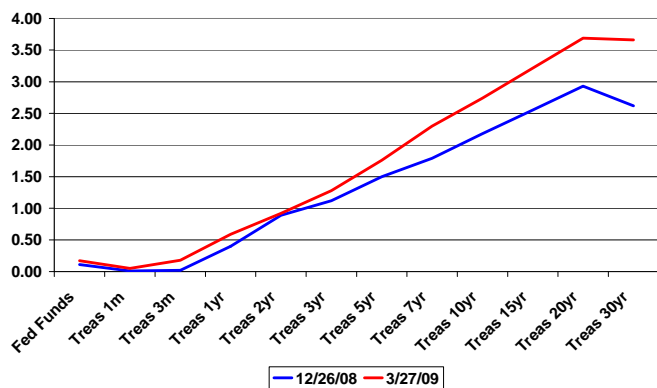


Taxable Market Update and Opportunities

The sweeping government support and intervention through the TARP program has had a significant impact on various sectors of the taxable fixed income markets during the past quarter. With the recent passage of the “American Recovery and Reinvestment Act of 2009” (ARRA), we expect to see even more of an impact that will cause temporary dislocations in certain sectors, as well as create new opportunities for investment.

The most immediate impact has already been visible on the U.S. Treasury yield curve. Despite very weak economic data; the Federal Reserve’s commitment to keep interest rates low; a continued flight to quality; and recent outright Federal Reserve purchases of treasuries (Quantitative Easing), since year end yields have risen and the yield curve has steepened (long maturity yields have risen more). Given all of the above factors, one would have expected rates to be lower than they currently are. However; under the specter of a \$1.8 trillion budget deficit, and a substantial increase in the amount of treasury debt that has to be raised, it is probably a testament to the above mentioned government’s efforts that interest rates are not higher. Over the near term, we expect to see treasury yields remain range bound as these opposing forces offset each other.

Treasury Yield Curve Comparison
Source: Federal Reserve



New Investment Opportunities

TLGP – FDIC Debt

As a result of numerous new Federal programs, entirely new asset classes have been, or are in the process of being created that represent new opportunities for investment. As mentioned in our November 2008 newsletter, the first FDIC guaranteed (Aaa/AAA rated) senior bank note was issued under the TLGP program in late November. Since then, more than \$225 billion has been issued by various banks and finance companies. The debt carries a short maturity structure with the final maturity limited to June 2012. The notes have been issued at attractive spread levels; and for the most part, they are large, liquid issues, that are actively traded by most of the major dealers.

Build America Bonds (BABs)

Under the ARRA, a new financing tool is being created to aid state and local municipalities issue debt in the taxable market. This debt will provide a tax credit to the issuer from the Federal government. It is an option that is only available for issues that would normally be issued as tax-exempt bonds, specifically directed to new capital projects. The municipality would issue a bond as a taxable BAB and receive a 35% tax credit from the government payable on the coupon interest dates. The details have yet to be finalized by the government; however, many analysts expect that in order to attract taxable investors, the bonds will have to be issued in large liquid, index eligible (\$250mm) bullet maturities. It is projected that if municipalities issue more taxable debt in longer maturities, it may have a positive effect on corresponding tax exempt bonds given the reduced supply in the tax exempt market. New issuance is expected in the near future from large, well recognized issuers; however, we don’t believe that smaller tax-exempt issuers will have the cross-over appeal to taxable investors.

Private University Taxable Bonds

During the past quarter many highly rated universities have issued senior unsecured general obligation debt in the taxable bond market. The recent issues have been targeted to traditional taxable bond investors with large, liquid, bulleted maturity structures. They have been well received by investors as diversification in a high quality asset. These highly rated universities, while not entirely insulated from endowment losses, demand and tuition pressures; enjoy very strong student demand, as indicated by low acceptance rates and substantial freshmen matriculation. Revenue streams tend to be diverse, including research grants and gift income, reducing dependence on tuition and student fees. While the landscape for many universities will be challenging, especially for smaller, tuition-dependent schools in competitive markets, we believe selective opportunities are available in the high-quality segment of the sector.

High Grade Corporate Sector Offers Select Opportunities

Corporate bond yield spreads remain near historically wide levels reflecting weak credit fundamentals, and investor risk aversion. Despite the challenges of this recessionary environment, there are several high-quality non-financial corporate issuers that we believe are attractively priced. Demand for high quality issues is high, and new highly rated issues have been well-received.

Breckinridge Strategy

Our focus on high quality, liquid issues remains steadfast, and we remain opportunistic in our purchases. We are finding attractive relative value within the traditional taxable market sectors (taxable municipals, agencies, and corporates), and the newer sectors as described above.