

Closed End Funds

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Most investors are familiar with mutual funds. You can purchase shares of a mutual fund and the basic mechanism is that your money is put into a pool with other investors and a professional manager then decides what to buy with the pool of money. These "open ended" funds allow investors to add and subtract money in and out of the fund or pool of money. When investors add or subtract money the fund manager is forced to buy or sell investments as cash flows in and out of the fund. With this basic understanding we can explore what makes closed end funds (CEF) so intriguing. Unlike their open ended cousins CEFs do not allow investors to add or subtract money from the pool. After the initial offering the CEF shuts its doors and no new money is allowed in and no money can be withdrawn. This is how CEFs differ from your typical mutual funds. Investors must *sell shares of the fund on the market rather than redeem them from the pool of money in the fund*. This gives CEFs the following characteristics:

- 1) CEF managers are not forced to sell holdings due to share holder redemptions. In times of panic selling, CEFs can hold onto investments without fear of forced liquidation.
- 2) Closed end funds allow you to purchase shares at a discount or a premium to their actual NAV (net asset value). Meaning you can sometimes buy \$20 worth of shares while the NAV of the underlying securities may be worth \$22. In 2008, at the height of investor fear, many CEFs traded for as much as 25% discounts because there were more sellers than buyers.
- 3) Many CEFs use leverage by borrowing cheaply and investing in higher yielding investments.
- 4) You may be able to receive higher yields from CEF's because as mentioned you can buy them at a discount to their NAV and CEFs may use leverage to enhance their yield.
- 5) CEFs trade throughout the day like a stock, allowing investors to use stop loss and limit orders.

Many investors and professionals use CEFs for the reasons described above. Their unique nature makes them very appealing for some investments but it can also add risk.

Warm Regards,

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