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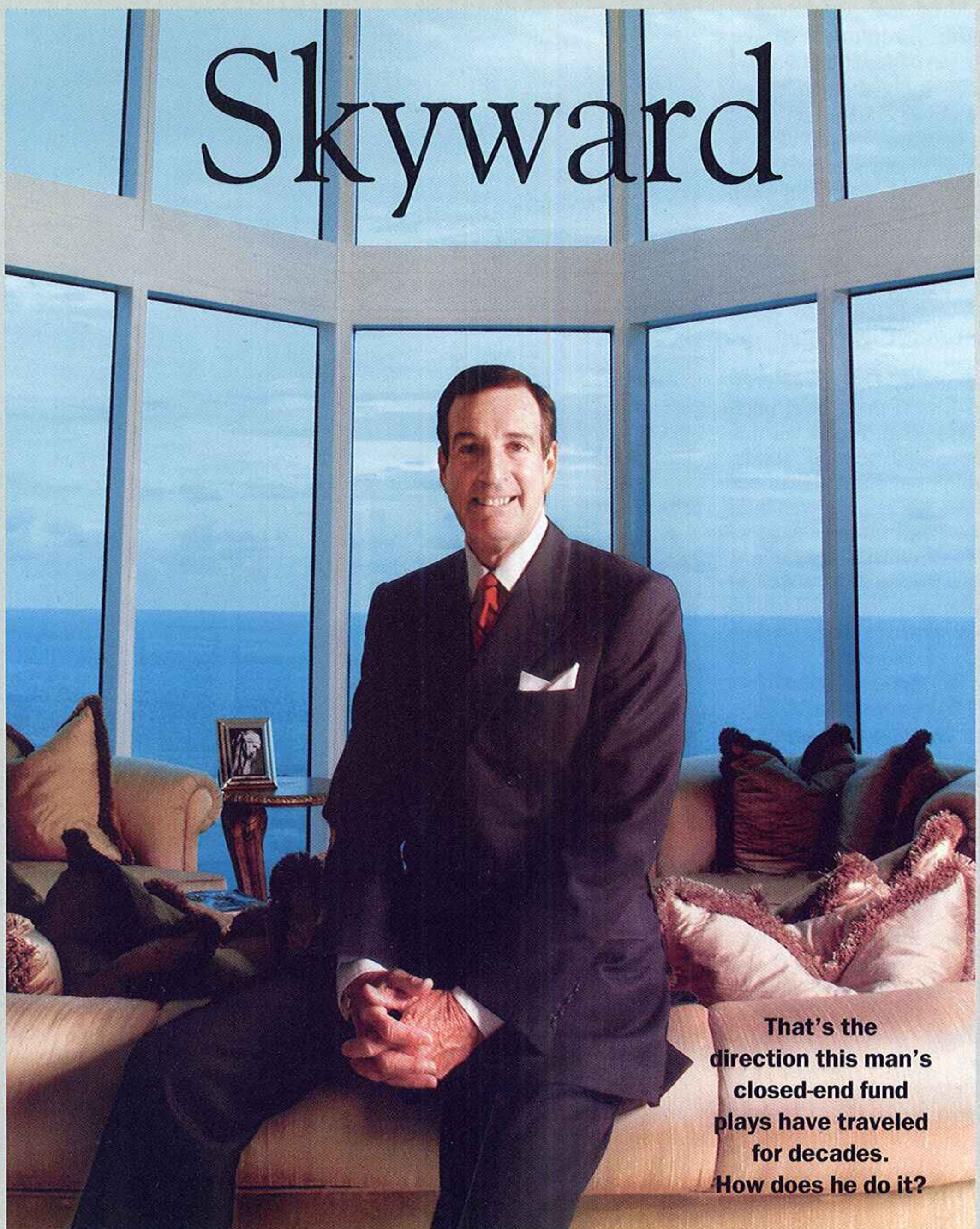
Mutual Funds

PULL-OUT SECTION

FOR THE WEEK JULY 21 THROUGH JULY 25, 2003



Michael Price for *Barron's*

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Mr. Closed-End

Miami-based guru Tom Herzfeld thrives in a tricky field

BY NEIL A. MARTIN

DON'T TELL TOM HERZFELD you can't make money in closed-end funds. The Miami-based closed-end guru has been hearing that for more than a generation. And during that time, he's garnered a worldwide reputation for himself as the reigning authority on the industry—and become a wealthy man along the way.

"Throughout my 35 years in this business, I've come across two groups of investors time and time again," Herzfeld says. "There are those who have never heard of closed-end funds, and the know-it-alls who are familiar with the products but insist that you can't make money investing in them," he adds.

"I feel sorry for both groups," he adds. "One's missing an opportunity and the other is simply dead wrong."

Herzfeld should know. Often referred to as Mr. Closed-End Fund, he's been profiting from closed-end funds all his career. Unlike open-end mutual funds, which can issue unlimited shares that can be redeemed at the underlying value of the securities, closed-end funds consist of a fixed number of shares that are bought and sold on exchanges, just like stocks. They typically trade at a discount to the net asset value; the average discount last year was 6%.

Herzfeld, age 58, has authored six books, including an encyclopedia of closed-end funds, written hundreds of articles, and given thousands of interviews about the closed-end industry. His "Herzfeld Closed-End Average," an index of price performance and premium/discount levels based on 15 domestic equity closed-end funds, is considered an industry yardstick and is published by countless newspapers and magazines, including *Barron's*.

Tom Herzfeld sees good things on the horizon for closed-end funds. Discounts have narrowed and the stock rally has sparked renewed interest in closed-end equity funds.

Herzfeld doesn't confine himself to research, either. Through his investment advisory firm, Miami-based Thomas J. Herzfeld Advisors, he manages about $100 million in discretionary money for hedge funds, pension funds, charities and other institutions, as well as for wealthy individual investors (current minimum: $1 million). He invests that money exclusively in closed-end funds.

Since the late '80s, Herzfeld also has been managing some money—currently around $15 million—for subscribers of his monthly research report, "The Investor's Guide to Closed-End Funds" ($475 per year). These investors plunk at least $100,000 into "managed portfolios" based on one of six closed-end fund categories—balanced, bonds, foreign securities, domestic equities, tax-free municipals and "special situations," meaning funds involved in making tender offers or possibly converting to "open-ended" mutual-fund status—and invest right alongside Herzfeld.

"Basically, what I did was open accounts with $100,000 each for myself and gave subscribers of our research report the opportunity to open matching accounts with $100,000 in their names," he explains

"Whenever I trade for my account, I buy or sell for participants in the program," he says. "They get the same price and pay the same commission rate. Their performance, therefore, is identical to the performance in my account. So if I make money, they make money."

And, Herzfeld says, he and his clients have consistently made money over the years.

Herzfeld's first product—a balanced account established in March 1987—has returned 12.84% this year through the end of June and 256% since inception. Similarly, Herzfeld's bond portfolio is up 6.22% for the year and 354% since De-

HERZFELD'S PICKS...

Name	Ticker	Type	Recent Discount*	Recent Price
Boulder Total Return	BTF	equity	-15.0%	$12.88
Boulder Growth & Income	BIF	equity	-15.2	5.01
Equus II	EQS	equity	-37.0	8.18
Brantley Capital	BBDC	equity	-52.5	8.18
Korea Fund	KF	foreign equity	-15.0	16.62
Renaissance Capital Growth & Income III	RENN	convertible	-23.0	10.25
Gabelli Global MultiMedia Trust	GGT	specialized equity	-14.2	7.75
New Germany Fund	GF	foreign equity	-18.0	5.27
Fort Dearborn Income Securities	FTD	bond	-9.5	14.74
Emerging Markets Telecommunications	ETF	foreign equity	-14.0	6.18

...AND PANS

Name	Ticker	Type	Recent Premium*	Recent Price
Zenix Income	ZIF	high yield	32.0%	$3.92
Nuveen Arizona Premium Income Municipal	NAZ	municipal	18.0	16.50
Nuveen Virginia Premium Income Municipal	NPV	municipal	15.0	17.43
Nuveen Maryland Premium Income Municipal	NMY	municipal	15.3	16.62
Progressive Return	PGF	equity	21.0	25.84

*Discount or premium to net asset value

Source:Thomas J. Herzfeld Advisors, Inc.

cember 1989; the foreign-equity portfolio is ahead 23.99% this year and 153% since September 1990; domestic equity is up 14.22% this year and 413% since December 1990; tax-free income, mostly municipals, has returned 2.51% this year and 189% since November 1992; and special situations is up 14.86% this year and 80% from April 1996.

If an investor had placed $100,000 in each program as it was started up, or $600,000 in total, Herzfeld points out, the investment would currently be worth $2,040,977, Herzfeld says. "This year, to date, the total of all six units is ahead 11.18%, after fees and commissions," he adds. Herzfeld's management fees generally run between 1%-to-2%.

"The most interesting statistic we find is that the $600,000 was worth approximately $1.5 million at the top of the market in January 2000—and since then, has gained about 33% in a time period when everyone else was losing their shirt," he says, noting that the Dow Jones industrial average lost 23% over that time span.

"A lot of people have come and gone in this business, but Tom is a survivor," says David Schachter of Gabelli Asset Management in White Plains, New York, a longtime friend and ex-employee of Herzfeld. "In the vacuum of information about the industry, he is an absolute authority and has proven that you can make money in closed ends."

Of course, that hasn't always been the case for many investors. For much of the past decade, especially the bear market of the past three years, closed-end funds have been the Rodney Dangerfields of the mutual-fund industry. No matter that they have been around longer than open-end funds, nor that they offer a discount-supermarket approach to investing; closed-end funds just couldn't get "no respect."

Part of the reason is that countless investors have been burned by buying into the hype of underwriters and brokers that the latest closed-end offering was a sure-fire winner. Investors later watched the funds' price sink to cavernous discounts within just a few months.

But this persistent tendency of closed-ends to trade at substantial discounts to the net asset value, or NAV, of the underlying securities in their portfolios has been a prized profit opportunity for Herzfeld. He makes his money by rotating in and out of closed-ends over periods as short as a day or as long as a few months, depending on whether the discount is narrowing or widening. Typically he buys when the discount widens and sells when it narrows or starts to move toward a premium.

For example, in a textbook example of his approach, Herzfeld over a six-day trading period last month exploited the discount of **Templeton Global Income Fund**, which invests primarily in foreign debt, including emerging markets.

He had noticed that the discount of the bond fund had widened from less than 2% in May to almost 10% on June 23, 2003, when it was changing hands at a share price of $7.90. That discount to NAV met Herzfeld's two criteria: It was five percentage points wider than the fund's own average discount and it was wider than the discounts of similar funds.

Herzfeld bought stock around $8.00 per share and sold it within two weeks as high as $8.40 per share as the discount narrowed to 4%. That resulted in a tidy profit; a 1.6% gain over a nine-day period.

Herzfeld is generally sanguine about the outlook for closed-ends these days. Discounts have been narrowing, interest in income funds has been especially strong the past 12 months, and this year's surge in stock prices is generating some renewed interest in closed-end equity funds.

Reflecting these improving conditions, the general discount of the funds in the Herzfeld Closed-End Average has narrowed so far this year to 2.28% of NAV compared with 6.09% at the end of calendar 2002 and 12.14% five years ago.

More important, after a drought of new issues since 1995, there's been a resurgence recently of new funds coming to market, mostly income funds—municipals, preferred stock, convertible preferreds, and funds specializing in real-estate investment trusts. These are designed to capitalize on investors' search for higher yields and their desire to capitalize on the recent cut in dividend taxes.

In 2002, there were 79 closed-end initial public offerings—the highest yearly total since 1993, when 126 were issued, and in stark contrast with only one in 2000. What's more, the pace has spilled over into 2003 with 19 IPOs hitting the market through last June 30.

"The pace of new issues has picked up dramatically this year, especially during the May-June period when the bulk of them were brought to market," says Cecilia Gondor, executive vice president and Herzfeld's longtime head of research and regulatory matters. "Most of the 79 new funds we saw come to market last year were relatively small, meaning less than $100 million," she adds. "This year's crop is significantly larger and includes several $1 billion-plus funds."

While only one of the recent crop of new listings was a stock-market index fund—**First Trust Value Line 100 Fund**—Herzfeld believes more will follow as the market picks up.

Among the funds he likes now are two equity funds—**Boulder Total Return** and **Boulder Growth & Income**—that are trading at current discounts of 15% and 15.2%, respectively. Both have large positions in **Berkshire Hathaway**, which he believes is a play on economic recovery. He also likes **Korea Fund**, as a way to ride the current upswing in the Seoul stock market; **Gabelli Global MultiMedia Trust**, whose discount he expects to narrow as the media sector continues to recover; **New Germany Fund**, a play on small- and mid-cap German companies that is trading at one of the widest discounts in the foreign-equity group of closed-ends; and **Fort Dearborn Income Securities**, an unleveraged bond fund that has less interest-rate risk than its leveraged counterparts.

What's next for Herzfeld? "We'd eventually like to manage about 0.1% of the industry's assets which currently run about $140 billion," Herzfeld says. "But we are in no hurry. We want to stay focused and small." ■