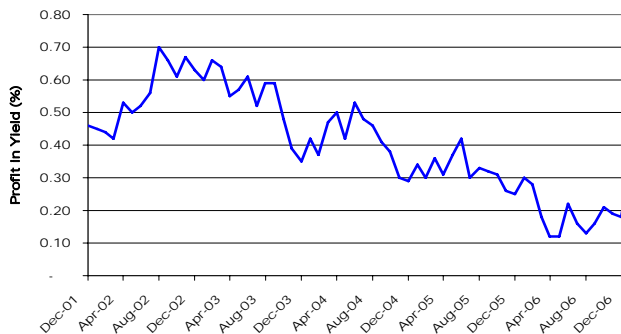


In December, yields rose when the economic reports for the month showed significantly more strength and convinced market participants that the Fed would not adjust rates until late in 2007. The main reports that moved the market were stronger Nonfarm Employment, higher Housing Starts and higher Producer Price Index (PPI) for November. The combination of these raised the estimated rate of growth for the fourth quarter based on more employment and less weakness in housing than anticipated. The PPI report was somewhat discounted because the major rise in prices was derived from cars, small trucks and aircraft. By the end of December all indicators seemed to support the Fed's policy of allowing a 5.25% Fed funds rate to remain unchanged through at least the first quarter of 2007.

For the year, the municipal yield curve continued to flatten. The flattening is partially driven by Tender Option Bond programs and leveraged municipal accounts purchasing long-term municipal bonds and issuing floating rate debt. The accounts were taking advantage of the steeper slope in the municipal yield curve versus taxable yields curves for Treasuries and swaps. The profit in this trade has deteriorated from 70 bp to 20 bp over the last three years. We believe the current return is very low compared to the market risk of the trade¹.

TOB Profitability 20 Yr



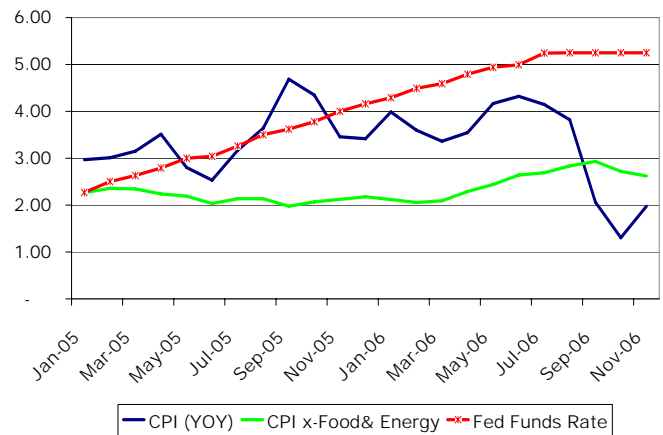
Overview of 2006

2006 was the year of the Fed. In January, Ben Bernanke became the new Fed chairman succeeding Alan Greenspan. The economy seemed very strong and inflation was rising due to commodity prices. The market was cautious about the new direction the Fed would take to fight inflation. It turned out the direction was the same in the first half of the year as it had been for the previous two. After increasing the Fed Funds rate to 5.25% through 17 straight 25 bp increases, the Fed left the rate unchanged through the rest of the year. Municipal market yields rose through the June meeting then stabilized or fell through the rest of the year.

Shorter bond yields were slightly higher at year-end and longer term yields fell.

The other key story in the municipal market was new issue supply compared to the record volume for 2005. In the first quarter of the year, volume indeed fell well short of the record pace dropping 30%. By year-end the refunding supply in 2005 was replaced by new money issues and total volume finished at 94% of 2005, the second busiest new issuance year for the market.

Fed Funds vs. CPI



Outlook for 2007

In 2007, we expect the yield curve to steepen as the Fed begins to lower the Fed Funds rate in the second half of the year. The economy seems to be responding as the Fed expected. Economic growth has slowed and inflation has begun to fall back into the "acceptable" range of 1-2%. If inflation continues on its current track, the Fed will be able to lower rates.

As 2007 maturities roll off, we will be rebalancing the portfolios to be more bulleted to the benchmark by the end 2007. The new model portfolio for 2007 reflects increased purchases in 2012-2013 using 2007 maturities. In addition, we are focusing on purchasing more short call bonds from issuers that are less likely to refund the issues. If long term yields remain flat to slightly higher by year-end, the likelihood of the calls drops and the additional coupon income will add to the total after-tax return of the portfolio for the period from the call date to maturity.

¹ TOB profitability is the net income from a leveraged bond position using BMA swaps as a hedge.