

## Month in Review

### Unprecedented Declines

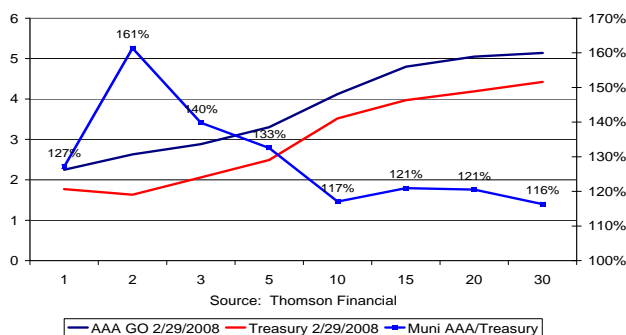
The municipal bond market was hit from many sides during the month of February and sharply underperformed all other fixed income sectors. Despite the fact that the taxable market posted positive returns, the general muni market declined a record-breaking 4.89% (as measured by the Merrill Lynch Municipal Master Index), as tax exempt yields rose dramatically. Yield curves in both the taxable and tax-exempt markets steepened. The tax-exempt yield curve rose across all maturities with long rates rising more than short rates. In contrast, the Treasury yield curve steepened with short rates declining and long rates rising.

The treasury yield curve steepened in reaction to macro-economic concerns about rising inflation. As the Federal Reserve Board continued on its path of lowering short term rates, concerns over rising inflation and a declining dollar caused long rates to rise. In contrast, the steepening in the municipal yield curve was not due to macro-economic concerns, but can be attributed to several technical and unprecedented factors. Liquidity in certain sectors of the municipal bond market virtually dried up as sellers overwhelmed buyers. This was exacerbated by investment banks' unwillingness to provide back-up liquidity as risk aversion reigned.

### Municipal Market Dislocation

The sharp divergence in municipal bond performance expanded in February as many negative factors came together at once. The downgrading of the bond insurers by the rating agencies, combined with an unexpected change in the shape of the treasury yield curve, led to massive deleveraging (selling of long maturity municipals) by municipal bond hedge funds. At the same time, short term investors concerned about losing the AAA ratings from insurers attempted to put back Auction Rate Securities, and found that the auctions failed. These investments generally do not have back-up liquidity providers. Investment banks who underwrote the deals refused to step in and provide liquidity to the issuer due to their own capital constraints. Lastly, the loss of AAA ratings by the bond insurers forced investors to consider the weak underlying credit quality in certain municipalities. All of these factors together created a "perfect storm" of negative concerns; and the municipal market experienced one of its worst months ever.

Municipal/Treasury Yield Curves and Ratios



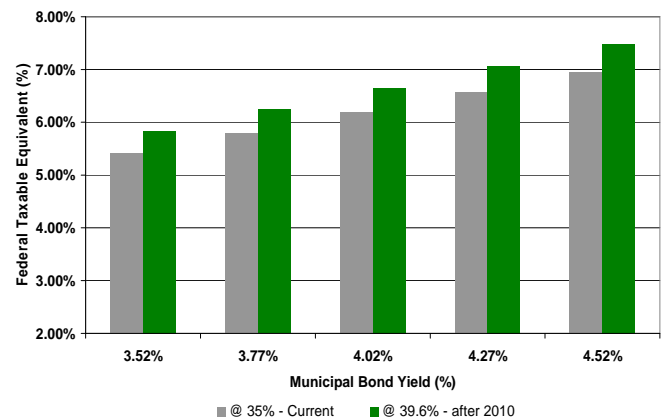
## Breckinridge Strategy

### Unique Opportunity

We view this period of unprecedented market disorder as a time of opportunity to purchase bonds at extremely attractive yields – both on an absolute basis, and relative to U.S. Treasuries. As seen in the above chart, Municipal bond yields are currently at higher levels than Treasuries across the yield curve, and in some cases are trading at 160% of comparable maturity Treasuries. Our objective is to be very nimble and take advantage of this market volatility while maintaining our goal of high after-tax income and limited capital risk.

Within the Tax-exempt portfolios we are focusing on slightly longer maturities than what we have previously been purchasing. Our goal is to lock in higher income at historically attractive yield spreads to Treasuries. In the Blended portfolios we are swapping out of Agency bonds into tax-exempt bonds in order to capture the yield advantage on both a pre-tax and after-tax basis. We are implementing the same strategy within the Taxable bond portfolios by taking advantage of the high yield spreads on new issue Taxable Municipal Bond, as well as Agency notes.

MUNICIPAL TAXABLE EQUIVALENT YIELDS

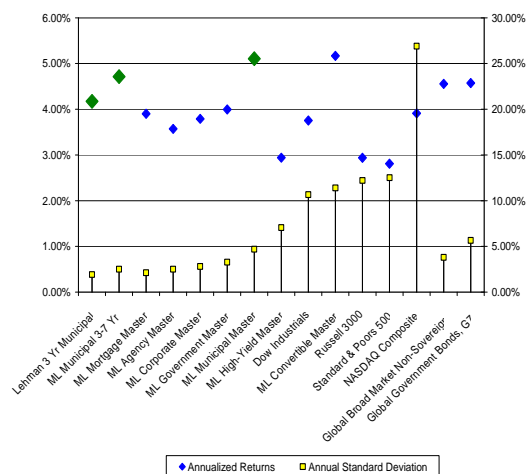


### Setting the Stage for the Next Change in the Shape of the Yield Curve

As we take advantage of this opportunity we are shifting slightly our overall portfolio strategy. This will be the first step in preparing the portfolios for what we believe will be the next major shift in the shape of the yield curve. Looking forward to the second half of the year, we are anticipating a change in the shape of the curve to a more flat structure as the Federal Reserve Board stops lowering rates and perhaps moves to a tightening bias. Under this scenario, longer maturity bonds should perform well. The target duration of the portfolios is being moved to +.25 years relative to the respective benchmark as we focus on the 10-15 year maturity range. This target maturity range is

where we are seeing the most attractive yields (between 4 and 5%), with coupons over 5% in the tax-exempt market.

After-Tax Total Return Analysis 1998-Feb 2008



Source: Merrill Lynch, Lehman Brothers, Dow Jones, Nasdaq, S&P, Bloomberg, and Russell

## Credit Quality and the Global Scale Rating

### Tax Adjusted Municipal Bond Returns Remain High

The high credit quality of municipal bonds has always been one of the major attractions for investors. For example, AAA-rated corporations over the last ten years have had a default rate of 0.5% while the default rate on investment grade municipal debt has been 0.2%. The chart above shows the relative 10-year after-tax returns for various market indices. Even after one of the worst months of municipal bond performance, the historical relative tax-adjusted returns for municipal bonds remain extremely high.

### Global Scale Ratings Recognize High Quality of Municipal Bonds

The major rating agencies have maintained a separate rating scale for municipal bonds in contrast to taxable bonds. In March of 2007 Moody's announced the creation of a "Global Scale Rating" methodology that takes into account the much lower risk profile of municipals when comparing them with taxable corporate bonds. This was a process long in the making, beginning in 2002.

### Expected Loss vs. Willingness to Pay

The Global Scale Rating is based on an "expected loss" analysis, while the traditional Municipal Rating is a measurement of the "intrinsic ability and willingness of an entity to pay its debt service." Reflecting the lower risk profile of the U.S. municipal bond sector, many lower-rated municipal issuers are significantly upgraded when rated on the Global Scale.

An example of this may be a lower quality bond that is rated Baa2 on the traditional Municipal Rating scale may have a Aa2 rating on the Global Scale Rating, based on the expected probability of default. If in fact municipal bonds were evaluated and traded based on the Global Scale Rating rather than the Municipal Rating, the implication is that many more Municipal bonds would be rated AAA and there would be a much reduced need for bond insurance. Some analysts believe that a shift to the use of the Global Scale Rating is a strong possibility. The arguments are that it would not only stabilize the uncertainty in the municipal bond market due to the downgrading of the insurers, but it would help restore the balance sheets of the bond insurers by reducing the amount of capital required.

At this point in time we doubt there would be immediate broad market acceptance of a shift to the use of the Global Scale Rating due to the lack of differentiation amongst various credits. However, we believe that we will see an evolution towards the use of a more universal rating system such as the Global Scale Rating.

Reflecting the current valuations of municipal bonds, we believe the merit of investing in municipal bonds is not fully recognized in the marketplace. This is especially true when considering their superior credit quality. With or without bond insurance, municipal bonds in general are very attractive investments.