHY). No taxable fixed-

income funds look overvalued on a three-year basis, including PIMCO High Income (PHK). The fund's three-year average premium of 52% is well below the current 60% premium, but because the premium was above 70% for much of 2012, PHK looks fairly valued over the three-year period.

Exhibits 2-5

Most expensive and inexpensive¹ CEFs by broad category

Data as of 2/11/2015

Source: Morningstar

Taxable Bond 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							
Federated Enhanced Treasury Income	FTT	Short Government	-7.70	3.77	1.28	-1.43	0.80	-0.53	0.77
Guggenheim Strategic Opp Fund	GOF	Multisector Bond	9.66	10.24	0.92	6.74	12.64	11.64	12.91
MFS® InterMarket Income Trust	CMK	Corporate Bond	-7.70	4.58	0.86	2.19	6.64	4.32	5.48
PIMCO High Income	PHK	Multisector Bond	60.05	12.09	0.75	11.24	11.93	18.83	11.50
Montgomery Street Income Securities	MTS	Multisector Bond	-9.31	3.62	0.44	5.72	8.16	5.67	6.45
Inexpensive Funds									
Pioneer Diversified High Inc	HNW	High Yield Bond	-4.32	9.26	-2.15	1.16	-6.09	8.63	4.79
Credit Suisse High Yield Bond	DHY	High Yield Bond	-4.48	10.40	-2.08	1.22	-2.97	10.16	7.05
Templeton Emerging Markets Income	TEI	Emerging Markets Bond	-11.43	7.22	-1.69	-3.17	-12.24	2.13	-2.50
Babson Cap Participation Invs	MPV	High Yield Bond	-6.82	8.67	-1.68	12.76	1.68	12.94	2.50
Dreyfus High Yield Strategies	DHF	High Yield Bond	-5.50	9.64	-1.59	2.90	-3.15	10.17	2.61

Equity CEFs

MS Eastern Europe (RNE) looks quite overvalued with a three-year z-statistic of 4.3, but the fund will liquidate in the coming weeks, mostly due to its long-time double digit discount. Following the liquidation announcement, the fund's share price rose to its net asset value, making it appear overvalued.

BlackRock Energy & Resources (BGR) lost 7% of its share price in November 2014 and dropped another 4% in December as energy prices plummeted and sentiment soured on the energy sector. Some investors may believe we've reached a floor in energy as this fund's share price bounced back more than its NAV over the last two months, making its 7.2% premium look rich relative to its three-year trading range.

Equity 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							
MS Eastern Europe	RNE	Miscellaneous Region	-0.07	4.43	4.32	-26.84	-17.98	-5.09	-1.25
BlackRock Energy & Resources	BGR	Equity Energy	7.21	7.84	3.40	-13.28	4.05	-0.20	4.50
Herzfeld Caribbean Basin	CUBA	Mid-Cap Blend	23.84	0.11	2.84	-2.12	36.05	9.57	22.75
European Equity Fund	EEA	Europe Stock	-8.08	1.29	2.80	-3.83	-3.44	10.75	10.64
Nuveen S&P 500 Buy-Write Income	BXMX	Large Blend	-3.25	7.61	2.73	8.48	12.00	9.60	11.95
Inexpensive Funds									
Cushing MLP Total Return Fund	SRV	Energy Limited Partnership	-8.66	21.06	-3.02	-16.93	-41.64	-3.81	-15.23
GDL Fund	GDL	Mid-Cap Growth	-15.95	6.21	-2.11	1.04	-0.67	3.55	3.00
Aberdeen Israel	ISL	Miscellaneous Region	-15.28	2.75	-1.94	0.09	0.60	12.47	11.52
Asia Pacific Fund	APB	Pacific/Asia ex-Japan Stk	-11.24	0.00	-1.82	13.36	14.09	1.96	1.55
Aberdeen Australia Equity	IAF	Miscellaneous Region	-5.41	11.62	-1.61	0.88	-7.67	2.97	-2.33

Municipal CEFs

After a strong January, the municipal market fell victim to negative headlines out of New Jersey and Illinois. The two states (as well as Connecticut) continue to struggle with underfunded pensions and big budget gaps. While no municipal CEFs look undervalued on a three-year statistical basis, some funds are looking cheaper after last month's drop off in share price.

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	11.09	5.06	2.70	12.24	23.93	6.41	11.21
Pioneer Muni High Inc Adv	MAV	High Yield Muni	21.84	7.40	1.29	16.72	18.64	8.82	9.12
Neuberger Berman CA Inter Muni	NBW	Muni California Intermediate	3.81	5.07	1.20	11.38	14.88	5.34	5.90
Western Asset Muni Defined Opp	MTT	Muni National Long	3.79	4.23	1.13	8.59	11.41	5.50	5.64
BlackRock MuniAssets Fund	MUA	High Yield Muni	-1.13	5.38	1.09	13.19	19.37	8.15	7.92
Inexpensive Funds									
Invesco Trust NY Inv Grade Muni	VTN	Muni New York Long	-9.23	5.88	-1.46	12.34	1.96	5.71	1.19
PIMCO NY Municipal Income	PNF	Muni New York Long	-3.70	5.97	-1.26	17.60	13.76	8.24	4.93
PIMCO CA Municipal Income II	PCK	Muni California Long	10.17	6.62	-1.22	17.89	6.06	10.79	6.58
BlackRock Muni 2018 Term Trust	BPK	Muni National Intern	1.15	3.57	-1.18	3.87	3.80	4.62	3.29
Nuveen Minnesota Municipal	NMS	Muni Minnesota	-1.86	5.42	-1.18	9.87	-4.66	5.70	2.91

Other CEFs

Other 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 (%)
Calamos Convertible & High Income	CHY	Convertibles	4.47	8.42	2.06	3.17	15.09	10.34	13.36
EV Tax Adv Global Div Opps	ETO	World Allocation	-0.81	8.87	1.88	6.34	12.69	14.40	18.84
Gabelli Convertible & Income	GCV	Aggressive Allocation	2.15	7.86	1.54	3.92	11.74	11.21	13.58
Wells Fargo Adv Util & High Income	ERH	Moderate Allocation	1.15	6.79	1.45	8.76	16.78	12.40	12.52
Dividend and Income Fund	DNI	Tactical Allocation	-5.11	10.69	1.25	9.87	11.38	11.82	14.75
Inexpensive Funds									
Central Fund of Canada	CEF	Canada Commodity	-8.59	0.09	-1.43	-14.50	-15.96	-17.32	-18.49
Calamos Global Total Return	CGO	World Allocation	-4.72	9.02	-1.20	4.06	-1.07	7.27	5.74
Special Opportunities Fund	SPE	Tactical Allocation	-10.90	9.74	-1.17	5.33	3.59	9.35	9.17
Advent Claymore Cnvt Secs&Inc II	AGC	Convertibles	-12.95	8.56	-1.16	-4.20	-8.81	8.51	6.49
Cohen & Steers REIT & Preferred Income	RNP	Conservative Allocation	-13.88	7.77	-1.11	22.71	22.20	17.72	14.57

News You Can Use

Fund Liquidations and Mergers

MS Eastern Europe (RNE) announced shareholder approval of the fund's liquidation. The board anticipates the liquidation should complete during the first quarter of 2015. The fund will make a cash payment to shareholders.

The board of directors of Cornerstone Progressive Return (CFP) and Cornerstone Strategic Value (CLM) approved a merger of the two funds, which it anticipates will close in the second quarter of 2015.

Fund Manager and Name Changes

BlackRock Enhanced Capital & Income (CII) announced the addition of Peter Stournaras to the management team. Stournaras joins co-managers Kyle McClements and Christopher Accettella. Stournaras joined the firm in 2010.

Due to a new advisory agreement with Sprott Asset Management, Royce Focus (FUND) changed its name to Sprott Focus Trust, effective March 9. The ticker remains the same.

Other News

PIMCO announced results of a voluntary tender offer to purchase the outstanding Auction Rate Preferred Shares (ARPS) of PIMCO Corporate & Income (PTY). The fund offered to purchase 100% of the outstanding ARPS for 87% of liquidation value. Not surprisingly, preferred shareholders tendered just 27% of the outstanding shares.

The board of directors of Federated Enhanced Treasury (FTT) approved a managed distribution policy to pay 2.5% of the fund’s net asset value on an annualized basis.

Exhibit 6 below lists significant distribution changes during February.

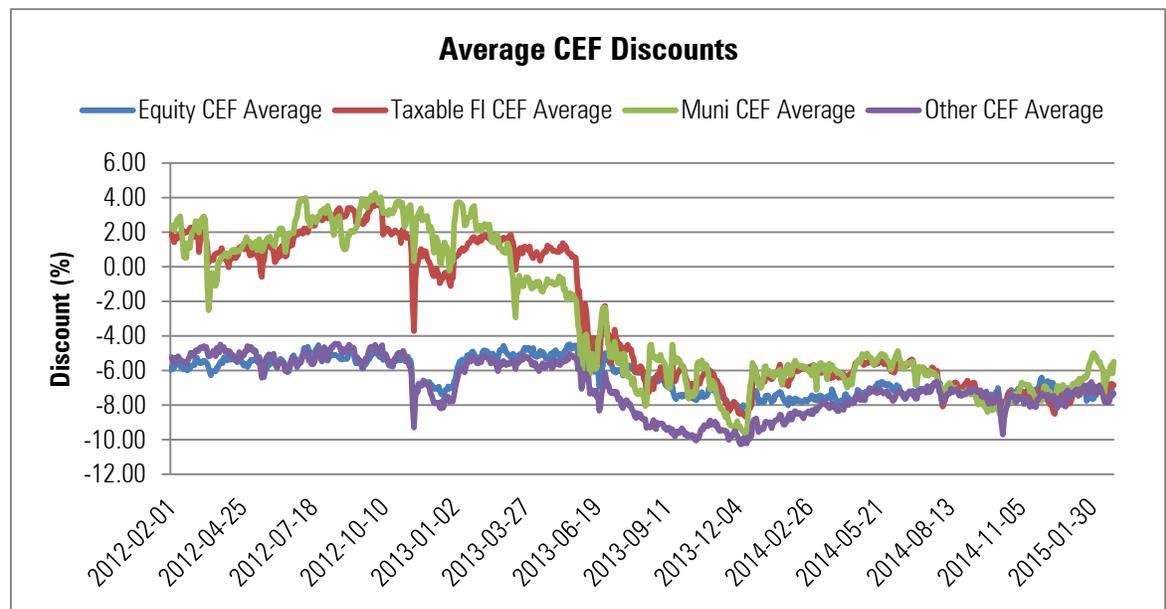
Exhibit 6
Significant distribution changes announced in February.
Source: Morningstar

Significant Distribution Changes				Current	Previous		
Fund Name	Ticker	Frequency	Amount (\$)	Amount (\$)	Change (%)	Pay Date	
Western Asset Mortgage Defined Opportunities	DMO	Monthly	0.18	0.16	12.50%	3/27	
Nuveen Credit Strategies Income	JQC	Monthly	0.05	0.04	11.49%	3/2	
Tekla Healthcare Investors	HQH	Quarterly	0.63	0.59	6.78%	3/15	
Tekla Life Sciences Investors	HQL	Quarterly	0.50	0.47	6.38%	3/15	
Invesco Value Muni Income	IIM	Monthly	0.07	0.08	-6.67%	2/27	
Alliance Bernstein National Muni Income	AFB	Monthly	0.07	0.07	-9.60%	3/20	
Nuveen Long/Short Commodity TR	CTF	Monthly	0.12	0.14	-11.85%	3/2	
Pioneer High Income Trust	PHT	Monthly	0.12	0.14	-16.36%	2/27	
Gabelli Convertible & Income	GCV	Quarterly	0.12	0.15	-20.00%	3/24	
Gabelli Multimedia	GGT	Quarterly	0.22	0.39	-43.59%	3/24	

Discounts & Premiums

The average discount of equity and taxable fixed-income CEFs narrowed a bit last month while the average discounts for municipal and other CEFs widened somewhat. Municipal CEFs, which experienced a drop in discount near the end of 2014, saw the average discount narrow about 150 basis points since the start of the year. Investors continue to search for yield, making tax-free distributions quite appealing, despite the typical long-durations of municipal CEFs. Exhibit 7 below shows the average discounts for CEFs over the past three years.

Exhibit 7
Average discount and premium of CEF broad category groups over three years.
Source: Morningstar



Conclusion

Rising interest rates is a concern for all investors, but leveraged CEFs face a unique set of challenges. To create leverage, a fund borrows money, either in the form of debt or by issuing preferred shares. The fund pays interest on the outstanding debt or pays a dividend to preferred shareholders. The past seven-plus years of low interest rates allowed many funds to utilize cheaper floating rate sources of financing over more expensive fixed-rate financing. As funds anticipate a rise in short-term rates, issuance of variable rate leverage has dropped. For example, according to Fitch Ratings, during the second half of

2010, nearly half of all leverage issuance was variable rate compared to about 20% of the leverage issued in the second half of 2014. A fund's cost of leverage plays an important role in long-term profitability—the more a fund pays for leverage, the less it has for distributions to shareholders, lowering total return.

Another issue for fixed-income CEF investors to consider is the role that leverage plays in lengthening a fund's duration. Because funds typically borrow at short-term (or "shorter term") rates and invest in long-term assets, the fund's overall duration will be higher than compared to a similarly invested, but unleveraged fund. Longer duration portfolios will suffer more as interest rates rise. That said, it all depends on the shape of the yield curve and which parts of it are rising or falling. In all, CEF investors need to be aware of the potential impact of rising leverage costs as well as the impact that rising rates may have on a fund's underlying bond portfolio before investing.

1The 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."