



NEWGATE
CAPITAL MANAGEMENT LLC



TERM
7.5%
PRIME
6.25%
fees 4
RATE
5.25%



CLOSED-END FUNDS



WHY INVEST IN CLOSED-END FUNDS

- Broad range of investments
- Niche strategies
- Ability to use leverage
- Buying assets at a discount
- Inefficient asset class
- Low minimum investment
- Liquidity

WHAT IS A CLOSED-END FUND

Closed-end funds (CEFs) are an established form of mutual fund regulated by the Securities and Exchange Commission under the Investment Company Act of 1940. Like their better known cousins, traditional open-end mutual funds, CEFs are pools of capital raised from different sources in order to create a common investment vehicle. As with mutual funds, the investment mandates CEFs have become more specialized over the years. CEFs were first created in the United States in 1893, 30 years before the creation of the first open-end funds. They began in England as a tool for investors to be able to participate in ventures that were not otherwise accessible, such as the building of railroads in the US. CEFs can be global, regional, single country and invest in both equities or fixed income.

OPERATIONS OF THE CLOSED-END FUNDS

For open-end funds, the fund company has the obligation to create or redeem shares of the fund daily, based on the value of the underlying holdings in the fund, called its net asset value (NAV). Investors and potential investors deal directly with the fund company to buy and sell their shares. In contrast, CEFs are standard equities. The fund sponsor raises the initial pool of capital in an initial public offering (IPO) process. Once the capital is raised, shares of the fund trade on stock exchanges in the same way other equities do. The fund company has no obligation to redeem shares or to create new ones. Invested capital is fixed, except for special activities such as direct share repurchases or the issuance of new shares, both of which require authorization from the fund's board of directors. Investors who wish to own the fund must buy it on a stock exchange through a broker. By contrast, open-end fund companies are constantly issuing and redeeming shares.

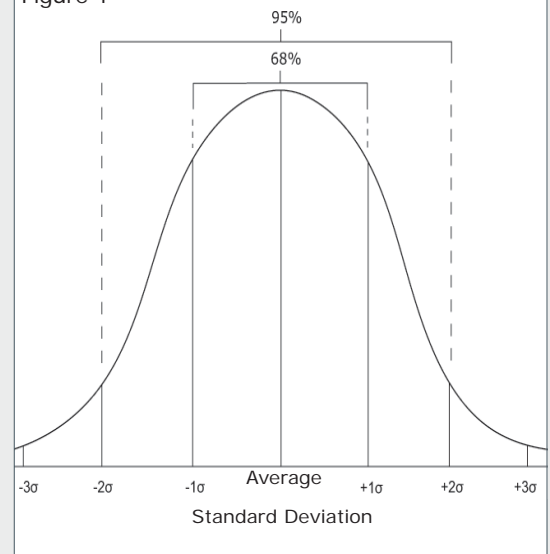
PREMIUM/DISCOUNT ON CLOSED END FUNDS

CEFs are different from open-end funds in many ways, but the most important is their trading behavior post-launch. The price of a CEF in the market is rarely equal to its NAV. Funds typically trade at a discount to their NAV, meaning that shares of a fund often cost less than if an investor purchased the same amount of the fund's underlying holdings. This discount leads to higher yield on the CEF, because the yield is simply the dividend amount divided by the price – the lower the price, the higher the yield. A fund trading at a discount also provides the potential for capital appreciation should the discount narrow, that is, if the price increases relative to the NAV.

There are several reasons why a fund may trade at a discount. CEFs are not generally known and well understood by the investing public. They are often traded purely on the basis of yield, without apparent regard to the fund's underlying portfolio. While CEFs are liquid investments, traded volume is often light. Shorting of CEFs is difficult, in any size.

PROBABILITY DISTRIBUTION

Figure 1





Purchasing the underlying holdings is impractical to the point of impossible. As a result, many of the market mechanisms that prevent mispricing of other financial assets are not applicable to CEFs.

When a fund's price is higher than its NAV, it is said to trade at a premium. This occurs when a fund is in high investor demand because it has characteristics that make it a desirable asset by investors. Sometimes it is a function of the scarcity or the difficulty in investing in the underlying assets. Often a fund will trade at a discount simply if it has a yield significantly higher than other CEFs.

MANAGING THE FUND DISCOUNT

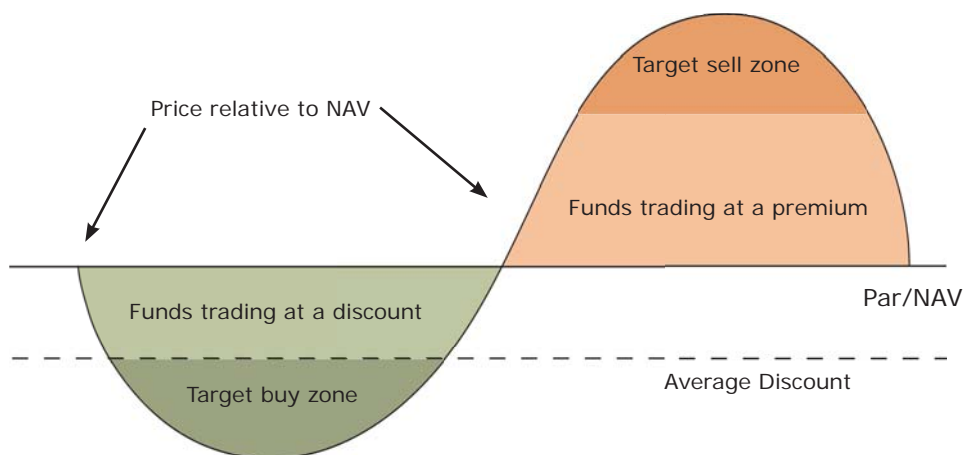
Knowing a fund's current discount from its NAV is not itself useful information. It is more important to know where the current discount is relative to the historical discount of the fund. For example, if a fund has an average discount of 5% historically and is currently trading at 10%, then it is undervalued. Conversely, if

a fund has had an average discount of 15% and is now trading at 8%, then it is expensive. Newgate was a pioneer in the sector by introducing the notion of analyzing a fund's average discount and its standard deviation (Figure 1, a bigger measure of dispersion or volatility) in order to determine the attractiveness of the fund at any given time. Newgate's research has shown that the discount/premium behavior of a fund tends to vary around its average. Typically, funds become relatively cheap, reach an average level of discount, and may become relatively expensive before the process reverses itself (see Figure 2). Newgate tends to buy funds when their discounts are significantly below their historical norm and tends to sell funds as their discounts move above their historical average. At times, funds that trade at a premium to their NAV may be purchased. The important decision is not the absolute level of the discount, but the current level of discount (or even premium) relative to its historical average.

[continued]

HYPOTHETICAL BUY/SELL DISCIPLINE FOR CLOSED-END FUNDS

Figure 2



FIXED INCOME CEF SECTORS

- Senior Loans
- US Mortgages
- Investment Grade
- High Yield
- US Treasury
- Preferred
- Convertible
- US Treasury
Inflation Protected
Securities
- Muni
- Emerging Markets
- International
Governments
- Non-US Dollar Bonds

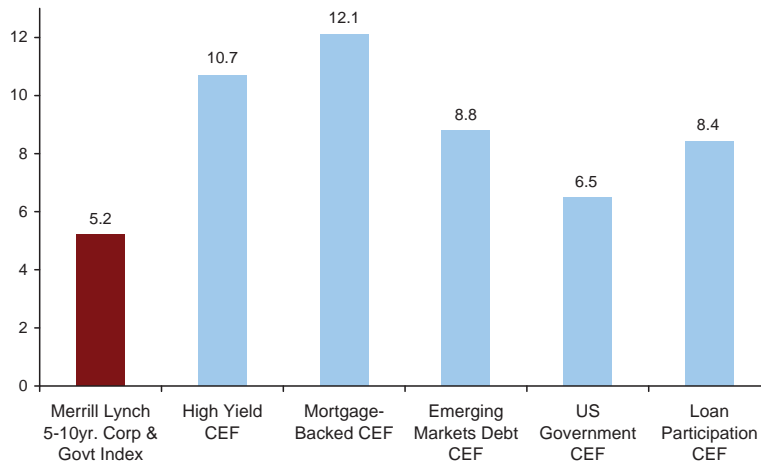


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Current YIELDS

Figure 3.



Source: Bloomberg – 06/30/08

ADVANTAGES OF CLOSED-END FUNDS

CEFs have other advantages for investors beyond the ability to buy funds at a discount. Funds can employ leverage in a portfolio, enhancing returns by taking advantage of the difference between short and long term interest rates, or between relatively risk-free and higher yielding assets. Although such strategies can add volatility to a fund, they can add returns if properly managed. The ability to use leverage is often most attractive to municipal bond investors, where the ability to use leverage is limited by law.

Managers of CEFs can invest a portion of their portfolio in higher yielding, less liquid investments, since they do not have to be prepared to redeem existing shareholders. This allows for investment in asset classes like bank loans, preferred stocks, convertible bonds and other types of investments that may possess a yield premium (Figure 3).

ABOUT NEWGATE

Newgate was founded in 1982 by statistician Dr. Sonia Rosenbaum. Early on, the firm analyzed the investment trust sector in the UK, the original version of closed-end funds. Newgate introduced the Global Fixed Income Portfolio and has continuously managed it since 1984. Newgate was one of the first firms to apply quantitative techniques and to develop analytical tools for CEF portfolio management. In 1994, the firm launched the Municipal Income Portfolio, applying models and techniques to a dedicated municipal bond mandate. ♦

MINDING THE FUTURE TODAYSM

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