

# Closed-end fund update

## Update on Convertible Funds: Asset Composition

Lead Analyst  
Sangeeta Marfatia

### Highlights

- In recent weeks we have seen pressure from several directions on the convertible funds we cover. This note provides an update on these funds and a breakdown of the assets in them. This will help in understanding the recent weakness in the funds' prices and net asset values.
- We cover three convertible funds -- NCV, NCZ and CHI -- and the CSQ total return fund, all of which have exposure to convertible and high-yield securities. Convertible securities holdings include both convertible bonds and convertible preferreds (see Table 2 for the breakdown).
- Recent weakness in the underlying preferred securities market since the proposed plan regarding of Fannie Mae and Freddie Mac and the downgrade of their preferred securities by the rating agencies have led to weakness in the preferred market overall. This has put pressure on the convertible preferred holdings of the funds. The pullback in the equity markets also hurt convertible bond prices.
- As of yesterday's close, convertible funds were trading at a 3% discount, with a yield of almost 13 percent. We believe the dividends are stable at this level based on the current yields on NCV, NCZ and CHI.
- CSQ is trading at a 12% discount versus its 52-week average discount of 10% and yielding 11.4%. The decline in NAV is largely due to the weakness in equities and convertible securities in the portfolio.
- **Action:** Our top picks in the taxable sector are the two non-leveraged Putnam funds listed below (see Table 3 for the asset breakdown). These funds have recently increased dividends and trade at attractive valuations.

**Table 1: Convertible Funds Asset Composition**

Ticker	Convertible	High-Yield	Other
CHI	35%	54%	11%
NCV	54	41	5
NCZ	55	41	4
CSQ	24	22	52 (47 stock))

Source: Fund Reports and UBS

**Table 2: Convertible Holdings Breakdown**

Ticker	Bonds	Preferreds	Synthetic Preferreds
CHI	19	14	2
NCV	9	45	-
NCZ	9	46	-
CSQ	11	10	3

Source: Fund Reports and UBS

**Table 3: PIM and PPT Asset composition**

Ticker	High-Yield	US Govt Securities	Int'l/Emerging Mkts
PIM	34	46	20
PPT	31	46	23

Source: Fund Reports and UBS

**Table 4: Coverage Universe**

Fund Name	Ticker	Rating	Price	NAV	Premium (Discount)	Dividend	Yield
Calamos Convertible Opport & Income	CHI	Hold	\$13.34	\$13.30	0.3%	\$1.68	12.6%
Nicholas-Applegate Convertible& Inc	NCV	Hold	\$10.94	\$11.28	-3.0%	\$1.50	13.7%
Nicholas-Applegate Convertible&Inc Fd II	NCZ	Hold	\$10.61	\$11.11	-4.5%	\$1.43	13.4%
Calamos Strategic Total Return Fund	CSQ	Buy	\$10.80	\$12.27	-12.00%	\$1.23	11.4%
Putnam Master Intermediate Income Trust	PIM	Buy	\$5.92	\$6.44	-8.1%	\$0.54	9.1%
Putnam Premier Income Trust	PPT	Buy	\$5.88	\$6.54	-10.1%	\$0.52	8.8%

Source: Bloomberg and UBS as of July 28, 2008

**Statement of Risk**

Both credit risk and interest rate risk exist for the funds we cover. Market risk is also a factor since closed-end funds can and do trade above or below their NAVs.

**Appendix**

Terms and Abbreviations	
Terms / Abbreviation	Description / Definition
Closed-End Fund	A closed-end fund (CEF) is a publicly traded investment company registered under the SEC Investment Company Act of 1940. Capital is raised through an IPO and the proceeds are invested in securities as determined by the investment objectives set by the particular fund's prospectus. The shares of a CEF trade on major exchanges such as NYSE and AMEX.
Net Asset Value	Net Asset Value (NAV) = (total assets – total liabilities)/shares outstanding. The NAV of a CEF fluctuates as the value of the underlying portfolio changes.
Market Price	As CEFs are publicly traded securities, the market price of a CEF fluctuates depending on the supply and demand in the market.
Discount/Premium	<p>When demand exceeds supply, CEFs trade at a premium to the NAV. When supply exceeds demand, the shares of the CEF may trade at a discount to its NAV (i.e., the share price will be less than the fund's NAV).</p> <p><i>Example:</i></p> <p>Market Price:   USD 9</p> <p>NAV:            USD 10</p> <p>Discount:       10%</p> <p>Premium/discount = (market price/NAV) -1</p>
Leverage	Many funds use leverage to enhance income and returns to shareholders by borrowing capital at a lower rate (possibly by issuing senior securities such as preferred stock or debentures) than the fund's earnings on investments.
Duration	Duration is a rough measure of a bond's sensitivity to changes in interest rates.
Qualified dividend income (QDI)	Some or all of the fund's dividend income qualifies for the reduced dividend tax rates to individuals and is set to expire on 31 December 2010.

## Appendix

### Required Disclosures

#### Analyst Certification

Each research analyst primarily responsible for the content of this research report, in whole or in part, certifies that with respect to each security or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about those securities or issuers; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that research analyst in the research report.

If the date of this report is not current, the investment opinion and contents may not reflect the analyst's current thinking.

For a complete set of required disclosures relating to the companies that are the subject of this report, please mail a request to UBS Wealth Management Research Business Management, 1285 Avenue of the Americas, 13th Floor, Avenue of the Americas, New York, NY 10019.

UBS Securities LLC is a subsidiary of UBS AG and an affiliate of UBS Financial Services Inc.  
UBS Financial Services Inc. is a subsidiary of UBS AG.

## Appendix

### Stock Recommendation System

Analysts provide two ratings, an absolute rating and a relative rating. The absolute rating is based on the current Estimated Fair Value Range (EFVR) for the stock and the recent trading price for that stock. The relative rating is based on the stock's total return potential against the total estimated return of the appropriate sector benchmark over the next year.

The EFVR is the price range within which the analyst estimates the stock to be fairly valued. The estimation of the EFVR is based on methods such as discounted cash flow valuation or valuation multiples comparison. In the definition of the EFVR analysts take into account the risk profile (predictability) of the stock.

#### Absolute Stock Rating System

##### Buy

We believe the stock is undervalued relative to current market prices.

##### Hold

We believe the stock's current market valuation is within a fair range.

##### Sell

We believe the stock is overvalued relative to current market prices.

##### Under review

Upon special events that require further analysis, the stock rating may be flagged as "Under review" by the analyst.

##### Suspended

If data is not valid anymore, the stock rating may be flagged as "Suspended" by the analyst.

##### Restricted

Issuing of research on a company by WMR can be restricted due to legal, regulatory, contractual or best business practice obligations which are normally caused by UBS Investment Bank's involvement in an investment banking transaction in regard to the concerned company.

#### Industry Sector Relative Stock View

Outperform (OUT)	Expected to outperform the benchmark
Marketperform (MKT)	Expected performance in line with the benchmark
Underperform (UND)	Expected to underperform the benchmark

#### Current WMR Global Rating Distribution

Buy	27%** (48%*)	Outperform	32%*** (53%*)
Hold	62%** (54%*)	Marketperform	46%*** (46%*)
Sell	2%** (44%*)	Underperform	12%*** (45%*)

\*Percentage of companies within this rating for which investment banking services were provided by [UBS AG or UBS Securities LLC] or its affiliates within the past 12 months Source: UBS WMR, as of 1 June 2008

\*\* At present, not all securities in WMR's global coverage universe have been assigned an Absolute Stock Rating in a Corporate Report. The Absolute Stock Rating distribution calculation includes only securities that have been assigned an Absolute Stock Rating as of the last month-end.

\*\*\* Under our Industry Sector Relative Stock View system, "Outperform" most closely corresponds with a "Buy" recommendation, "Marketperform" most closely corresponds with a "Hold" recommendation, and "Underperform" most closely corresponds with a "Sell" recommendation.

### UBS Closed-End Funds Ratings: Definitions and Allocations

UBS Financial Services Rating	Definition and Criteria	% of companies under coverage with this rating	% for which IB services have been provided
Buy	Higher stability of principal and higher stability of dividends	36	38
Hold	Potential loss of principal, lower degree of dividend stability	61	31
Sell	High potential for loss of principal and dividend risk	3	33

Source: UBS WMR, as of 17 July 2008

## Appendix

### Disclaimer

In certain countries UBS AG is referred to as UBS SA. This publication is for our clients' information only and is not intended as an offer, or a solicitation of an offer, to buy or sell any investment or other specific product. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situation and needs of any specific recipient. We recommend that recipients take financial and/or tax advice as to the implications of investing in any of the products mentioned herein. We do not provide tax advice. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. Other than disclosures relating to UBS AG, its subsidiaries and affiliates, all information expressed in this document were obtained from sources believed to be reliable and in good faith, but no representation or warranty, express or implied, is made as to its accuracy or completeness. All information and opinions are current only as of the date of this report, and are subject to change without notice. This publication is not intended to be a complete statement or summary of the securities, markets or developments referred to in the report.

Opinions may differ or be contrary to those expressed by other business areas or groups of UBS AG, its subsidiaries and affiliates.

**UBS Wealth Management Research (UBS WMR)** is written by, and intended for use by clients of, UBS Global Wealth Management and Business Banking. **UBS Investment Research** is written by UBS Investment Bank. The research process of **UBS WMR** is independent of **UBS Investment Research**. As a consequence research methodologies applied and assumptions made by **UBS WMR** and **UBS Investment Research** may differ, for example, in terms of investment horizon, model assumptions, and valuation methods. Therefore investment recommendations independently provided by the two UBS research organizations can be different.

The analyst(s) responsible for the preparation of this report may interact with trading desk personnel, sales personnel and other constituencies for the purpose of gathering, synthesizing and interpreting market information. The compensation of the analyst(s) who prepared this report is determined exclusively by research management and senior management (not including investment banking). Analyst compensation is not based on investment banking revenues, however, compensation may relate to the revenues of UBS Global Wealth Management and Business Banking as a whole, of which investment banking, sales and trading are a part.

At any time UBS AG, its subsidiaries and affiliates (or employees thereof) may make investment decisions that are inconsistent with the opinions expressed in this publication, may have a long or short positions in or act as principal or agent in, the securities (or derivatives thereof) of an issuer identified in this publication, or provide advisory or other services to the issuer or to a company connected with an issuer. Some investments may not be readily realisable since the market in the securities is illiquid and therefore valuing the investment and identifying the risk to which you are exposed may be difficult to quantify. UBS relies on information barriers to control the flow of information contained in one or more areas within UBS, into other areas, units, groups or affiliates of UBS. Some investments may be subject to sudden and large falls in value and on realisation you may receive back less than you invested or may be required to pay more. Changes in foreign currency exchange rates may have an adverse effect on the price, value or income of an investment. Past performance of an investment is not a guide to its future performance. Additional information will be made available upon request.

All Rights Reserved. This document may not be reproduced or copies circulated without prior written authority of UBS or a subsidiary of UBS. UBS expressly prohibits the distribution and transfer of this document to third parties for any reason. UBS will not be liable for any claims or lawsuits from any third parties arising from the use or distribution of this document. This report is for distribution only under such circumstances as may be permitted by applicable law. The securities described herein may not be eligible for sale in all jurisdictions or to all categories of investors.

**UK:** Approved by UBS AG, authorised and regulated in the UK by the Financial Services Authority. A member of the London Stock Exchange. This publication is distributed to private clients of UBS London in the UK. Where products or services are provided from outside the UK they will not be covered by the UK regulatory regime or the Financial Services Compensation Scheme. **USA:** Distributed to US persons by UBS Financial Services Inc., a subsidiary of UBS AG. UBS Financial Services Inc. accepts responsibility for the content of a report prepared by a non-US affiliate when it distributes reports to US persons. All transactions by a US person in the securities mentioned in this report should be effected through a US-registered broker dealer affiliated with UBS, and not through a non-US affiliate. **Canada:** In Canada, this publication is distributed to clients of UBS Wealth Management Canada by UBS Investment Management Canada Inc.. **Germany:** Issuer under German Law is UBS Deutschland AG, Stephanstrasse 14 - 16, 60313 Frankfurt am Main. **Bahamas:** This Publication is distributed to private client of UBS (Bahamas) Ltd and is not intended for distribution to persons designated as a Bahamian citizen or resident under the Bahamas Exchange Control Regulations. **Hong Kong:** This publication is distributed to clients of UBS AG Hong Kong Branch by UBS AG Hong Kong Branch, a licensed bank under the Hong Kong Banking Ordinance and a registered institution under the Securities and Futures Ordinance. **Singapore:** Distributed by UBS AG Singapore Branch, an exempt Financial Adviser under the Singapore Financial Advisers Act. **Australia:** Distributed by UBS Wealth Management Australia Ltd (Holder of Australian Financial Services Licence No. 231127), Chifley Tower, 2 Chifley Square, Sydney, New South Wales, NSW 2000.

© UBS 1998-2008. The key symbol and UBS are registered and unregistered trademarks of UBS. All rights reserved.