

Fund banks on Cuba

A Miami-based closed-end fund focusing on companies that may eventually benefit from trade ties with Cuba produced high returns, as investors bet change is coming soon to the communist island.

The Miami Herald
Jan. 05, 2007

Miami investment advisor Thomas J. Herzfeld created his closed-end fund for the day -- near or distant -- when political change opens Cuba to investment.

But it's doing just fine in the meantime.

Shares of the Herzfeld Caribbean Basin Fund, which trades on the Nasdaq index under the ticker **CUBA**, rose 124 percent in the past year, according to the Closed-End Fund Association. That makes the fund the No. 2 performer among 673 peers. Only the Greater China Fund fared better, with a 167 percent return, according to the trade group.

The small fund, which has assets of about \$14 million, scouts for companies with ties to Florida and the Caribbean that will do well without a change in Cuba but will likely get a boost once the embargo ends.

"We have no interest in violating the embargo," says Herzfeld, chairman of the fund, which he launched in 1994. "We needed to develop a strategy in the period in between when we raised the money and when the embargo is lifted."

The fund will enter its second phase when the embargo ends, which Herzfeld thinks may be soon. "I don't think Castro will live very long, and I don't think the embargo will survive him," says Herzfeld, an expert on closed-end funds whose main business, Herzfeld Investment Advisors, manages \$100 million in assets in closed-end funds for institutional investors. Those portfolios rose 19.6 percent last year.

Herzfeld says he's in talks with South Florida investors, mostly Cuban Americans, about joint ventures the fund could pursue when the island opens up.

The big rise in the share price last year -- amid widespread speculation Fidel Castro won't live long -- reflects investors' enthusiasm in grabbing a piece of the action if Cuba opens up.

A closed-end fund invests in a basket of securities -- just like the more common open-end mutual funds -- but has a fixed number of shares. As a result -- based on demand -- a closed-end fund can trade above or below its net asset value, or NAV, the net value of the investments in the fund divided by the shares.

MORE FOR THE MONEY

For much of 2006, shares of the fund were trading at a discount to NAV -- meaning investors buying shares were getting a basket of stocks worth more than they were paying. But since last fall -- with rising speculation that Castro is close to death -- the fund has been trading at a premium to its NAV.

So while its share price soared 124 percent last year, its return on NAV was a more modest 15.3 percent.

On Jan. 3, the fund closed at 92 percent above its NAV, according to CEFA, the second highest premium of any closed-end fund it tracks.

Meanwhile, the fund's chairman, Herzfeld, has reduced his stake in the fund several times in recent months, paring his holdings to 13,424 shares as of Dec. 28 from 63,375 in May.

Herzfeld says his sales were driven by estate and financial planning. "I was the first shareholder when I was in my 40s, and now I'm 62," he said.

Some closed fund experts say the big premium makes the fund expensive -- and potentially risky.

"I would much rather invest directly in the companies that I believe would benefit from the eventual removal of Fidel Castro," says Jon White, the chief investment officer at Beacon Hill Financial, an Orlando-based money management firm. "This would include resort companies, hotels, cruise ships and other service industries with an emphasis on those based in the Miami area."

NICHE APPEAL

Still, investors are willing to pay up for the fund's peculiar niche.

"The high premium would be a concern, but the price is because there is no good alternative for one-touch investing in Cuba," says Herb Blank, a closed-fund expert who is director of institutional services for Amba Research in New York, which provides investment research to institutions. The fund's investments are mostly well-known names to Floridians. Last year, its biggest holding was Florida East Coast Industries, whose shares rose about 41 percent. Herzfeld says the Jacksonville-based company, which operates Florida East Coast Railway and has real estate holdings, is poised to gain when Cuba opens because of all the goods to be transported. The rail gauge in the United States and Cuba match, he adds, "so it's very easy to operate a rail barge."

Shares of Consolidated Water, a Cayman Islands-based operator of seawater desalinization plants that the fund has invested in, climbed 26 percent last year.

Other big holdings in the fund are Miami-based cruise operators Carnival Corp. and Royal Caribbean Cruises, which he thinks will hit the jackpot when they can sail to Cuba. However, the cruise operators' stocks got hammered by high fuel prices and weak prices for Caribbean cruises in 2006. If Cuba opens up, Herzfeld has plans to launch another fund, called the Cuba Fund, which would focus on direct investments in Cuba.

He's regularly been updating a registration statement with the Securities and Exchange Commission since 1994 to be ready to move when the time comes. He declined to discuss the future fund, saying there is no prospectus out, but notes: "That will be a much larger fund."