BRECKINRIDGE CAPITAL ADVISORS

MARKET COMMENTARY

November 2011

Market Review

European Debt Crisis Drives Rampant Risk Aversion

The European debt crisis continued to dominate global investor sentiment and market activity during the month of November. The likelihood of increasing economic weakness from prolonged austerity measures in Europe caused economists to ratchet down 2012 global growth estimates. Risk aversion was rampant and market volatility high as investors reacted to headlines on the debt crisis. Due to widespread risk aversion and despite the Super Committee's failure to deliver a debt reduction plan, U.S. Treasuries were again the top-performing fixed-income sector in November.

U.S economic data, especially consumer spending, improved last month. Retail sales increased and auto sales and manufacturing were robust, which was enough to reduce fears of a U.S. recession near term. However, the sustainability of increased consumer spending is questionable given a decline in real wages and the personal savings rate. Additionally even though U.S. data improved, the global economic outlook continues to dampen investor enthusiasm

Tax-Exempt Market Review

Relative Yields Remain High

The tax-exempt sector performed well last month despite negative headlines concerning Harrisburg, PA and Jefferson County, AL. Investor demand remained solid, driven by attractive tax-exempt yields relative to taxable alternatives across the yield curve. In fact, in a number of instances, yields on tax-exempt bonds were higher than those of similar-quality corporate bonds. The table below shows some representative trades during the past month.

Source: Breckinridge Trading Activity

Mat Yr	*Security*	*Ratings*	*Yield*	*Purchase Date*
2014	Shell	Aa1/AA	0.69	11/28/2011
	Arrowhead WI HS Dist	Aa1/NR	0.75	11/28/2011
2017	Cisco	A1/A+	1.70	11/28/2011
	Castaic Lake Wtr Agncy	NR/AA-	2.00	11/28/2011
2020	Boeing	A2/A	2.67	11/22/2011
	MI Trunk Line	Aa2/AA+	2.72	11/22/2011
2022	McDonalds	A2/A	2.70	11/22/2011
	IN St Fin Auth	Aa1/AA+	3.20	11/22/2011

Among the factors driving high relative tax-exempt yields are investor concerns about muni credit quality and potential changes to the tax exemption proposed in the Jobs Act. Additionally, the limited capacity of retail investors to absorb the supply of long-term tax-exempt bonds is also keeping relative yields high. In the past, much of this supply was restructured into floating-rate debt and diverted to the short-term market. When the demise of bond insurance limited this strategy, Build America Bonds (BABs) enabled municipalities to tap into an alternative source of demand. Today, with neither floating-rate debt nor BABs available, yields have adjusted to levels required to attract non-traditional or "crossover" muni buyers, which are typically hedge funds and other institutions that don't benefit from the tax exemption.

Demand from crossover buyers has provided much needed support as new issue volume of tax-exempts totaled a healthy $34.4 billion in November. Some of these investors may look for an opportunity to exit their position in tax-exempt municipals early next year when there is typically a seasonal lull in supply and solid retail demand from reinvestment of year-end maturities. However, we believe a substantial portion of crossover demand is longer-term investments from institutions attracted by the risk-adjusted returns of municipals even absent a tax benefit. Breckinridge shares this view, and as noted previously we have been extending durations slightly in the current quarter.

Taxable Market

Taxable Munis Outperform

Most taxable sectors underperformed in November compared to Treasuries. In particular within the corporate sector, bank, brokerage and finance bond spreads widened quite significantly. The failure of MF Global, newly announced Federal Reserve stress tests for U.S. banks, and European bank contagion fears exacerbated the spread widening. Like Treasuries, taxable municipal bonds benefited from risk aversion last month and performed well. We have consistently advocated a large overweight in taxable municipal bonds, which are less volatile, high quality bonds with low default rates that provide a stable and consistent income stream – qualities that are consistent with a long-term goal of capital preservation.

Breckinridge Strategies Driven by Long-Term Goals

Not Short-Term Results Relative to Indices

At Breckinridge our focus is on constructing a portfolio of high-quality investments in a manner consistent with our long-term goals of income building and capital preservation. We are less concerned with short-term results versus indices. This is particularly noteworthy given the recent volatility of index composition and duration. For example, in the Treasury sector durations have increased with the Treasury Department's policy of issuing longer maturity debt. Additionally, mortgage durations are increasing, as expected prepayments have not materialized in the depressed housing market, and agency debt duration is decreasing as issuance declines. The composition of taxable indices has also changed, as sectors with greater appetites for debt have grown to dominate index weightings. For example, the bank and finance sector is now the largest sector within the corporate bond sector indices. As a result, many investors and index funds are heavily weighted in banks. Over the long-term, we believe our straightforward approach will prove more efficient and less volatile than one that is overly concerned with emulating indices to achieve short-term results relative to a benchmark.

200 High Street, Boston, MA 02110 • Ph: (617) 443-0779 • Fx: (617) 443-0778 • www.bondinvestor.com