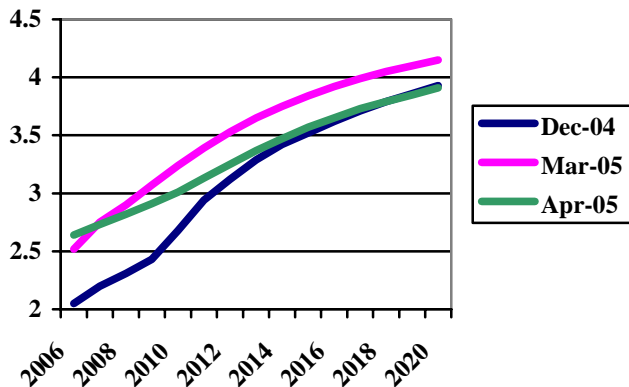


## April 2005

In April, the fixed income markets benefited from weaker economic reports than we have seen in previous months. The month started with a disappointing change in Nonfarm Payrolls that added just 110,000 jobs in March. The notes from the March 22 FOMC meeting indicated that there was more discussion of inflationary risks and potentially more aggressive tightening to slow the economy further. 10-year AAA-Muni bond yields fell from 3.84% to 3.57% by month-end. Short-term yields rose with the higher Fed Funds rates from 2.52% to 2.64%. This flattened the yield curve to levels close to the average for the last 10 years.

### CHART OF AAA GO YIELD CURVES



Source: Thomson Financial Municipal Market Data, 2005

We updated our trading strategy in April in response to the flatter yield curve. We are now rolling into the middle of the curve to rebalance portfolios to a more neutral stance on the shape of the curve. With the municipal 1-10 year maturity spread at the 10-year average, we will begin to unwind the barbell positions in portfolios using short-term maturity bonds and some swaps of longer bonds that have minimal gains. As planned over the last year, the significant number of bonds maturing from the short end of our barbell should provide adequate liquidity to rebalance most portfolios and avoid capital gains.

Our duration strategy is unchanged in that we are short of neutral. As our Outlook has pointed out for the last year, we anticipate that 10-year municipals should hold their value as the yield curve flattens. Now that much of the flattening trade has happened, we will be watching the FOMC actions on Fed Funds. Market economists are predicting a Fed Funds rate of 3.5% to 4.5% by year-end. As short-term rates rise, we think that the yield curve should begin to hold its slope and yields should move up more evenly across the curve. The risks to the market this month are the FOMC meeting notes. Although the Fed Funds rate was raised by 25 b.p. on May 3 to 3%, the

markets will be closely watching the meeting notes due in early June for a better indication of the FOMC outlook. With economic data in April pointing to slower growth, the FOMC did not change its rate change statement about the balance of economic risks.

### Heavy Cash Flows Coming Up

Some investors may question why we are selling such short-term maturities early. We anticipate that demand will be very strong as municipal holders reinvest in June and July and the supply of new issue municipal bonds will fall off in July and August. By moving to reinvest early, we can lock in rates before the demand overwhelms the supply of bonds.

Municipal market cash flows will be very heavy over the next three months. Traditionally, municipal issuers prefer to have bonds mature on January 1 and July 1 to meet calendar and fiscal year-ends. The chart below shows the share of cash flow for each of the next fourteen months. The maturities over the next few months should produce relatively strong performance for municipal bonds. During April, municipal bond yields peaked as a percent of treasury yields because tax payments generally come from municipal bond holders. Typically, municipal yield percentage drops in June and July due to the high demand from maturities and coupon payments. Roughly 1/3 of the annual cash flow from municipal bonds is paid in June, July and August. Supply typically drops off in July and August due to the summer holidays. Breckinridge is looking to swap some of these maturing bonds in May and early June. This is done to take advantage of the historically high issuance in May and June.

### Cash Flow Distribution

