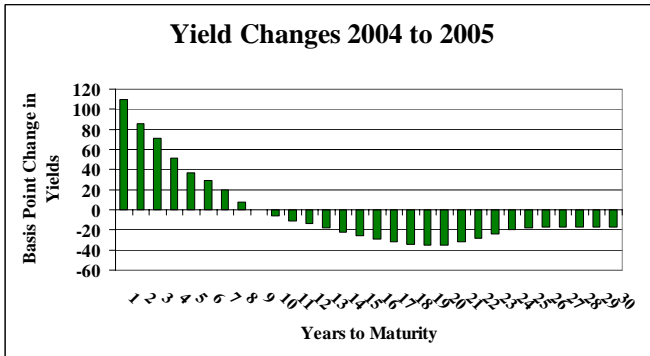
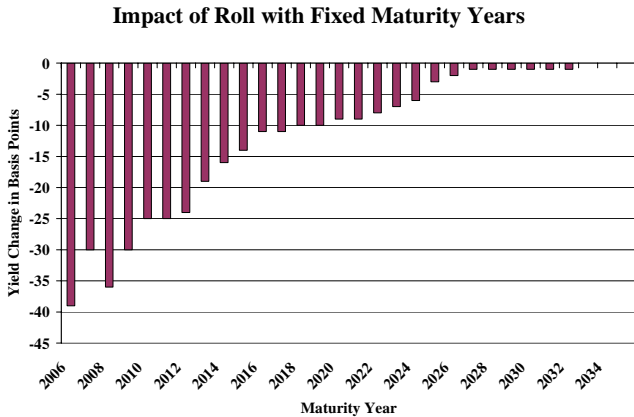


January 2005

In January, municipal bonds yields flattened significantly. The first chart below shows the last twelve month change in yields for years to maturity. The change in yields reflects the significant flattening of the yield curve with one-year bond yields rising 110 basis points and ten-year bond yields falling 6 basis points. The relative returns of the barbell strategy were very strong versus the return indices for most accounts.



The second chart shows the last twelve month yield curve maturity roll for fixed maturity years. For most accounts the roll represents a large positive total return over each twelve month period. The maturity roll simply means a bond maturing in 2007 was a three year maturity in 2004 and a two year maturity in 2005. Since the municipal yield curve is still very steep, the maturity roll means the yield of a bond will drop for the change in years to maturity.



We continue to invest portfolios in a barbelled maturity structure with a slightly short duration compared to the relative index. We believe the yield curve will continue to flatten as short-term rates are increased by the FOMC and longer-term bond yields are more stable in a moderate growth/low inflation economy. The short maturity bonds we purchased in 2004 are now maturing. We are actively reinvesting these bonds in a mixture of one-year and ten-year maturities. The effect of the rebalancing should increase portfolio income compared to last year.

We will continue to reevaluate the portfolio structure as the year progresses and more economic information is available.

Review of the Barbell Strategy

At the beginning of 2004, Breckinridge began rebalancing portfolios to a modified barbell focused on one-year and ten-year maturity bonds. At the time the yield curve was historically steep and ten-year yields offered a significant yield premium over five-year bonds. We established a model trade portfolio which had 25% exposure to 2004-2006 maturities and 30% exposure to 2013-2014 maturities. Because our main concern is after tax returns, we have not pursued the strategy in accounts where the tax liability was more than the expected added value of the trade.

The barbell strategy was built based on the relative performance of one-year and ten-year bonds when the yield flattened. The yield curve is considered flatter when the spread between short maturity and long maturity bonds drops because either short-term yields rise or long-term yields fall. The short-term bonds have lower price volatility, so the price of the bond will tend to be very stable as maturity approaches. Longer-term bonds either increase in price more or fall in value less than intermediate-term bonds.

The Merrill Lynch 3-7 year Municipal Index is typical of the benchmarks for intermediate investors. The index bonds are in a limited maturity range. The chart below shows the cumulative total return difference between the Breckinridge Trade Model and the ML 3-7 Index. Through 2004, the Model total return was about 34 basis points higher than the index. With the strong flattening and maturity roll in January, the cumulative return of the Model jumped to 114 basis points. Breckinridge continues to invest portfolios in a barbell strategy in early 2005 to take advantage of the flattening municipal yield curve.

