BRECKINRIDGE CAPITAL ADVISORS

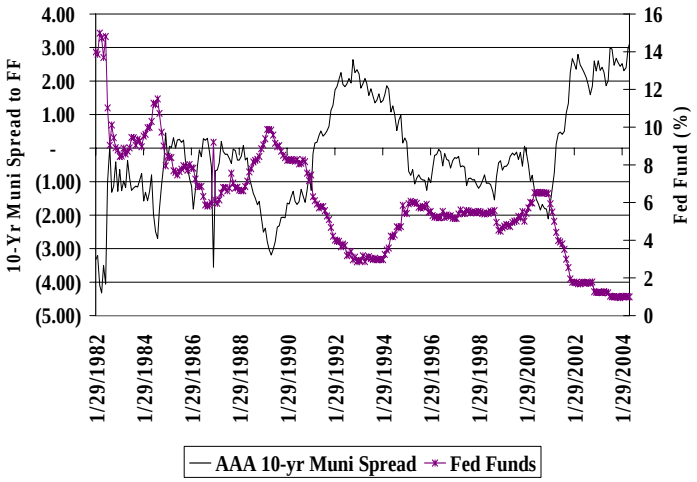
May 2004

In early May, the municipal market continued to sell off, with 10-year municipal yields rising as much as 27 basis points. The target duration for accounts was extended to a more neutral stance as we felt the market was oversold. We also began to reinvest the large 6/1 maturity in mid-May. By month-end the 10-year municipal yield had dropped back 30 basis points to finish the month slightly lower than the end of April. The major change in the yield curve came in the one-year maturity bonds, which saw rates raise 26 basis points over the month. The flatter yield curve we are positioned for began to take shape as the 1-10 year spread fell by 29 basis points during the month.

When the Federal Reserve Board meets at the end of June, the market is expecting the first of several increases to bring the Fed Funds rates back in line with the growth of the economy and potential inflation. The chart below tracks the spread of a 10-year municipal bond over the Fed Funds rate. We are currently at the highest spread in the last twenty years. The 10-year municipal bond has historically priced at 0.30% less than Fed Funds. With the ten-year at 4.11%, the market implies an average Fed Funds rate of 4.41%. If the Federal Reserve moves to increase rates, we would expect intermediate municipal yields to increase more slowly than taxable bonds.

Our strategy has been modified to a short-neutral duration, barbelled portfolio. In addition, we have purchased California bonds in National and lower-tax states at comparatively wide spreads. We believe this a temporary market aberration that will normalize as the economy recovers. In addition, we have moved our minimum target coupon from 5% to 5.25% for maturities longer than seven years (see "Market Discount Rules").

Spread to Fed Funds



Market Discount Rules

Traditionally, municipal bonds are priced at new issue at par. After the initial issue of the bonds, the prices of bond vary based on the level of interest rates. As interest rates rise, the prices of bonds will decrease and what were par bonds will trade at a discount. Once the discount exceeds the "de minimus" level, the accretion of the discount to the maturity value is treated as ordinary income. Note that the accretion of the discount is taxable as ordinary income even if the bond is sold for a capital loss prior to maturity.

Market discount bonds trade at higher market yields but much lower after-tax yields. For example, in trading of AAA non-call bonds maturing in 2014 on May 27, the average tax-adjusted yield for market discount bonds was 3.97% while par bonds traded at an average yield of 4.05% and premiums traded at an average yield of 4.21%. The market discount was $110 per bond. At an ordinary income tax rate of 36% at maturity, the owner of the 3% bond would owe $40 per bond in taxes on the accreted value. In this case, a market yield of 4.30% would have an after-tax yield of 3.97%, significantly less than the par or premium bonds at maturity.

Total Returns for Yield Changes to Jan. 05

Coupon	**3.00%**	**4.00%**	**5.00%**	**5.50%**
Maturity	**7/1/2014**	**7/1/2014**	**7/1/2014**	**7/1/2014**
Market Yld	**4.30%**	**4.05%**	**4.19%**	**4.21%**
After-Tax	**3.97%**	**4.04%**	**4.19%**	**4.21%**
-25 bp	4.49%	4.31%	4.58%	4.71%
+0 bp	2.02%	2.41%	2.78%	2.95%
+25 bp	-0.48%	-0.07%	0.90%	1.09%
+50 bp	-2.90%	-2.41%	-0.94%	-0.72%
+75 bp	-5.24%	-4.68%	-2.73%	-2.49%
+100 bp	-7.15%	-6.88%	-4.62%	-4.22%

In a rising yield environment, par bonds will drop into the market discount rules. The chart above tracks the total returns for discount, par and premium bonds over changes in yields through year-end. Premium bonds have a clear advantage in after-tax yield and market value stability when interest rates are rising or falling moderately.