

Market Update

Commodity Price Break/Inflation Fears Abate

The early July peak in commodity prices proved to be the breaking point for the U.S. consumer. Economic data reported in August revealed a decline in consumer spending, particularly autos and certain retail sectors. The effects of rising prices and the end of the government rebate checks finally forced significant change in spending habits by both consumers and business. Economic data weakened, unemployment rose, and financial markets continued to be under stress as losses were realized. The treasury market rallied sharply as inflation fears abated in response to this weakness. The treasury yield curve flattened as long rates declined more than short rates. At the same time, the municipal yield curve steepened reflecting increased investor preference for shorter maturity securities.

Municipal Market Update

Moving Towards Resolution

On a positive note, several potentially disruptive situations that have plagued the municipal bond market seem to be moving toward some sort of resolution. The dominant issue has revolved around the *Auction Rate Securities* market. The Auction Rate Securities market was particularly impacted by the credit crisis, and has been essentially frozen since February. Government regulators have forced a resolution, and issuers are in the process of restructuring and remarketing their issues. This is expected to intensify in the coming months. Supply will likely increase as short term auction rate notes are termed out into longer fixed rate maturity bonds; thus causing the municipal yield curve to steepen as long maturities cheapen. Fund flows indicate that investors are favoring short and intermediate debt, which could put added pressure on the long end of the municipal bond yield curve. Accordingly, we are taking advantage of attractive yield and ratio levels, and are opportunistically purchasing securities with maturities slightly longer than 10 years. Given the continued uncertainties in the financial markets, as well as the strong possibility that taxes will be raised next year, we believe that investors currently invested in auction rate notes will remain invested in municipals.

Taxable Market Update

In the taxable bond market, Agency debt had cheapened as uncertainty over how Fannie Mae's and Freddie Mac's credit crises would be resolved. Yield spreads on all Agency debt had widened in response to increased supply, and nervousness over the timing and form of the government support. We viewed the spread widening in FHLB and FFCB debt as a buying opportunity. With the recent announcement of the Federal government's takeover of both Fannie and Freddie, spreads of the senior debt of all the government agencies have tightened dramatically. This

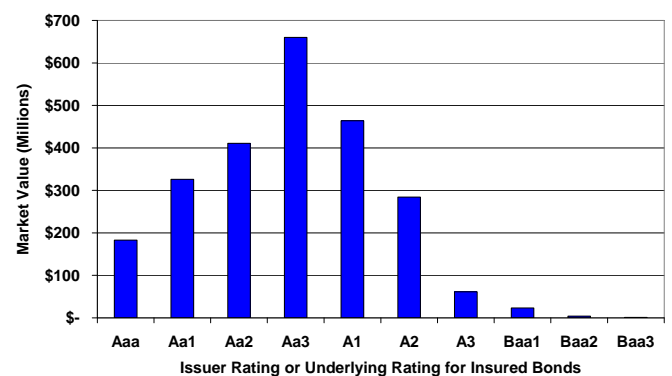
government intervention may be viewed as a significant step in the future stabilization of the housing sector, and a positive move towards resolving a deepening crisis.

Global Scale Rating Changes

Moody's announced that it will begin migrating municipal ratings to its global rating scale in October, leading to upgrades for a substantial number of credits. They anticipate issuing new ratings for state governments (comprising general obligations and bonds backed by state appropriations) and the 50 largest local government issuers. Higher education and hospital credits will follow in November, six revenue bond sectors (among them airports and public power) will be recalibrated in December and all remaining issuers, including local general obligations and water & sewer bonds, will have new global ratings by the close of January. The agency projects that, on average, general obligation ratings will rise two rating notches, while revenue bonds will improve one notch. Issuers rated below Aa3 will likely see greater movement than those rated above that level.

The upgrades will reflect the much lower default experience of municipal bonds as compared to corporate debt, and could improve pricing on many of Breckinridge's holdings, especially insured bonds that are now trading based on the quality of the underlying credit. The chart below displays our general obligations and appropriation debt rated by Moody's that will benefit from the October review.

Breckinridge Holdings by Moody's Rating for GOs and Related Sectors



Breckinridge Strategy

Municipal bonds in the 10+ year maturity range and rated below Aa3 are currently trading at wider spreads and yields that are at or higher than treasuries. We view this as a very attractive opportunity; and, as warranted, are purchasing longer maturity bonds with cash, or to replace bonds in the four-six year maturity range. We are continuing to move to a more barbelled structure through the rest of the year in preparation for a flattening yield curve in 2009.