



CLAYMORESM

Claymore Closed-End Fund Market Update

Q4 2008

● CLOSED-END FUNDS

“Historic Opportunities”

HIGHLIGHTS

- Closed-end fund discounts reach historic levels
- Leverage and liquidity issues dominate markets
- Dividend cuts and delays accelerate
- IPO market remains muted
- “January effect” lifts market prices in early 2009

Review

The events of the third and fourth quarters of 2008, in particular, offered valuable insight into the implications of leverage¹ and liquidity. Instead of simply reviewing 2008, we thought it would be appropriate to highlight some of the lessons learned, while humbly acknowledging that class is still in session.

Leverage

Approximately three-fourths of all U.S.-listed closed-end funds currently utilize some form of financial leverage.² Leverage magnifies both the upside and the downside performance potential and in a market such as the one investors experienced last year with the S&P 500 Index³ losing more than one-third of its value, leverage exacerbated the downside performance. However, in 2008, the average closed-end fund actually fared better than the S&P 500 Index, based on both market price and net asset value (“NAV”), registering losses of 35.3% and 33.8%, respectively.² The best-performing closed-end fund category, based on NAV, was national municipal bond funds with an average total return of negative 19.1%.² The best-performing category based on market price was investment grade corporate bond funds with an average loss of 11.1%.² The worst-performing category based on both market price and NAV performance was real estate investment trust (“REIT”) funds with average losses of 67.9% and 61.8%, respectively.² The divergence in these category returns highlights an important lesson – closed-end funds are not an asset class. Closed-end funds encompass a diversity of asset classes, including historically less volatile areas such as municipal and corporate bonds. It was this diversity that helped closed-end funds, on average, outperform the S&P 500 Index. Of course, the S&P 500 Index is not a relevant benchmark for all funds and, more importantly, relative outperformance didn’t help console investors who experienced absolute losses.

Dividends

Leverage also impacted closed-end fund dividends, even though the cost of leverage actually fell throughout the second half of 2008 with most taxable and tax-exempt funds paying approximately 2% or less by year-end. Leverage magnified NAV losses, thereby decreasing the earnings potential for many closed-end funds. More than half of all closed-end funds were forced to cut or even postpone dividends in 2008 due to significant NAV declines. The dividend delays were concentrated primarily in the asset classes that were hardest hit, such as REITs, preferreds, senior loans and high-yield bonds, among others. Even certain municipal bond funds, historically considered to be more conservative than the

forementioned asset classes, were forced to delay dividends. The dividend delays occurred as a result of certain asset coverage requirements mandated by the Investment Company Act of 1940 (which all U.S.-listed closed-end funds are registered in accordance with) and the credit rating agencies that assign credit ratings to preferred shares issued by closed-end funds.

Asset Coverage

Without discussing in greater detail, essentially the asset coverage requirements under the Investment Company Act of 1940 were designed to prevent closed-end funds from utilizing excessive amounts of leverage, requiring funds to maintain a minimum of 200% asset coverage in the case of outstanding senior securities, such as auction-rate preferred shares ("ARPS"), or a minimum of 300% asset coverage in the case of outstanding debt. Both of these figures are calculated by dividing a closed-end fund's total managed assets by the amount of assets attributable to leverage. The asset coverage requirements mandated by the credit rating agencies are less straight forward. Generally speaking, the rating agencies' asset coverage requirements are calculated by discounting a fund's underlying investments according to various factors and comparing this figure to the amount of leverage outstanding. Depending on the fund, these asset coverage requirements may require a delay in the declaration and/or payment of common share dividends. Some of the funds affected were forced to redeem portions of their outstanding leverage, or "de-lever", others relied upon market appreciation, while still others took advantage of both. Thus far in 2009, closed-end funds have continued to closely monitor the asset coverage requirements as the markets have remained volatile and, in certain cases, relatively illiquid.

Liquidity

Liquidity is a measure of how readily and efficiently a security can be bought or sold. One market adage during periods of illiquidity advises "sell what you can, not necessarily what you wish to sell." This proverb summarizes much of what the markets experienced in the second half of 2008; a situation that was only exacerbated by leverage in the overall market. Even securities with high credit ratings and strong business fundamentals, depreciated to levels that falsely indicated their inevitable default. Both debt and equity securities of many public companies were said to be "no longer trading on fundamentals." That is, the belief was that the market had moved away from assigning values to those companies based on their underlying businesses or overall growth prospects and began focusing almost exclusively on the macroeconomic

backdrop. Leverage also created "forced sellers", comprised of individuals or institutions that were forced to sell their investments as a result of various external pressures, such as redemptions or margin calls. We believe this combination of leverage and illiquidity affected not only the closed-end funds' underlying investments, but also the closed-end funds themselves.

Discounts

Closed-end funds were not immune to the forced selling, as evidenced by the historic discounts witnessed in October of 2008. As our third quarter closed-end fund commentary entitled "History in the Making" indicated, the average discount to NAV for all closed-end funds reached an all-time record of 26%.² To put that into perspective, the ten-year average discount was approximately 4%, as of December 31, 2008.² By the end of the year, the average discount had narrowed significantly to 12.4% and as of January 23, 2009, the average discount was 6.5%.² In our opinion, this discount narrowing provides evidence of the eagerly anticipated "January effect". Further supporting this case, the average closed-end fund market price return was 5.7% with more than three out of four funds experiencing positive year-to-date returns through January 23, 2009 - meaningful considering most equity and fixed-income indices were negative over that same time period.²

Outlook

Understanding the lessons of 2008 may offer investors some consolation and renewed confidence that the risks are somewhat more quantifiable now than before. If the equity and credit markets remain volatile, the environment will likely remain negative for closed-end funds and their investments. We believe the factors discussed herein will continue to play a role in 2009 to varying degrees.

Leverage will continue to magnify volatility both on the upside and the downside. We expect funds will continue to closely monitor leverage levels and make adjustments accordingly. Given the historically-low cost of leverage and attractive valuations on several asset classes, implementing a prudent amount of leverage may make sense for certain funds. Of course, leverage increases the risk of greater loss and may continue to affect dividends as funds manage through the ongoing turmoil.

We would expect funds to continue to evaluate dividends to reconcile the earnings potential of their underlying investments with current dividend rates. As one closed-end fund analyst pointed out, a reasonable expectation for the magnitude of

CLAYMORE CLOSED-END FUND RESEARCH DATA POINTS

	12/31/07	3/31/08	6/30/08	9/30/08	12/31/08
Average CEF Premium/(Discount)	(8.56%)	(6.02%)	(5.92%)	(13.20%)	(11.12%)
S&P 500 Index	1468.36	1322.70	1280.00	1166.36	903.25
CBOE Volatility Index ⁴ (VIX)	22.50	25.61	23.95	39.39	40.00
10-Yr. Treasury Yield	4.03%	3.41%	3.97%	3.83%	2.21%

For illustrative purposes only. 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.
Source: Claymore Data/Fundamental Data Limited, 12/31/08

potential dividend reductions would be a range that is somewhat proportional to the fund's NAV losses. For example, NAVs of domestic equity closed-end funds lost 38.7% last year, according to Fundamental Data.² Therefore, one could anticipate dividend reductions in that category, on average, to be somewhat proportional to the magnitude of NAV losses. However, not all funds implement such dividend policies and, further, funds may also factor in the outlook for the fund's investments when establishing the dividend. In addition, some funds implement managed payout policies, whereby the fund establishes a fixed-rate dividend based on NAV or market price and pays this amount regardless of income and gains, until the policy is modified. Such funds may experience significant returns of capital, especially given the widespread losses experienced in 2008. Of course, there is no guarantee that these estimates will come to fruition.

Discounts in several categories remain historically wide, albeit much narrower than the records set in 2008. Further dividend reductions or NAV volatility may increase the risk that discounts widen. However, current market price discounts to NAV may already reflect this possibility to a certain degree. Regardless, it is important to evaluate closed-end funds not simply on their current discount to NAV, but also as compared to their own historical average and peer group.

In spite of the significant fiscal and monetary stimulus, current investor sentiment appears to reflect an ongoing lack of confidence or uncertainty surrounding the economic outlook. In fact, consumer confidence sank to the lowest level on record in January, according to The Conference Board, which is sometimes considered a contrarian indicator. However, once confidence is restored, we believe closed-end funds may offer a variety of investors several potential advantages, including the ability to buy assets at a discount with exchange-traded visibility. Undoubtedly, risks remain and investors should carefully consider these risks when evaluating an investment in closed-end funds. In the long run, the combination of undervalued asset classes and discounted closed-end funds may provide a historic opportunity to take advantage of the potential for attractive current income and total return.

Claymore's Closed-End Fund Group - January 2009

¹As 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.¹

²Data Source: Fundamental Data Limited

³Standard 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 Pools)

⁴CBOE 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)

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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