

a guide to



Closed-End Funds

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investment

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What Is a Closed-End Fund?

a closed-end fund is a type of investment company whose shares are listed on a stock exchange or are traded in the over-the-counter market. The assets of a closed-end fund are professionally managed in accordance with the fund's investment objective and policies, and may be invested in stocks, bonds, or a combination of both. Like other publicly traded securities, the market price of closed-end fund shares fluctuates and is determined by supply and demand in the marketplace.

This brochure provides an overview of some of the types of closed-end funds and how they operate. However, each closed-end fund is different, and investors should learn more about a particular fund before investing.

Professional Management

A closed-end fund's investment portfolio is professionally managed by the fund's investment manager. A closed-end fund raises cash for investment by selling a fixed number of shares, and the manager invests the cash in accordance with the fund's investment objective and policies. The amount available for investment by a closed-end fund does not depend on redemptions or purchases by investors, because the fund does not issue redeemable securities and typically does not offer its securities for



sale on an ongoing basis. A closed-end fund does not need to liquidate securities to meet investor demands for cash or to purchase securities to invest the proceeds of investor purchases.

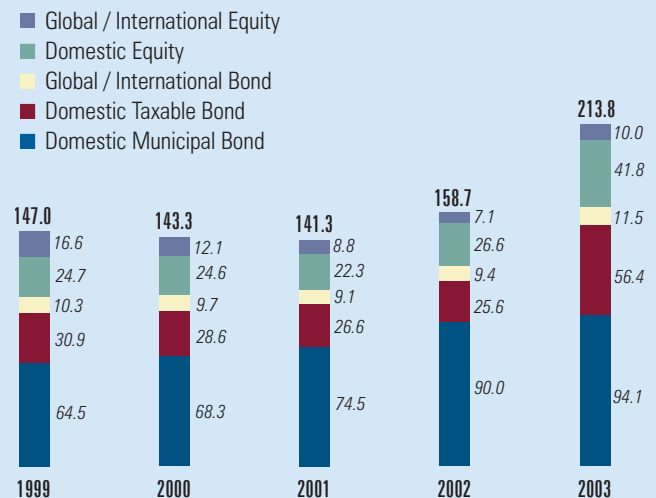
Because a closed-end fund is not subject to the demands of investors for cash, the fund may invest in less liquid portfolio securities. For example, a closed-end fund can invest in securities traded in countries that do not have fully developed securities markets.

Portfolio Composition

A closed-end fund may be diversified and invest its assets in many different stocks or bonds. As a result, the impact on the fund of a change in the price of any one stock or bond holding is diminished. Some funds may be nondiversified. Nondiversified funds may have larger holdings in particular investments. In most cases, however, an investor on his or her own would find it difficult and expensive to construct a portfolio as varied as that of a closed-end fund.

Assets of Closed-End Funds

(billions of dollars at year-end)

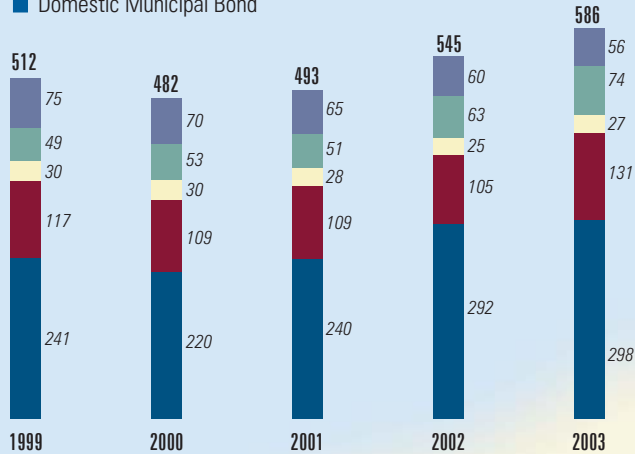


Source: Strategic Insight and the Investment Company Institute

Number of Closed-End Funds

(year-end)

- Global / International Equity
- Domestic Equity
- Global / International Bond
- Domestic Taxable Bond
- Domestic Municipal Bond



Source: Strategic Insight and the Investment Company Institute

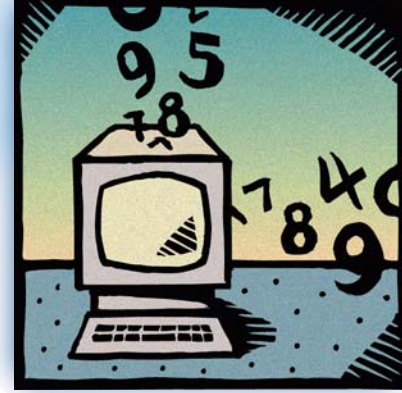
Types of Closed-End Funds

There are two main types of closed-end funds—stock and bond. Of the total \$213.8 billion invested in closed-end funds at the end of 2003, \$51.8 billion was invested in stock funds and \$162 billion in bond funds. In addition, stock and bond funds may hold a portfolio of domestic or foreign securities.

Closed-End Stock Funds

All closed-end stock funds are subject to the risk that the portfolio securities held by the fund will decline in value, thus causing a decline in the fund's NAV and market price. The value of a particular stock in a fund's portfolio

may increase or decrease in response to the business activities and financial condition of the issuer of the stock, or in response to market and economic conditions affecting the issuer's business or the stock market generally.



Domestic Closed-End Stock Funds

General equity funds seek a combination of capital appreciation and current income by investing in equity securities issued by a broad mix of U.S. companies.

Sector/Specialty equity funds seek a combination of capital appreciation and current income by investing in equity securities issues by U.S. companies in a focused industry or by investing in specialized securities.

Global/International Closed-End Funds

General global/international equity funds seek a combination of capital appreciation and current income by investing in equity securities issued by a broad mix of U.S. companies.

Single country global/international equity funds seek a combination of capital appreciation and current income by investing in equity securities issued by companies in a single country.

Closed-End Bond Funds

All closed-end bond funds are subject to some degree of market risk and credit risk. Market risk is the risk that interest rates will rise, lowering the value of bonds held in the fund's portfolio. Generally speaking, the longer the remaining maturity of a fund's portfolio securities, the greater the volatility of its net asset value (NAV) due to market risk. Credit risk is the risk that issuers of bonds held by the fund will default on their promise to pay principal and interest. A closed-end bond fund's investment policies typically define the credit quality and maturity of the investments the fund may make.

Taxable Closed-End Bond Funds

U.S. Government bond funds seek to provide current income by investing in taxable bonds sponsored by the US Government.

Investment grade corporate bond funds seek to provide current income by investing in the high quality debt securities of corporations.

High yield corporate bond funds seek to provide current income by investing in lower-rated corporate bonds (Baa or lower by Moody's and BBB or lower by Standard and Poor's rating service).

Loan participation bond funds seek to provide current income by investing in senior-secured floating or variable rate bank loans.

Mixed bonds taxable bond funds seek to provide current income by investing in a broad mix of domestic fixed income securities.

Convertible bond funds seek to provide current income by investing in convertible securities issued by a broad mix of companies.

Mortgage backed funds seek to provide current income by investing in pooled mortgage-backed securities.

Mixed securities funds seek a combination of capital appreciation and high current income by investing in a mix of stocks and fixed income securities.

Municipal Closed-End Bond Funds

National municipal bond funds invest in national municipal bonds with the objective of providing high after-tax yields.

Single state municipal bond funds invest in the municipal bonds of a single state with the objective of providing high after-tax yields for residents of that state.

Global/International Closed-End Bond Funds

General global/International bond funds seek to provide current income by investing in the debt securities of a mix of U.S. and foreign governments and companies.

Single country global/international bond funds seek to provide current income by investing in the debt securities issued by the government and companies in a single country.

Finding Information About Closed-End Funds

Stock market tables include information about closed-end stock and bond funds. In addition, every week, many periodicals and newspapers—for example, *The Wall Street Journal* on Monday—list separate information on closed-end funds, including NAVs, market prices, and discounts or premiums (see the hypothetical listing below).

Some newspapers' stock market tables offer other information, including a closed-end fund's high and low market prices for the past 52 weeks; dividend payments made during the past 12 months; and the high, low, and closing market prices for the previous day.

Fund Name (Symbol)	Stock Exchange	NAV	Market Price	Premium/ Discount	52-week Market Return (or 12-month yield)
ABC Fund	NYSE	8.26	6 $\frac{3}{4}$	-22.8	25.4
XYZ Fund	AMEX	17.18	19 $\frac{1}{2}$	+13.5	7.1

Column 1: The name of the closed-end fund and its ticker symbol.

Column 2: The exchange or market where the closed-end fund trades.

Column 3: NAV per share—the market value of the fund's total net assets (securities, cash, and any accrued income less expenses and liabilities) divided by the number of shares outstanding.

Column 4: The market price of the stock for the final transaction of the previous week.

Column 5: The plus or minus figure indicates the percentage premium (+) or discount (–) above or below the fund's NAV per share at which the shares last sold.

Column 6: For stock funds, the final column shows the 52-week percentage change in stock market price plus dividends. For bond funds, the final column shows dividends paid from income during the last 12 months, as of the prior month's end, as a percentage of market price.

Other sources of information about closed-end funds include the financial press and the fund itself. Many closed-end funds have personnel available to answer questions about the fund and to provide written information. In addition, the U.S. Securities and Exchange Commission (SEC) maintains a website at www.sec.gov. Fund periodic reports, proxy statements, and, in some cases, fund registration statements are available on the SEC's website.

Pricing

Many closed-end funds calculate the value of their portfolios every business day. Others may calculate the value of their portfolios weekly or on some other basis. The NAV of a fund is the market value of all the fund's portfolio securities, minus expenses and liabilities, divided by the total number of outstanding shares. The NAV changes as the total value of the underlying portfolio of securities rises or falls.

Because a closed-end fund's shares trade in the stock market based on investor demand, the fund may trade at a price higher or lower than its NAV. For example, a closed-end fund in great demand may trade at a share price higher than its NAV. In this case, the fund's shares are said to be selling at a "premium" to the NAV.

The opposite may also be true. Based on a less favorable perception of its underlying portfolio or of the market in which it trades, or a lack of investor knowledge or market recognition, a fund may trade at a share price lower than its NAV. Such a fund's shares are said to be selling at a "discount" to the NAV. For example, if a fund has an NAV per share of \$100, based on the current value of its portfolio, but is priced at \$90, it is selling at a 10 percent discount. Viewed from another perspective, when a share is trading at a 10 percent discount to NAV, an investor can purchase a \$100 share of the fund's assets for \$90.

Fund management may take measures in an attempt to reduce discounts by increasing market visibility of the fund through public reports and communications. A closed-end fund may also attempt to increase the demand for its shares by offering a dividend reinvest-

ment plan, engaging in tender offers (where the fund offers to purchase its shares directly from shareholders at NAV), or instituting a stock purchase program (where the fund purchases its shares on the open market). Further, some closed-end funds may periodically consider conversion to open-end status, which would permit shareholders to redeem their shares at NAV. Of course, any such measures must be approved by the fund's board of directors as consistent with the best interests of the fund.

Investment Return

There are three components to a closed-end fund's investment return:

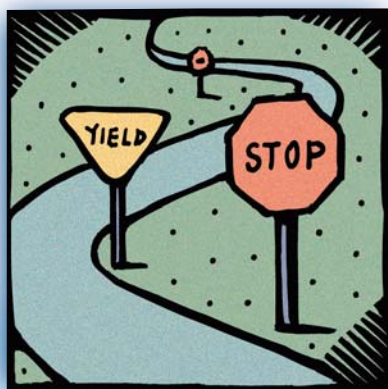
- 1) **Share price appreciation or depreciation.** A closed-end fund's share price may increase or decrease based on the market demand for the fund's shares. Market demand for fund shares may be influenced by many factors, including market perceptions about the fund or its investment manager, perceptions about the types of securities or geographic region in which the fund invests, and the investment performance and NAV of the fund.
- 2) **Dividend income.** A closed-end fund may earn interest and dividend income from securities held in its portfolio. This income, minus fund operating costs, is typically distributed to shareholders as dividends. Bond funds tend to be chosen for their dividend-earning potential, although stock funds may earn income too. Investors can also choose funds that earn income exempt from federal income tax (see page 5). If a fund's dividend payments exceed the dividends and interest the fund earns on its portfolio during the fiscal year, shareholders will receive a return of capital.

3) **Capital gain distributions.** If a fund profits from selling securities during a calendar year, the fund may distribute the gains to investors. Distributions of capital gains typically occur annually near the end of the calendar year. If a fund retains its capital gains from selling portfolio securities, the fund may be subject to federal taxes on those capital gains.

Taxes

In order to avoid the imposition of federal tax at the fund level, a closed-end fund must meet IRS requirements for sources of income and diversification of portfolio holdings, and must distribute substantially all of its income and capital gains to shareholders annually.

Generally, shareholders of closed-end funds must pay income taxes on the dividends and capital gains distributed to them. Each closed-end fund will provide an IRS Form 1099 to its shareholders annually that summarizes the fund's dividends and distributions. When a shareholder sells shares of a closed-end fund, the shareholder will realize either a taxable gain or a loss.



Regulation and Disclosure

All U.S.-registered closed-end funds are subject to stringent laws and oversight by the SEC and the exchanges on which their shares are listed. All funds must provide a written prospectus containing complete disclosure about the fund when its shares are initially offered to the public. Following the initial public offering (IPO), other disclosure documents, including the annual and semiannual reports and the proxy statement, provide information to investors. This information should be read carefully before investing in the fund.

Closed-end funds are regulated under federal laws designed to protect investors. The Investment Company Act of 1940 requires all funds to register with the SEC and to meet certain operating standards; the Securities Act of 1933 requires registration of the fund's shares and the delivery of a prospectus to investors who purchase shares in the IPO; and the Securities Exchange Act of 1934 regulates the secondary market trading of the fund's shares and establishes antifraud standards governing such trading. Finally, the Investment Advisers Act of 1940 regulates the conduct of fund investment managers and requires them to register with the SEC.

The SEC conducts inspections of fund operations to determine compliance with applicable laws and SEC regulations. Stock exchanges on which a fund's shares are listed also impose certain requirements. Stock exchanges require the prompt public disclosure of material information and require certain corporate governance and management procedures, including annual shareholder meetings.

Fees and Expenses

A closed-end fund incurs operating expenses associated with fund portfolio management, fund business operations, custody of the fund's assets, and shareholder services. These operating expenses are paid by the fund from its assets before any distributions are made to the investor. A fund's expenses are summarized in a fee table included in the fund's prospectus. Updated expense information is provided in a fund's semiannual and annual reports to shareholders.

Buying and Selling Shares

Closed-end fund shares are bought and sold in much the same way one would buy corporate stocks—through broker-dealers and investment firms.

During the initial public offering, a fixed number of closed-end fund shares are offered to investors. After the IPO, an investor may purchase shares of existing closed-end funds in the secondary market as shares become available for sale. Investors can obtain information on closed-end fund IPOs and secondary market price quotes from brokerage or investment firms. Market prices are also available daily through various newspapers.

In an IPO, a closed-end fund's shares are typically sold subject to a sales charge that is paid to the underwriter and the broker-dealer who sells the shares. In addition, a closed-end fund investor buying or selling shares in the secondary market likely will pay a sales commission to a broker at the time of the transaction. The purchase or sale price for shares reflects the current market price, plus or minus this brokerage commission.

To raise additional capital, a closed-end fund may make additional public offerings of its shares. A fund also may institute a rights offering, in which shareholders of the fund are issued rights to purchase additional fund shares at a price established by the fund, usually at a discount to NAV. Fund shareholders who are offered rights will receive a prospectus describing the offering, and should read it carefully before making an investment decision.



Shareholder Information

The annual and semiannual reports that closed-end funds provide to shareholders contain financial statements and information on the fund's portfolio, performance, and investment goals and policies. A fund's annual report contains financial statements that have been audited by the fund's independent public accountants and management's discussion of fund operations, investment results, and strategies. In addition, a fund or an investor's broker may provide statements that update and summarize individual account holdings and values.

Before the Purchase

An investor should always determine his or her investment objectives before purchasing shares. These objectives will depend on such factors as the investor's financial circumstances, age, income, and whether he or she has a dependent family. The investor also should assess his or her attitude toward risk. All investments involve some risk, and some investments more than others. Usually, the greater the risk, the greater the potential return.

For More Information

The Investment Company Institute is the national association of the investment company industry. For a catalog of other investor awareness materials, please write to the Investment Company Institute, 1401 H Street, NW, Suite 1200, Washington, DC 20005-2148.



1401 H Street, NW, Suite 1200
Washington, DC 20005-2148
202/326-5800

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