A View of the Convertible Securities Market

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Convertibles, Closed-End Funds and Current Market Volatility

An unfolding credit crisis has affected almost all investments, including equities, bonds, foreign exchange, money markets, and all asset-based securities where leverage is used. Of course, convertible securities and closed-end funds have not been immune to this crisis. As we all know by now, the crisis began when several highly leveraged investment programs stopped working in the wake of the home mortgage crisis. The question on investor's minds is, "What should I do now?" That's why it is essential to step back, remind yourself of your investment goals and why you invested in a particular security. One of the worst mistakes investors can make is to "sell low" in response to the very type of market fluctuations we are experiencing.

Have Convertible Securities been Affected?

The performance of convertible securities has been hurt in this time of high volatility by three major factors:

(1) The suspension of the short sale rules for many financial stocks limited the ability of convertible arbitrage desks (the primary market-makers of convertible securities) to provide liquid markets for many issues.

(2) Many of those same convertible arbitrage desks reduced the capital they were willing to put at risk to make markets in convertible securities.

(3) Many hedge funds that used a convertible arbitrage strategy were forced by their circumstances to unwind positions quickly.

The overall effect of this environment has been to make convertible securities more volatile than history or pricing models would project. The apparent positive side to this volatility is that convertible securities appear to us to have more value than at any time in our experience.

What About CEFs and Leverage?

Closed-end funds use a structure that allows for individuals to invest in financial strategies to fit their investment needs without requiring a large amount of liquid assets to respond to redemption requests. Although the net asset value of most closed-end funds have declined with the markets, the advantage of closed-end funds is that management has not been forced to liquidate securities to meet redemptions. Although neither Bancroft Fund nor Ellsworth Fund uses leverage, the Investment Company Act of 1940 allows investment companies to use leverage if their charter permits. Those that do are restricted to no more than 33.3 cents of debt for every dollar of assets (or 50 cents of senior equity for every dollar of assets), a level many consider to be conservative.

Remember the Track Record

Like all investments during stressful economic times, some strategies work better than others. Bancroft and Ellsworth Funds have weathered multiple business downturns and other challenging times to continue providing investment value.

Volatility Can Create Opportunity

Although market downturns are not desirable, they can create silver linings of opportunity. Dividend reinvesting can help lower average costs by purchasing new shares at lower NAV's. The discount feature can also provide the same benefit in a sense, increasing the value of new shares purchased. And of course, lower prices and discounts can often lead to good buying opportunities for educated investors.

Do Your Homework

Many closed-end funds use different approaches to managing their investments such as leverage and exposure to different economic sectors. These approaches will affect a particular fund's performance and income and should be understood by investors whenever they make a decision to add to or reduce their holdings. Bancroft and Ellsworth Funds do not use leverage and invest primarily in convertible securities to meet their total return objective. The fact that past performance is no guarantee of future returns makes it even more important to take some time to get and study the prospectus and other information available on these investments. It will be time well spent and can help make for better investment decisions.