

Closed-End Fund

As of December 31, 2018, the market-price total return of the Morningstar U.S. All Taxable ex-Foreign Equity Closed-End Fund Index¹ was –9.5% for the year, while its return on a net asset value (NAV) basis was –6.1%. By comparison, the S&P 500 Index² and the Barclays Capital U.S. Aggregate Bond Index³ had total returns of –4.4% and 0.0% in 2018.

Investment Review

Closed-end funds struggled in 2018, in what was a tumultuous year for investments in general. Following a period of steady gains after a sharp correction in February, equity and credit markets again encountered turbulence in the third quarter amid tightening financial conditions, rising global trade tensions and slowing economic growth. The broad global equity market suffered its largest annual decline since 2008.

Although economic growth remained above trend globally, momentum slowed across most regions. Europe and China in particular showed signs of deceleration. Inflation remained subdued, but indications that price pressures were building prompted the U.S. Federal Reserve (the Fed) to continue to normalize interest rates. The Fed also began to unwind its balance sheet, while the European Central Bank ended its bond buying program. Additionally, the strengthening U.S. dollar indirectly led to tighter credit conditions globally during the year—especially in emerging markets.

The period saw a general widening in closed-end funds' discounts to their NAVs. Equity closed-end funds average discount went from 3.4% to 6.8% at the end of the year, somewhat wider than the historical average. The average discounts on taxable fixed income and municipal funds also expanded, to 7.9% and 11.5%, compared with long-term averages of 3.1% and 3.8%, respectively.

The equity and fixed income categories both declined, although fixed income held better than equity funds as a group. Within equities, the energy/resources and MLP sectors both fell more than 20% amid a sharp decline in oil prices in the year. The more defensive health-biotech and utilities sectors outperformed with market-price returns of –5.1% and –6.8%, respectively. Within fixed income, emerging market income (–12.7%) and preferred (–11.2%) funds were among the poorer performers. Multi-sector funds (–1.2%), which have the flexibility to maneuver around the various asset classes within fixed income, outperformed.

Investment Outlook

We continue to find attractive values across various closed-end-fund categories. However, we believe selectivity will be the key to success in the coming months. The best long-term returns are likely to occur in categories where the underlying

asset class offers relative value and discounts to net asset values are wider than their historical averages, in our opinion.

Given the likelihood of continued economic growth, the Fed is expected to remain on a tightening path, with two or more rate hikes possible in 2019. Rising interest rates may continue to challenge the earnings power for closed-end funds with leverage in their capital structure, although we believe rates will remain low relative to long-term historical averages.

Our favored groups include multi-sector and tax-advantaged funds. In taxable fixed income, we like the relative earnings and dividend advantage associated with multi-sector funds. We also favor multi-sector funds based on their longer-term record of successfully maneuvering among a wide range of fixed income asset classes. Within the equity category, we see particularly attractive opportunities in equity tax-advantaged funds.

Underweight high yield and senior loans. Our relatively cautious positioning in the high yield and senior loan groups is based on underlying valuations, although we continue to find compelling funds with exposure to those asset classes in other sectors, including multi-sector and limited duration. While high yield and senior loan funds offer relatively wide discounts, the yields and credit spreads on the underlying high yield bonds and loans leave little room for error, especially if default rates for low-quality companies pick up even modestly.

(1) Returns are based on market price per Bloomberg L.P. Sector constituents are determined as per the Morningstar U.S. All Taxable ex-Foreign Equity Closed-End Fund Index. The Morningstar All Taxable ex-Foreign Equity Index measures the market-capitalization-weighted total return of taxable equity and fixed income closed-end funds; it excludes international, regional and country closed-end funds. Index returns update frequently and are subject to change.

(2) The S&P 500 Index is an unmanaged index of 500 large capitalization, publicly traded stocks that is frequently used as a general measure of stock market performance.

(3) The Barclays Capital U.S. Aggregate Bond Index includes U.S. government, corporate and mortgage-backed securities with maturities of at least one year. Benchmark returns are shown for comparative purposes only and may not necessarily be representative of the Fund's portfolio.

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Closed End Sector Returns

	Q4 2018		YTD 2018	
	Market	NAV	Market	NAV
Health-Biotech	-15.84%	-14.20%	-5.09%	-2.26%
Energy-Resources	-19.54%	-14.04%	-21.48%	-16.48%
Covered Call	-16.77%	-12.13%	-10.57%	-6.92%
Commodities	7.35%	6.83%	-5.68%	-3.73%
Global Equity Dividend	-14.81%	-9.90%	-16.70%	-9.15%
International Equity	-7.88%	-8.40%	-14.08%	-14.42%
Preferreds	-7.76%	-6.89%	-11.23%	-7.08%
Convertibles	-16.59%	-13.55%	-10.30%	-6.39%
Senior Loan	-9.23%	-5.72%	-6.69%	-1.19%
Municipal High	-4.38%	0.57%	-6.65%	0.97%
Multi-Sector	-10.99%	-4.91%	-1.20%	-0.20%
Investment Grade	-8.69%	-3.58%	-5.78%	-1.71%
State Municipal-Other	0.16%	1.66%	-5.39%	0.31%
Taxable Municipal	1.39%	0.92%	-2.57%	0.01%
Limited Duration	-5.30%	-4.37%	-7.67%	-2.59%
NY State Municipal	-0.20%	1.21%	-6.02%	0.06%
High Yield	-7.89%	-5.61%	-7.74%	-3.29%
CA State Municipal	-0.48%	0.95%	-7.40%	-0.49%
US General Equity	-16.11%	-13.86%	-8.67%	-6.62%
National Municipal	-1.28%	1.07%	-5.39%	0.36%
Equity tax-Advantaged	-19.99%	-14.33%	-14.63%	-10.49%
Global Hybrid (Growth & Income)	-19.19%	-13.15%	-17.88%	-12.43%
Global Income	-3.80%	-1.14%	-5.93%	-2.87%
Global Equity	-18.30%	-14.97%	-6.08%	-7.23%
Mortgage Bond	-1.56%	0.17%	-1.93%	2.73%
Government	-4.95%	-2.25%	-7.52%	-4.41%
US Hybrid (Growth & Income)	-10.77%	-7.74%	-3.00%	-3.86%
Real Estate	-11.96%	-7.95%	-12.94%	-8.06%
MLP	-23.48%	-21.98%	-22.91%	-17.48%
Emerging Market Income	-5.81%	-1.39%	-12.69%	-10.19%
Utilities	-6.13%	-6.58%	-6.83%	-6.64%
Finance	-22.21%	-19.74%	-23.05%	-16.39%
US Equity Dividend	-14.64%	-12.34%	-10.82%	-10.12%

Source: Cohen & Steers.

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