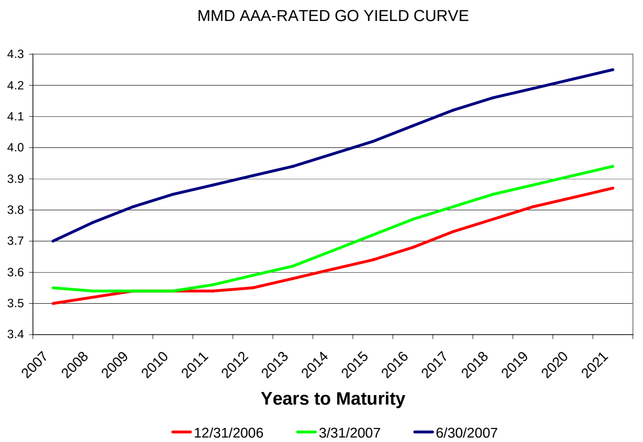
Monthly Review

During the quarter ending June, interest rates rose, particularly in the intermediate part of the yield curve, in response to stronger than expected economic data, inflation fears, and subsequent realignment of investor sentiment. In the first quarter of the year most investors were positioned for a Fed easing later this year and Fed Funds futures were priced accordingly. As it became clear that the Federal Reserve remained concerned with the level of inflation, and the economy continued to grow slowly, bond investors reversed course and prices declined. Yields rose steadily across the treasury curve from mid-May to mid-June, with the exception of notes with maturities less than two years, and the yields on these short maturities actually declined in a flight to quality as sub prime mortgage fears dominated the headlines. Municipal bonds sold off in line with treasuries although short maturities did slightly better with bonds under four years producing positive returns (compared with treasuries with maturities under three years producing positive returns). Total returns for the second quarter were generally negative for intermediate bonds with the Merrill Lynch 3-7 Year Municipal Index off -0.183% and the Lehman 5 Year Municipal Index off -0.312%. The positive side of this is that the average yield on intermediate portfolios has risen to 4% for the first time since 12/31/00.



Source: Municipal Market Data

Breckinridge Strategy

We continue to target a slightly longer duration than the benchmark in the portfolios due to our outlook for a further steepening in the yield curve and eventual lower rate structure. The Fed's inflation fighting resolve and consequent tightening of credit conditions, combined with the deterioration in the housing market will eventually cause the economy to slow and rates to decline. We are targeting a modestly bulleted structure within the portfolios by the end of 2007.

In the tax exempt portfolios we are concentrating on maturities in the 2012 to 2015 range since we expect this range to perform well in the steepening yield curve scenario we anticipate for 2008. We expect municipal supply to remain strong given the current range-bound yield environment.

Within the taxable/tax-free Blended Portfolios we are pursuing a similar strategy in terms of portfolio structure and duration. We are purchasing Agencies - Federal Home Loan Banks and Federal Farm Credit Banks – (which are tax free at the state level) in shorter maturities, and tax-exempt bonds in the longer maturities.

Taxable portfolios are also pursuing a more bulleted structure from 2012 to 2015, and new purchases are in the three to ten year maturity range. We are more focused on short maturity Agencies and callable Agencies to take advantage of the additional yield in these bonds. As in the Blended portfolios, Taxable Municipals make up the longer maturities. The taxable municipal bond market continues to be well-supported due to a lack of supply, and flight to quality. For the first six months of the year new issue supply was half of that of 2006, although we expect to see issuance increase as the year progresses. With very low credit spreads, we continue to focus on the highest grade issues.

Return to Risk Aversion

The long awaited spread widening and underperformance in the credit and mortgage sectors began in June as concerns about sub-prime mortgage delinquencies and defaults became a reality. The sharply increasing rise in defaults has caused several highly visible and highly leveraged hedge funds to either liquidate or be "rescued" with capital infusions as losses in sub-prime mortgage securities mount. The liquidity and price transparency of these securities has been challenged as it has become apparent that in many cases there currently is either no bid, or a very low bid.

Recent headlines highlight the difficult financing conditions in the high yield and structured credit and loan markets as investors begin to demand additional compensation and protection from riskier deals. More importantly, this appears to be a global trend as several foreign deals have also had to be postponed due to poor market conditions. As anticipated, this has caused credit spreads in the high yield sector as well as the investment grade sector to widen. Despite the mortgage sector's high quality rating, it continues to under perform with spreads widening to levels last seen in mid-2005, as volatility rises and sub prime concerns increase. The following chart illustrates the spread widening in the various taxable sectors.

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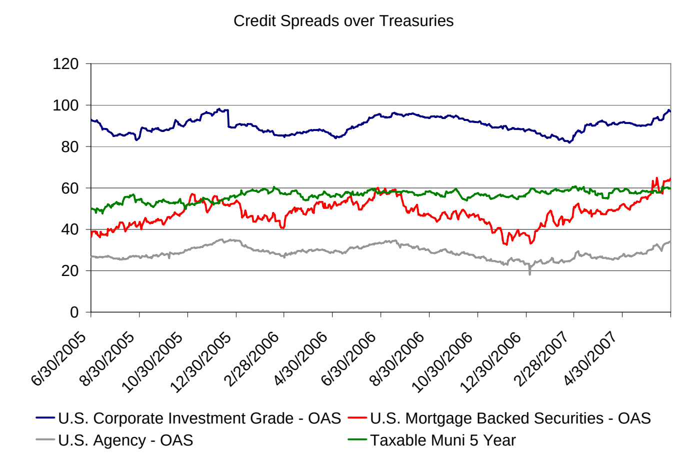

Source: Lehman Brothers

Additionally, the chart below is the ABX Index of sub-prime mortgages which illustrates the recent sharp decline in prices of the underlying mortgages. This deterioration has weighed heavily on the whole mortgage sector as investors wait to see if there is a "spillover" effect on the high quality (AAA) prime mortgage market.

ABX Index of Sub-prime Mortgage Prices

Source: markit.com

We expect to see further spread widening in the near future as the financing pipeline of announced deals builds in this difficult market environment, and the sub-prime mortgage market deteriorates further. Lower quality and less liquid bonds are being impacted more than higher quality bonds; however, the whole spectrum has been and will continue to be impacted to varying degrees.

We are seeing this phenomenon in all higher risk markets - from Emerging Markets and High Yield to the higher risk sectors of the Municipal market such as lower quality housing, hospital, and industrial revenue bonds. In general, the low volatility and low interest rate environment of the past few years enabled all higher risk assets to perform well. As volatility increases and credit conditions tighten, we expect this to reverse.

These issues further reinforce our view and strategy to avoid purchasing both corporate and mortgage bonds in taxable portfolios at this time. As previously mentioned, we are concentrating our investment in U.S. Government Agencies (Federal Home Loan Bank and Federal Farm Credit Bank) and high quality taxable municipal bonds. While we believe both the agency and taxable municipal market will experience minor spread widening in sympathy with all spread sectors, we expect the widening to be much less than other taxable sectors.

Recent events also remind us how important it is not to rely entirely upon ratings. This is increasingly true as ratings are now more often based on various credit enhancements and quantitative models rather than the financial strength of the ultimate obligor. In good times, markets take these ratings for granted. When problems develop however, investors grow skeptical and liquidity dries up quickly. Such is the state of the CDO and high-yield markets today. The muni market is again proving far more resilient. Still, the lesson makes the case for always maintaining a healthy level of skepticism with all ratings. This will remain the Breckinridge approach to analyzing credit quality - in good times and bad.