CASE EIGHT

The Gabelli Utility Trust*

"I personally think the premium is unsustainable. It's off the wall."

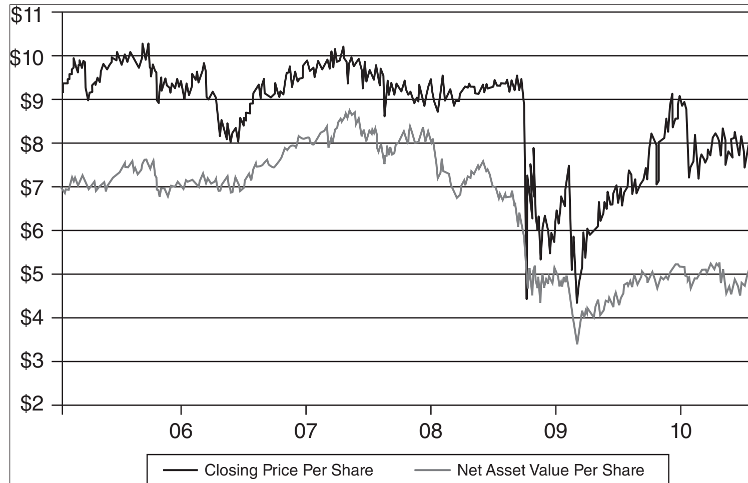
In early 2010, nobody was more puzzled about the price of The Gabelli Utility Trust (henceforth GUT) than its manager and namesake, Mario Gabelli. He made the quote above in a *Wall Street Journal* article published on February 20, 2010, when GUT traded at a premium of almost 70 percent to its net asset value. Yet despite Gabelli's quote, GUT continued to trade close to this premium over the following months.

Shares in investment funds like GUT that hold publicly traded securities are among the most straightforward securities to value. Recent prices of the securities that are held in these funds are usually readily observable and so shares in such a fund can be valued by summing the market values of the fund's investments and dividing by the fund's shares outstanding. The resulting amount is termed the "net asset value" of a share in the fund. So-called open-ended funds stand ready to redeem the shares of old investors or issue shares to new investors at net asset value. But so-called closed-end funds, such as GUT, do not. Instead, their existing shares are traded on securities exchanges at prices set by the investing public. In an efficient market, one would expect these prices to closely track the fund's net asset value. Yet GUT provided a glaring exception to this rule. GUT's premium to net asset value from January 1, 2005 to August 1, 2010 is shown in Figure 1.

GUT's investment objective is long-term growth of capital and income through common equity investments primarily in the utilities and energy sectors. The Fund's portfolio manager, Mario J. Gabelli, is a widely recognized manager and frequent commentator on CNBC and CNN. One unique feature of GUT is its generous managed distribution policy. Since 2003, GUT had maintained a regular monthly distribution of 6 cents/share. By early 2010, this represented an annual distribution rate of 14 percent on net asset

*This case was prepared by Assistant Professor Panos Patatoukas and Professor Richard Sloan as the basis for class discussion, rather than to illustrate either effective or ineffective handling of a business situation.

FIGURE 1
Closing Price and Net Asset Value for GUT



value and 9 percent on price. Further information concerning GUT's financial position at this time is provided in its 2009 annual report, available at www.lundholmandsloan.com.

QUESTIONS

1. It is well-established that the average closed-end fund sells at a small discount to its net asset value. Provide a potential explanation for this phenomenon.
2. Unlike most other closed-end funds, in early 2010, GUT was trading at a premium of almost 70 percent to its net asset value. Think of potential reasons why investors were willing to pay such a high premium for GUT's shares. As a starting point consider the following:
   a. Performance of GUT relative to a reasonable benchmark, and
   b. GUT's ability to create shareholder wealth through its managed distribution policy.
3. Based on your response(s) to the previous question, what type of events/outcomes would you expect to trigger a reduction in GUT's premium?
4. Describe an investment strategy that could be used to exploit the potential overpricing reflected in GUT's hefty premium. What might be the main obstacles to the practical implementation of this strategy?