

What is a closed-end fund?

Q: *One of my colleagues was talking about a closed-end fund. What is this, and when might it be a good investment option?*

A: A closed-end fund is a type of investment company, similar to a traditional "open-end" mutual fund. Unlike a mutual fund, a closed-end fund does not continually issue shares.

Instead, a fixed number of shares trade on an exchange or over the counter. With a traditional mutual fund, the mutual fund company will issue shares every time an investor seeks to purchase shares and will purchase shares back every time an investor seeks to sell shares.

Because the number of shares of a closed-end fund is fixed, an investor seeking to purchase or sell shares must pay whatever the market will bear. This situation is in sharp contrast to one involving a traditional mutual fund, where the market forces are on the fund's holdings, not on the mutual fund itself.

Inside both closed-end funds and traditional mutual funds are portfolios of investments (stocks and bonds). The net asset value (NAV) of all of the investments inside the fund is the fund's total assets minus its total liabilities. The NAV of a single share (or the "per-share NAV") is calculated by dividing its NAV by the number of outstanding shares. This is the price per share you see listed in the newspaper or on the Internet.

With closed-end funds, however, there is a second value: the actual price the market will bear to purchase the closed-end fund. Remember, you are not purchasing and selling a closed-end fund from a mutual fund company; you are trading on an exchange or over the counter. So, although logic would dictate that if the per-share NAV were \$20, then the price per share also should be \$20, oftentimes that is not the case.

When a closed-end fund is selling for \$19 and the per share NAV is \$20, the closed-end fund is selling for a "discount" of five percent. When a closed-end fund is selling for \$21 and the per share NAV is \$20, the closed-end fund is selling for a "premium" of five percent. Discounts and premiums are quite common based on the popularity of the funds underlying the investments.

Unfortunately, many investors chase closed-end funds and pay unnecessary premiums. They also sell closed-end funds, creating large discounts. All things being equal, an investor can profit handsomely by purchasing at a discount and selling at a premium, even if the per-share NAV never changes. An even better scenario is purchasing at a discount and then selling at a premium after the per-share NAV increases.

Because of the relatively lax reporting requirements (compared with traditional mutual funds), the market for closed-end funds is somewhat

limited. This reality can present opportunities for the conscientious investor.



Send your money management questions to memoney@advanstar.com. Answers to our readers' questions were provided by Aaron Skloff, AIF, CFA, MBA. He is chief executive officer of Skloff Financial Group, a registered investment advisory firm based in Berkeley Heights, New Jersey. He may be contacted via www.skloff.com or (908) 464-3060. A more extensive version of this column appears online.



WHAT ARE THE BASICS OF ESTATE PLANNING?

Q: *I'm relatively new to my practice and have a wife and a baby. Where should I begin when it comes to estate planning, and what should I focus on for now?*

A: Good estate planning can be as easy as 1, 2, 3, 4:

1) Will. With a will, you direct to whom, when, and in what amounts your assets are distributed. Also, you select the executor or personal representative, the person who is responsible for the disposition of the estate.

2) Guardianship. In your will, you can specify the person who is to be guardian of your minor children, and you can waive the requirement of a bond. Also, you can specify who will manage



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your children's inheritance, how the money is to be spent, and at what age your children will receive the money directly.

3) Living will. The advanced directive permits you (the patient) to communicate, in advance, the medical care decisions you would make regarding your care should you be rendered incapacitated.

4) Power of attorney. This document gives one or more people the power to act on your behalf.

Work closely with a financial adviser and estate attorney to develop an estate plan that meets your personal objectives.