



MARKET COMMENTARY

January 2010

MARKET REVIEW

A Renewed Flight to Quality

In January, investor concerns about sovereign credit risk and a weak global growth outlook generated a renewed flight to quality, especially to U.S. Treasuries. The massive fiscal stimulus provided in 2008 and 2009 by various governments has led to a significant deterioration in the quality of sovereign balance sheets. Negative headlines highlighting the deteriorating fiscal condition of Greece raised concerns about other European countries including Portugal, Ireland, Italy and Spain. At the same time, growth prospects are declining especially in Europe and Japan, and fears of weak global growth abound.

The result has been a strengthening of the dollar as investors once again flocked to the world's reserve currency. In January, investors also fled to U.S. Treasuries as a safe haven. Yields declined and the yield curve flattened. Intermediate maturities declined the most and in general, fixed-income markets posted positive returns for the month.

TAXABLE MARKET REVIEW

Higher Risk Assets Underperform

In their flight to quality, investors punished sovereign credits, which sharply underperformed Treasuries. Corporate bonds, particularly long-maturity financials also underperformed in response to the Administration's newly announced bank regulatory-reform proposals. In contrast, taxable municipal bonds were the top-performing taxable sector in January, outperforming Treasuries. Most likely this was due to the lag effect of catching up to the significant spread tightening in the corporate bond sector from the fourth quarter of 2009.

Most significantly, in its fiscal year 2011 federal budget released on Feb. 1, the Administration included a proposal making the BAB program permanent albeit with a lower subsidy of 28 percent versus 35 percent currently. While Congress has to approve this measure and there may be changes to the proposal, we continue to believe the BAB program will be made permanent.

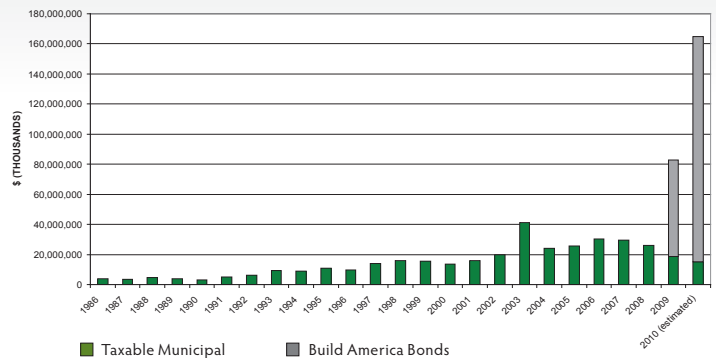
BUILD AMERICA BOND UPDATE AND COMMENTARY

Uncertainty Fading; Visibility Improving

With less than a year of history, BABs have evolved into a viable and visible taxable-bond sector. More than \$72 billion of BABs have been issued since April 2009. Estimates of 2010 issuance are as high as \$150 billion.

TAXABLE MUNICIPAL ISSUANCE

Source: Barclays Capital



Yet the BAB market like the tax-exempt market remains fragmented. The bulk of issuance has been concentrated in smaller issue sizes. Since the program's inception, more than 90 percent of BAB deals have an issue size of less than \$250 million and more than 70 percent were less than \$50 million. These small or mid-sized issues often offer excellent credit quality and attractive yields. Finding such opportunities requires credit research and broad market access through a wide network of municipal dealers.

The Administration's proposal to make the program permanent has further raised BAB visibility and will likely encourage new investor participation. Increasingly traditional taxable corporate-bond investors are participating in the BAB market – attracted by the structure, size, diversification and relative value of taxable municipals, along with their far lower historical default rates relative to corporates.

By attracting new investors, BABs have clearly improved overall municipal market liquidity. At the same, there continue to be positive trends in municipal disclosure and price transparency. Regulatory efforts encouraging municipal issuers to file audited financials and provide notification of material events are enabling more timely research. Trading is facilitated by the MSRB transaction reporting, which makes trade price information available within 15 minutes on sources including EMMA, TM3, and Bloomberg. As Dealers and institutions commit more capital to BABs, we expect further improvement in market liquidity and transparency.

BRECKINRIDGE STRATEGY

Stay the Course

Historically low money-market rates, the specter of higher individual tax rates and evolving issuance trends continue to support both tax-exempt and taxable municipals. In the current weak economic environment, we remain focused on intermediate-maturity, higher quality issues.