

August had an unexpected turn with a weak July employment report and oil prices at historically high levels. The market is now seeing oil as an anchor to economic growth. The bond market had remarkable returns with the 5-year indices rising 1.74% to 1.75%. During the month, secondary trading dropped by over 30% according to the MSRB reports. This made it very difficult to buy bonds at reasonable levels for much of the month.

We continue to hold our positions slightly short and with a maturity barbell anticipating generally rising rates and a flatter yield curve. Since the February peak, 5-year municipal yields rose 40 basis points. Over the same period, one-year yields rose 48 basis points and 10-year yields rose 18 basis points, progressing toward the flatter yield curve we expect over the next twelve months.

Breckinridge Bond Selection

Bond selection at Breckinridge is based on the individual needs of the portfolio. We review each portfolio and compare the holdings to the owner's goals and our current strategy. Portfolio managers share the oversight of all accounts to maintain a fresh set of eyes analyzing each portfolio. If any trading is needed, the portfolio manager informs the traders of the maturity and type of credit needed through an inquiry report that lists each individual account and its current needs. Our trading desk is in contact with over 150 broker-dealers. They review offerings and bid items to find the right bonds at the right price.

For 2004, we have focused on purchasing a maturity barbell, as seen by our 2004 purchases for selected intermediate portfolios. The pattern shows we are flexible to market opportunities. We actively seek out bonds that may not fit perfectly but represent great value. This approach allows us to be flexible enough to take advantage of market inefficiencies.

Credit Quality

Our credit analysts review all bonds held in Breckinridge portfolios. We have credit analysts who review credit developments and make recommendations on credits and sectors. We use an internal rating system that is different from the agencies due to factors such as:

1. Healthcare credits are rated on a scale to adjust for credit agency lags in the sector.
2. Bond liquidity is given more weight.
3. General obligation debt is given higher ratings because they represent more security.

Sector Distribution

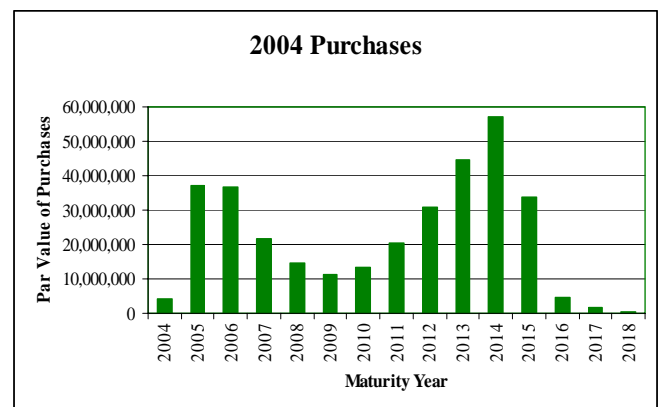
We focus on General Obligation, Essential Service Revenue and, when they represent unusual value, Pre-refunded bonds from quality issuers. General obligation bonds have the best track record for safety. With full taxing authority to back bonds, these issues have the support of potential tax increases and community property. Essential service revenue bonds include water, sewer, transit, and other municipal services that are needed to maintain population safety. As the name implies, these services are necessary and generally supplied by the local government as a monopoly. Pre-refunded bonds are municipal bonds that have been escrowed with US Treasuries or Agencies. We focus on these sectors because the credits tend to have strong, predictable cash flows.

Bond Structure

We analyze the market to determine the best value for structure in the market. Primary market municipal bonds generally are issued with 10-year call protection. In the secondary market, there are a variety of coupons, calls, sinking funds and maturities. We continuously reevaluate the various structures, together with our outlook for interest rates, to determine the best bond structures to buy. We are currently focused on non-call, premium coupon structures because we believe there is significantly more market risk in callable bonds and low coupon bonds when interest rates rise.

Pricing

Last month¹ we focused on the relative value of our bond selection compared to the trades reported by the Municipal Securities Rulemaking Board (MSRB). We search for bonds that are priced too cheaply in the market. This means we will often buy single pieces for portfolios because there are many opportunities in small trades. Please see last month's write up on our success with this strategy.



¹ See www.bondinvestor.com for Outlook, July, 2004