



CLAYMORESM

Claymore Closed-End Fund Market Update

Q3 2009

● CLOSED-END FUNDS

“Discounting”

HIGHLIGHTS

- Average discount slightly narrower than long-term average at quarter-end
- Distribution rates drive premium/discount relationship
- Cost of leverage remains low, affording some distribution increases
- IPOs continue to raise assets at modest pace
- Year-end tax-loss selling season approaches

Review

Discounting is one of the most important principles in finance. The process helps illustrate the significance of risk and the time value of money in investing. Similarly, closed-end fund investors often “discount” certain factors in arriving at a fund’s current market price. With the rally in the overall closed-end fund market this year, it is crucial to analyze not only dividends and market price discount to net asset value (“discount”), but also other factors to determine what information the market may be discounting and if the valuations are justified.

Discounts

As of the end of the third quarter, approximately three out of four U.S.-listed closed-end funds were trading at a discount to their net asset value (“NAV”) with an average discount of approximately 4.4%, substantially narrower than the beginning of this year, but right in line with the ten-year average discount. REIT funds’ discounts were near the bottom at the end of the quarter, registering a slightly less common double-digit discount. MLP funds remained the group trading at the highest average market price premium to NAV (“premium”) of nearly 10%. It is unclear why these funds continue to trade at relatively large premiums, although it may be partly attributable to the fund structure and convenient access to the MLPs asset class. When analyzing premiums and discounts, it is important to consider historical levels, among other factors, to identify potential opportunities. Given the substantial discount narrowing this year, investors should continue to be prudent and selective about their closed-end fund investment decisions.

IPOs

The closed-end fund initial public offering (“IPO”) market continued to raise assets at a modest pace, bringing the year-to-date total to approximately \$1.4 billion – still a far cry from the record-breaking pace of years past. Although the majority of the 10 funds launched this year have focused on municipal securities, recent filings with the SEC appear to indicate a slight increase in investor risk appetite. Confirming this trend was the decline in the CBOE Volatility Index¹ (“VIX”), the market’s “fear index,” to levels not seen in more than a year (approximately 21). During the height of the crisis last year, the VIX breached 80. Since there were only two closed-end fund IPOs during last year’s volatile market it may be reasonable to expect a more subdued IPO market if investor risk aversion returns.

Performance

Overall, performance year-to-date has been positive for closed-end funds. As of the end of the third quarter, the average closed-end fund provided a total return exceeding 40%, based on market price and 30%, based on NAV. From an NAV perspective, Senior Loan funds led all major groups with an average return of over 60% year-to-date, through September 30, although past performance is not indicative of future performance. Over that same timeframe, the worst performers were Covered Call funds, albeit registering a positive 13% total return. For reference, the S&P 500 Index² provided a total return of approximately 19%. Generally speaking, the Covered Call group may have lagged due to a lack of financial leverage and the potential limited upside participation associated with a call writing strategy. On a market price basis, the various closed-end fund categories provided year-to-date total returns ranging from approximately 30% (i.e., Covered Call funds) to over 70% (i.e., High Yield funds), as of September 30, 2009. Keep in mind, however, down 50% followed by up 50% does not arrive at breakeven; rather it still equates to down 25%. This fact not only places this year's outsized returns into perspective, but it may also become more relevant during year-end tax-loss selling, discussed later herein.

Dividends

At this point, the tide of dividend reductions seem to have subsided and certain groups, such as municipal funds, are witnessing increases. The increases are generally attributable to the low cost of leverage (typically 1.5% or less) compared to long-term yields and generally solid NAV performance. Although, there is no guarantee that this trend will continue. Funds that are still significantly underwater from last year on an NAV basis, have represented the bulk of dividend reductions as their earnings potential eroded. One factor that appears to be re-emerging is the correlation between a fund's distribution rate and its premium or discount, whereas over the past few months, greater emphasis may have been placed on NAV stability and dividend sustainability. In other words, generally, the higher a fund's distribution rate the smaller its discount or larger its premium to NAV. Merely focusing on a fund's distribution rate presents potential pitfalls to investors, including the possibility of a significant return of capital, higher volatility and diminished total return potential over time. It is important to be aware of the character of closed-end fund distributions. Unfortunately, it may be difficult to determine the exact composition of closed-end fund distributions until final tax information is made available in early 2010.

One simple, though somewhat imprecise, way to assess the sustainability of a closed-end fund's distribution rate (based on NAV), is to compare it to the NAV total return over time. For example, a fund providing an average annual total return of 10% over time is unlikely to be able to sustain a 15% distribution rate without a return of capital at some point. Closed-end fund distributions are comprised of income and gains (the two components of total return) and in the absence of these two, a potential return of capital. Given the substantial losses generated last year across a number of asset classes, though partially offset by this year's rally, there is the overall potential for relatively higher levels of return of capital for certain groups at the end of the year. An occasional return of capital is not necessarily detrimental, but it does erode total return potential if it becomes an ongoing trend. Another exception may include MLP funds, which, due to the nature of MLPs, often distribute a return of capital. This is sometimes referred to as an "earned" return of capital since the MLPs are actually generating revenue that may be offset by certain deductions or write-offs, resulting in tax-deferred distributions.

Outlook

Perhaps the most pertinent factor looming on the horizon is closed-end fund tax-loss selling. It is a year-end phenomenon that generally affects closed-end funds more profoundly than large-cap stocks or other highly liquid securities. At the end of the year, especially in years with widespread losses, investors may sell certain closed-end funds to generate losses for tax purposes. Since closed-end funds may be less liquid than other securities, the selling pressure may cause a disproportionate decline in a fund's market price, often causing the discount to widen or premium to narrow. As the year ends, so does the tax-loss selling.

Funds that are still underwater on a market price basis from last year, such as certain equity-oriented funds, may be more susceptible to tax-loss selling, whereas funds with strong market price returns, such as certain municipal bond funds, may experience less selling pressure. Of course, there can be no assurance of this actually occurring since it is difficult to determine the exact magnitude, timing or areas of tax-loss selling in any given year. It is worth noting that the past two year-ends (2007 and 2008) witnessed fairly substantial discount widening from mid-November through December. Investors may wish to be prepared for and potentially take advantage of this volatility by identifying investment opportunities in advance of year-end.

CLAYMORE CLOSED-END FUND RESEARCH DATA POINTS

	09/30/08	12/31/08	03/31/09	06/30/09	09/30/09
Average CEF Premium/Discount	-13.20%	-11.12%	-7.95%	-6.05%	-4.17%
S&P 500 Index	1166.36	903.26	797.87	919.32	1057.08
CBOE Volatility Index (VIX)	39.39	40.00	44.14	26.35	25.61
10-Yr. Treasury Yield	3.83%	2.21%	2.67%	3.64%	3.31%

For illustrative purposes only. Past performance is not a guarantee of future results.

Source: Claymore/Morningstar, 09/30/09

To help identify investment opportunities, it may be beneficial to analyze what the closed-end fund market is discounting (or assigning a premium to) and decide if the valuation is justified. It is important to analyze a multitude of factors, such as relative discount, dividend sustainability, liquidity, leverage and NAV performance. When some investors think of closed-end funds, they think of high dividend yields and deep discounts. However, when deep discounts are hard to come by and certain high dividend yields aren't really true "yields," it is even more critical to have an in-depth understanding of a fund's investments and outlook for its particular strategy.

We welcome any feedback and look forward to providing a full-year report at the end of the fourth quarter.

Claymore's Closed-End Fund Group - October 2009

All data as of 09/30/2009, unless otherwise noted. Source: Fundamental Data Limited

As a means of attempting to improve the common shareholder's total return, many closed-end funds will utilize leverage to help enhance a fund's yield and overall performance potential. A closed-end fund may benefit from leverage by borrowing and/or issuing preferred shares at a lower interest rate and investing those monies at a higher reinvestment rate to take advantage of any spread that may exist. In general, leverage may be a positive contributor to performance if the rate earned on the investment strategy exceeds the cost of borrowing or issuing preferred shares. Conversely, leverage can detract from the overall fund performance if the spread narrows; thereby pressuring a fund's cash flows.

Leverage can be structured in a number of different ways. The most typical forms of closed-end fund leverage include the issuance of senior securities in the form of preferred shares, or the utilization of commercial paper, bank loans or debt securities. Leveraging carries certain risks, including higher volatility of NAV, share price and income, which may increase the chance of loss to the common shareholders.

Leverage risk is the risk associated with the borrowing of funds and other investment techniques, including the issuance of the preferred shares by a fund, to leverage the common shares. Leverage is a speculative technique which may expose a fund to greater risk and increase its costs. Increases and decreases in the value of the fund's portfolio will be magnified when a fund utilizes leverage. For example, leverage may cause greater swings in a fund's NAV or cause a fund to lose more than it invested. A fund will also have to pay interest or dividends on its leverage, reducing a fund's return. This expense may be greater than a fund's return on the underlying investment. There is no assurance that a fund's leveraging strategy will be successful.

¹CBOE Volatility Index ("VIX") - Chicago Board Options Exchange (CBOE) Volatility Index ("VIX"), displays the market's expectation of 30-day volatility. It is constructed using the implied volatilities of a wide range of S&P 500 index options. This volatility is meant to be forward looking and is calculated from both calls and puts. The VIX is a widely used measure of market risk. The index is unmanaged and it is not possible to invest directly in an index. (Source: CBOE)

²Standard and Poor's 500 Index is a capitalization-weighted index of 500 stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. The index is unmanaged and it is not possible to invest directly in an index. (Source: Standard and Poors)

Performance data quoted represents past performance, which is no guarantee of future results, and current performance may be lower or higher than the figures shown. This commentary contains forward-looking statements about various economic trends and strategies. You are cautioned that such forward-looking statements are subject to significant business, economic and competitive uncertainties and actual results could be materially different. There are no guarantees associated with any forecast; the opinions stated here are subject to change at any time; are the opinion of Claymore's Closed-End Fund Group; does not pertain to any Claymore product; and is not a solicitation for any product.

There can be no assurance that any closed-end fund will achieve its investment objective(s). The value of any closed-end fund will fluctuate with the value of the underlying securities. Until the original listing of a closed-end fund on an exchange, no closed-end fund's shares will have a history of public trading and, historically closed-end funds often trade at a discount to their net asset value.

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