

Market Summary

Riskier Assets Rewarded

In a continuation of a trend that began in April, investors shifted away from higher quality assets as concern about the credit crisis appeared to wane. U.S. Treasuries were most affected as the flight from quality was compounded by rising inflation fears. Returns in the taxable bond market were negative for the most part as yields rose across the curve. In contrast, and as we expected, municipal bond yields declined and returns for the month were positive. This reflected strong investor demand and strong relative value since February.

Opposing Forces Put Fed on Hold

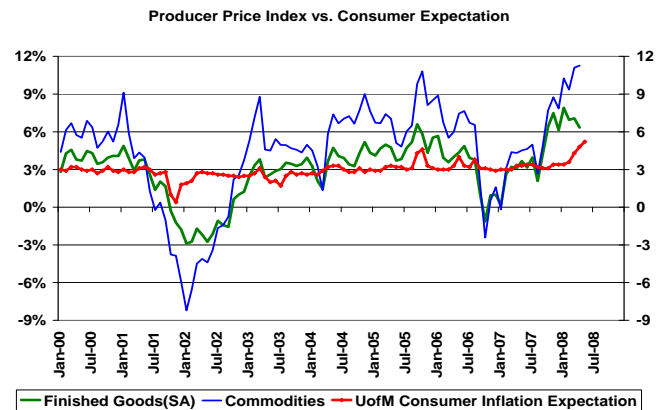
Economic weakness, driven by continued deterioration in the housing sector and consumer spending, continues to be a major concern of the Federal Reserve Board. Tightened credit conditions, rising food and energy prices, and declining real wages have added stress to a consumer already burdened with high debt loads. However, Chairman Bernanke has recently expressed optimism on the outlook for improvement in the second half. The Fed believes that the extraordinary measures that have already been undertaken (Fed rate cuts and increased bank/broker liquidity measures) will help in the transition to a slow-growing economy.

The following chart depicting Existing Home Sales reinforces the view that the sharp decline in home sales is sure to have a powerful negative impact on the overall economy.



At the same time, global inflationary pressures in commodity prices are beginning to be viewed as not so temporary increases. Recent data from the University of Michigan revealed that rising inflation expectations are becoming imbedded in consumer sentiment – a warning sign for the Fed that inflation concerns are mounting and could become self-fulfilling.

Commodity price increases (particularly energy) are clearly leading Producer Prices as shown below:



These two dueling forces – a softer domestic economy and global inflationary pressures - have resulted in the Fed essentially moving to a holding pattern as the impact of the previous rate cuts and fiscal stimulus works through the economy.

Breckinridge Strategy

As we mentioned in last month's newsletter, we are beginning to restructure the portfolios to a more level structure by reducing the amount invested in the mid part of the intermediate maturity range. When opportunities arise, we will lock in long term attractive yields (over 4%). This will gradually move our duration target from neutral to slightly longer than the benchmark. As always, our goal remains to increase income as much as possible while maintaining a stable capital value.

Davis v. Kentucky

After more than a year's wait, and with little fanfare, the Supreme Court opinion on the Davis v. Kentucky case was finally reached. As expected, the court found in favor of Kentucky allowing states to continue to exempt their own issues while taxing out of state municipal income. For more details, please see our report on our website: http://www.bondinvestor.com/Commentary/Special/May_2008-DavisvsKentucky_Resolved.pdf.

Important Addition to our Investment Team

We are very pleased to announce that Neil Grabowski has joined Breckinridge as a Senior Vice President in our credit research group. Neil has over 25 years experience in municipal credit research, which has included managing the municipal research groups at Aetna (where he and Peter Coffin worked together) and most recently, Gannett, Welsh & Kotler. Given the many challenges and opportunities in today's municipal market, we feel extremely fortunate to have Neil as a member of our research team. Neil's complete biography can be found on our website: <http://www.bondinvestor.com/Leadership.aspx>.