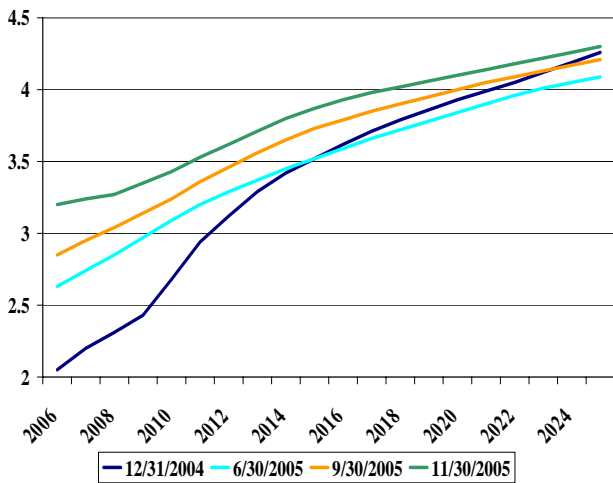


November 2005

In November, the municipal yield curve flattened significantly with one-year yields rising 20 bp to 3.20% and 10-year yields falling 5 bp to 3.87%. The municipal market had a brief rally through late November before GDP growth was reported much stronger, raising the fear that the Fed may continue to raise rates into 2006. The yield volatility of the municipal market has dropped significantly over the last year. Annual yield volatility peaked at 21% in August 2004 and has since fallen to 13%. This means the returns on municipal bonds are more stable than over the past three years. With 10-year yields approaching the high end of the recent trading ranges, we have seen strong support in both the Treasury (at 4.66%) and municipal markets (at 4%) when retail investors move into fixed income.

The municipal yield curve had a significant flattening from December 2004 to June 2005. Since then, the market has moved in a relatively parallel fashion. This pattern allows us to be more balanced in our portfolio allocations and gives us time to reallocate accounts to maximize the value-added of the bonds purchased and sold. We are continuing to change the allocations of portfolios from a barbelled maturity structure to a more balanced maturity structure by focusing on intermediate maturities and opportunistically buying longer bonds on market dips.

MMD AAA-rated GO Yield Curve

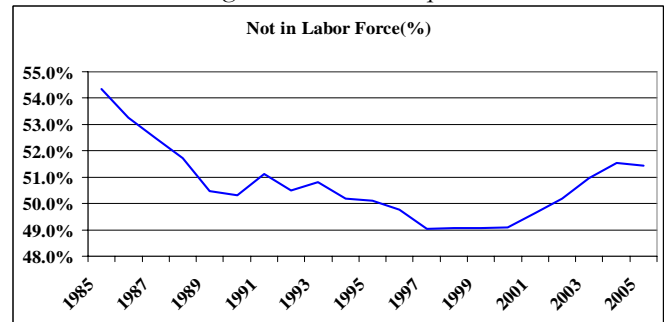


Our portfolios are positioned in a neutral stance over the yield curve. We are favoring six to nine year maturity bonds because we believe there is value when yields approach 4% in this range. Our average quality remains at AAA and heavily weighted in the General Obligation and essential service sectors. Account durations are targeted between 4.00 to 4.40 years to match benchmarks' durations of ~4.20 years.

Where is inflation?

One of the greatest risks in fixed income is the deterioration of purchasing power for fixed income instruments. The topic remains highlighted by the Fed raising rates and upcoming transition from Chairman Greenspan to Chairman Bernanke. Much of the current volatility in the market revolves around the question of whether the Fed is nearly finished raising rates.

In the US, the largest contributor to long-term inflation is wages and salaries implied in the cost of goods. The two main factors that affect the cost of labor are availability of people and productivity. The chart below shows the percent of people 16 years and older who are not in the labor force. Since 1999 roughly 2.5% of the population has left the work force, meaning they are not included in unemployment measures. If all were to return to the labor force, unemployment would be about 7.5%, close to recession levels. Offsetting this is the higher reported productivity of workers. Productivity has been one of the major driving forces in reducing the Unit Labor costs, up less than 1% through the first three quarters of 2005.



The Fed has followed inflation using the Core Personal Consumption Index Prices. This measure is up 1.92% in the last four quarters and excludes changes in Food and Energy prices which tend to be volatile. This measure is currently under the 2% target for inflation that has been implied in Fed comments. If this holds true, the Fed should be approaching a neutral Fed Funds rate. The PCE Index uses the CPI detail information but weighs the prices of goods by the reported volume sales of those goods in computing GDP.

Personal Consumption Expenditures Price Index

