

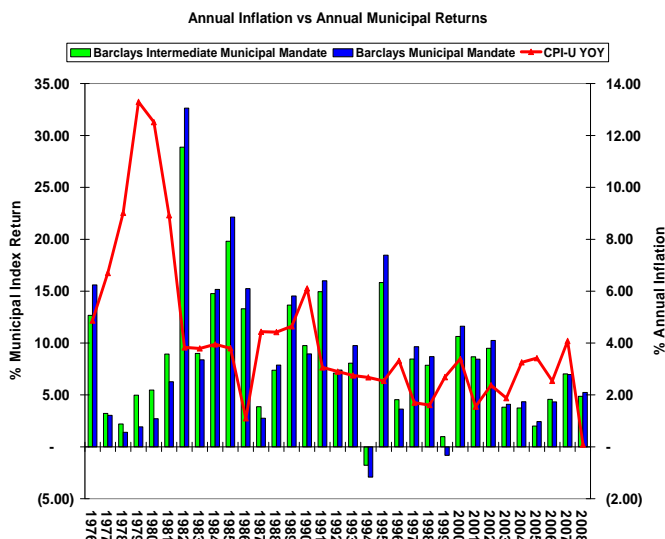
Tax Exempt Market Update

Municipal bonds performed well during the past quarter and posted positive returns; however, much of the outperformance occurred in January. Demand from individual investors was strong as municipal yields remained very attractive relative to treasuries. Municipal issuance in the quarter was slightly higher than the first quarter of 2008; and was dominated by several large state general obligation issues such as California and Wisconsin. The yield curve is steep with long maturities at particularly attractive yield levels. The steepness of both the municipal and treasury yield curves currently incorporates investors' inflation fears. This represents the view that government stimulus spending, combined with the Federal Reserve Quantitative Easing policy will lead to increased inflation in later years.

Munis and Inflation Hedging

This heightened concern has spurred interest in investing in TIPS (Treasury Inflation Protected Securities) as a hedge against future inflation. While these are certainly valid concerns, there are also compelling arguments to be made for a period of deflation given the extent, and possible duration, of the global recession.

In either an inflation or deflation scenario, municipal returns tend to hold up well. The chart below shows the returns for both the Barclays Municipal Mandate and the Barclays Intermediate Municipal Mandate, compared to the annual inflation rates. Notably, the returns remained positive through the hyper-inflation of 1976 to 1983.

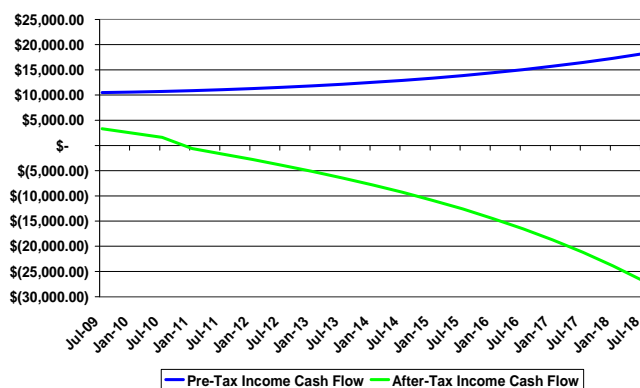


Source: Barclays Municipal Index System

For fully taxable investors, using TIPS as a hedge for inflation creates a negative cash flow from the investment when inflation is rising. We have analyzed TIPS using an estimated increase in inflation of 1% per year from 2% to 11.5% over the holding period of the April 2019 TIPS issue. If inflation accelerates, the tax liability for the quarterly

inflation adjustments will grow faster than the coupon flow from the TIPS. The investor would then be subject to negative cash flows until maturity of the TIPS, at which time the investor would be paid the maturity value adjusted for inflation. At maturity, the only taxes due would be the last coupon payment and the last inflation adjustment. The chart below shows the pre-tax and after-tax cash flows for the TIPS, excluding the purchase and maturity value. We assume the purchase price is the current market price of 105.75 for a gross cost with accrued of \$1,047,606. The maturity value is approximated at \$1,910,818 with the inflation adjustments. The pre-tax internal rate of return is 8.00% and the after-tax internal rate of return is 4.80%.

US TIPS Cash Flows vs After-Tax Cash Flows w/o Purchase and Maturity Value
Inflation starting at 2% rising 0.5% every six months



Breckinridge Strategy

We expect municipal bonds to provide attractive returns relative to treasuries given the steep yield curve, growing Treasury issuance and impending higher tax rates. Several states are already contemplating raising tax rates in order to close budget gaps; and we know the Federal rate for higher bracket individuals is going up in 2011. Our barbell strategy keeps the risk of inflation and deflation in balance. Deflation is hedged by longer maturities which lock in yields and thus, would preserve the portfolio's income stream through a period of low rates. Conversely, inflation risk is hedged by short-term bonds. If inflation and interest rates rise, proceeds from sales or maturities of short-term bonds can be reinvested at higher yields. This would help build the portfolio's income stream to maintain a positive return over inflation. Lastly, given the steepness of the muni curve today, we think the likelihood is for a flatter curve in the future. This could occur in either an inflation or deflation scenario. The barbelled structure would be expected to offer a better risk adjusted return than a bullet structure as the yield curve flattens. We remain committed to buying only issuers that have been thoroughly researched and internally rated by our credit staff. We continue to find opportunities in A-rated bonds which we pursue very selectively as opportunities arise.