

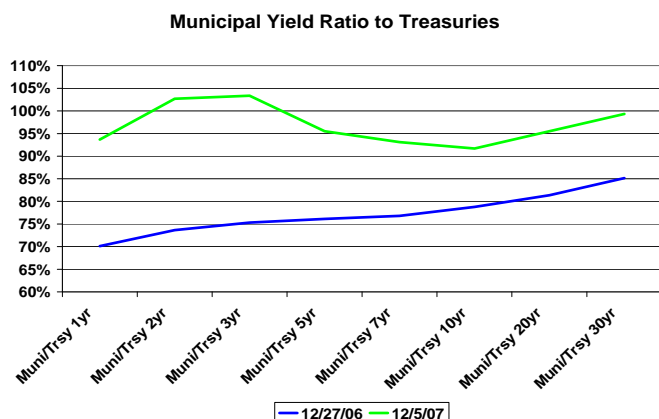
## Monthly Review

### *Treasuries Benefit in Flight to Quality*

The flight to quality to U.S. Treasuries dominated the fixed income markets again in November. Reported losses from sub-prime mortgage debt and derivatives escalated, affecting banks, brokers, finance companies, monoline insurers and various investment funds. Even the Federal Agencies, Freddie Mac and Fannie Mae reported significant losses in their investment portfolios. Investors responded by shunning risky assets and shifting funds to U.S. Treasuries. Treasury yields declined sharply with the intermediate part of the yield curve (2's to 10's) declining the most. Treasuries were the top performers for the month. All other sectors lagged treasuries; however, most investment grade sectors posted positive returns with the exception of long maturity finance bonds and Home Equity Asset Backed Securities.

*Municipal bond returns were strongest in the intermediate sector (5-10 years) reflecting the sharp decline in intermediate rates as the yield curves steepened. Some widening of credit spreads was evident in specific states as well as insured bonds with weaker underlying credits. As we anticipated, investors are beginning to analyze bonds with greater scrutiny. This is reflected in the differentiation amongst the valuation of various credits. We expect this trend to grow stronger as investors question the value of insured bonds, and economic weakness impacts certain parts of the country.*

*The decline in Municipal yields lagged Treasuries. On an historical basis, ratios to Treasuries reached very attractive levels. Due to the strong demand for short Treasuries, some short maturity municipals yielded over 100% of their taxable counterparts. We expect ratios to return to more normal levels as the municipal curve steepens, and Treasuries lose their flight to quality premium. The following chart compares current ratios with those of last year.*



## Breckinridge Strategy

### *Constructive on Short/Intermediate Rates*

We expect a further steepening of the yield curve in response to future FOMC interest rate cuts. We believe most of the benefit will accrue to short and intermediate rates as yields decline. For the municipal bond yield curve, we expect a further unwind of leveraged TOB/hedge funds which will put upward pressure on long term rates. Our goal is to remain positioned with a duration that is slightly longer than the benchmark, focusing on the six to ten year maturity range. In intermediate municipal portfolios, we have shortened our duration target to 4.30 years in response to the strong rally in bonds over the last two months.

## Monoline Insurers

### *Reputation Damaged*

Negative headlines surrounding the monoline insurers' exposure to sub-prime mortgages intensified in November. In light of growing losses, the rating agencies initiated reviews of the financial guarantors' capital requirements needed to retain their AAA ratings. While the ultimate outcome remains uncertain, we expect there has been permanent damage inflicted on the whole Financial Guarantee industry. Thus far, there has been no large scale selling, however, some weakness has been noted in insured bonds with poor underlying credits.

As always, we purchase only insured bonds with investment grade underlying ratings in core sectors like General Obligation, and Water and Sewer Revenue bonds. Although insurers are seeking capital to offset losses, the losses could continue into 2008. MBIA recently received a capital infusion to help sustain its AAA rating; however, the company also reported that additional losses will be forthcoming. Our concerns surrounding the value of bond insurance remain.

## State Investment Funds

### *More Problems Expected*

Many states and counties run short term investment pools for local municipalities. In November it was reported that some of these had invested in sub-prime mortgages or Asset Backed Securities and had incurred significant losses. Nervous municipalities began substantial withdrawals. The withdrawals prompted concern that the pools would have to liquidate weaker credits in a declining market. Alternatively, if withdrawals from the pools were limited; participating municipalities could possibly face cash shortfalls. Florida has gained the most headlines due to large withdrawals in its pool, and ultimately hired an advisor to manage the remaining investments. This is a developing situation that we are monitoring closely.