

February 2006

In February, the municipal yield curve was significantly flatter as the one-year yield leapt 15 basis points to 3.35% and ten-year yields fell 3 basis points to 3.75%. The short-end of the curve rose because the Fed raised the Fed Funds rate to 4.50% late in the day on January 31. Similar to the municipal curve, the Treasury curve flattened with short rates rising and, interestingly, the new 30-year Treasury note rallying on heavy demand for longer duration assets. The anticipated heavier supply of Treasury notes and bonds came through, but municipal supply remained very light. Some commentators are now expecting a drop in municipal issuance this year of 33% to 40% from last year's record level of municipal borrowing. The impact of the relatively light municipal supply has been a tightening of the after-tax spreads between municipal bonds and treasury notes. Generally, municipal volume is higher in March and secondary trading should pick up with tax payments due in April.

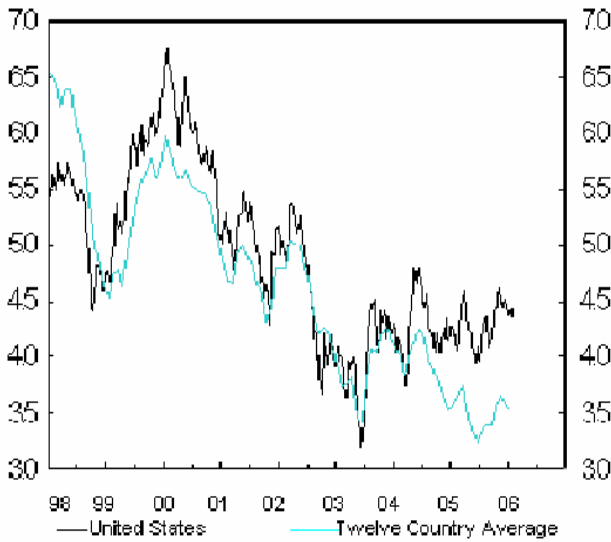
Breckinridge's municipal strategy remains neutral to the benchmark duration with an overweighting in the center of the yield curve. We continue to believe that the fixed income markets will remain stable with yield movement coming from Fed activity in the short-end of the curve. Over the long run, we are looking for the next major yield curve move to a steeper slope in municipal and treasury markets. To prepare for this eventuality, we continue to concentrate investments in the center of the curve to offset some of the risk of a steeper curve.

Taxable Equivalent Yields

Municipal reinvestment yields have been rising over the last three years. A five-year maturity High Grade municipal bond yield has risen from 1.84% in June 2003 to 3.52% in February 2006. During this period, the annualized total return for the Merrill Lynch 3-7 Year Municipal Index has been 1.604%, close to the high grade yield at the start of the period. In an intermediate municipal bond portfolio, it is not uncommon for longer term total return to closely match the beginning yield because coupon income makes up the largest component of the municipal intermediate index total return.

Municipal bond investors tend to be in the highest marginal tax bracket or close to it. In absolute terms, the yield on a municipal portfolio may not seem attractive when compared to taxable investments. It is helpful to look at the yields on a tax-equivalent basis to gain a level view of the returns and the municipal bond tax benefit. The chart below is an analysis of the 5-year AAA yield over the last three years. Over that period, the Taxable equivalent yield has risen from 3% to 5.41%. When evaluating other potential investments, we would suggest looking at the pre-tax equivalent municipal yield to gain a better perspective on the relative returns. We are currently looking to add bonds into portfolios with 4% or higher yields. The taxable equivalent yield for these bonds is 6.15%.

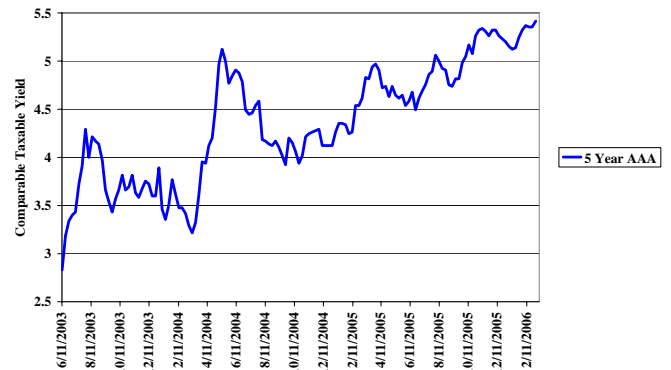
U.S. and Foreign Treasury Bond Yields



Source: George Friedlander Presentation, Citigroup, February 28, 2006.

The chart above was presented by George Friedlander, Municipal Strategist at Citigroup. It compares the yield of U.S. Treasury Notes to a global average of other major treasury markets. His point is that, although we may think interest rates are low, the U.S. market rates are significantly higher than comparable global markets. This explains the continued inflow of foreign investment into the U.S. Treasury market from excess savings in most other economies. This would tend to support the case for stable interest rates until the global interest rate markets come into more balance.

Taxable Equivalent Municipal Yields



* Graph based on 35% Federal Tax Rate