

INVESTOR EXPRESS

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Closed-End and Exchange-Traded Funds Compared

Many investors use equity closed-end funds (CEFs) as core holdings to help them reach their long-term investment goals, yet many are considering adding exchange-traded funds (ETFs) to their portfolios. Once primarily the province of institutional investors, ETFs are becoming more popular with individual investors. Although CEFs have been part of the investment mix for years, ETFs are relatively new investment instruments that have some similarities to CEFs as well as some differences.

Both ETFs and CEFs are bundles of securities traded on an exchange (thus both are exchange-traded funds). Both are continuously priced throughout the trading day, and their market prices are determined by supply and demand. ETFs and CEFs permit investors to take advantage of different types of trading strategies, such as short selling, buying on margin, and limit orders. And ETFs and many CEFs carry low expense ratios, which can increase returns for investors.

The major difference is that, at present, ETFs are passive investment vehicles designed to track closely to the performance of an index or other benchmark, while CEFs are actively managed portfolios. For actively managed CEFs, such as Adams Express and Petroleum & Resources, the investment manager makes the portfolio selection with the objective of outperforming, rather than just tracking, an appropriate index or benchmark. In the hands of an experienced portfolio manager, active management can produce above market returns and higher dividend yields, while passively managed ETFs are designed to match the returns and yields produced by the index. Because ETFs are based on discreet indexes, CEFs usually offer more portfolio diversity, thus reducing risk and volatility.



Another difference is how ETFs are bought and sold. For most individual investors, ETF shares are bought and sold on the secondary market through their broker, just as CEFs typically are. Many CEFs, on the other hand, are available for direct purchase through a transfer agent in addition to broker-conducted transactions. Institutions and very wealthy individuals, however, have the ability to deal directly with the ETF and to invest by delivering to the fund a basket of shares of stock of the companies in the ETF's portfolio in return for "creation units" that are converted into shares of the fund, typically in blocks of around 50,000 shares. When these investors want to redeem (sell) their "creation units", the basket of stocks are taken out of the ETF portfolio and delivered to the investor.

Because of their structure and the impact of institutional investor transactions in "creation units" just described, ETF share prices tend to trade at net asset value, and do not deviate significantly from the value of their portfolios' underlying securities; CEFs tend to trade either at discounts or premiums to the underlying net asset value of the funds.

ETFs also can provide an interesting portfolio option. However, CEFs are clearly designed for a broader range of investors—especially individual buyers.

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Petroleum
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Anniversary Archive— Family Owns Adams Express Company Shares for Nearly 130 Years



Although some families can trace ownership of a particular stock for two or maybe three generations, Adams Express can proudly claim at least one family that can trace ownership to four generations. The Cyr family has owned shares of Adams Express for close to 130 years.

“We don’t know the exact date, but we do know that my great-great-grand Uncle John Chatterton, who owned a feed mill in Rutland, Vermont, purchased 400 shares shortly after the Civil War,” explains Howard Cyr Jr., of Palmerton, Pennsylvania. “It was not a lot by today’s standards, but [he] saw the wisdom of investing for the long term. When he passed away, the shares passed on to my great-grand Aunt Sarah Chatterton, who bequeathed her shares to my great Aunt Lucy Cyr, under the proviso that she could live off the dividend, but would pass the shares on to the next generation—which included six nephews and nieces. That’s how my father, Howard Sr., came to own 44 shares of Adams Express stock and how we got our shares.”

The family tradition continues, with the current generation of Cyrs retaining their shares and seeing their stake in Adams Express grow. According to Howard Jr., “We’ve purchased additional shares and reinvested our dividends. From time to time, we’ve used the dividends to help with college education—we have six children. We’ve been loyal to Adams Express because we like the low internal management costs and the advantages of a closed-end fund. They have never let us down.”

What You Should Know About Portfolio Turnover Ratio

Investors should pay close attention to portfolio turnover ratios because they can be a good indicator of fund managers’ investment philosophy. Conservative managers, who maintain a long-term investment strategy, typically will have lower turnover ratios than will their aggressive counterparts, who traditionally trade more on short-term factors.

What exactly is a portfolio turnover ratio? It is the percentage of the fund’s assets that are bought and sold in a 12-month period. For example, if a \$100 million fund sells \$30 million of its stocks and then buys another \$30 million in other securities, that fund has a 30% portfolio turnover ratio. Thus, actively managed funds tend to have higher turnover ratios than do those that are not actively managed, such as index funds.

Most long-term investors require a fund to have a low turnover ratio, says Dennis Genord, manager of mutual fund education for BetterInvesting, a community of individual investors. “We encourage our members to look for funds with turnover ratios around 20%—because it means the fund manager has picked prudently and is holding on to shares for the long term.”

Mr. Genord points out that many funds exhibit extremely high turnover ratios, well in excess of 100%. Aside from generating transaction costs, which affect shareholders’ ultimate returns, high

turnover ratios could indicate that a fund manager is trying to cover for mistakes. Mr. Genord says some fund managers engage in “window dressing” to blunt criticism for poor performance of the portfolio by selling stocks with large losses and buying high-flyer stocks to improve the appearance of the portfolio before reporting to fund shareholders. “This practice allows the manager to blame the market indirectly for the fund’s results if they are not up to expectations,” Mr. Genord explains.

What about Adams Express and Petroleum & Resources—what are their turnover ratios? According to Doug Ober, fund manager for both companies, “Our turnover ratios tend to average 13–15% by design.”

“In both ADX and PEO, our goal is to be able maintain our position in a company for 7 to 10 years, because we believe in a long-term strategy. To achieve that goal, we are careful to pick stocks that we think will perform accordingly. That means high-quality companies with solid management in market segments that have a history of consistent success. That philosophy has allowed us to generate consistent returns at very low cost to our shareholders,” Mr. Ober said. “We are not averse to changing our position in a company if we feel we are overexposed or if the company is not performing like we thought it would, but generally, we think our long-term investment strategy, and the resulting low turnover ratio, is the way to go.”

Give the Gift of Shares This Holiday

With the holidays right around the corner, it’s time to put that gift list together. Might we suggest some shares of Adams Express or Petroleum & Resources? A gift of shares in either fund should appreciate—and be appreciated—now and in the future. You can help a young person pay college tuition or help that young couple start a nest egg. Give some shares to a friend who warrants a special thank you.

You can buy shares through a registered investment security dealer, such as your broker, or directly through American Stock Transfer & Trust Company (AST), the transfer agent for the Companies. AST’s

Direct Purchase Plan allows registered stockholders and interested first-time investors to buy and sell shares and to reinvest dividends and capital gains automatically.

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Forward-Looking Statements

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