



Capital Preservation & Income

Caprin Asset Management, L.L.C.

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Lower Rates, High Inflation

At the Federal Open Market Committee's April 30th meeting, the Fed Funds Rate was lowered to 2%, making it the seventh consecutive time since September that the Committee cut its target rate. However, the Fed hinted at a bias toward ending its recent initiatives and holding Fed Funds

moderate, hovering around 2.5% but this statistic excludes food and energy prices from its calculation. When food and energy are included, a broader CPI measure referred to as Headline CPI is created. Unsurprisingly, this number is much higher – roughly 4.0% with oil and

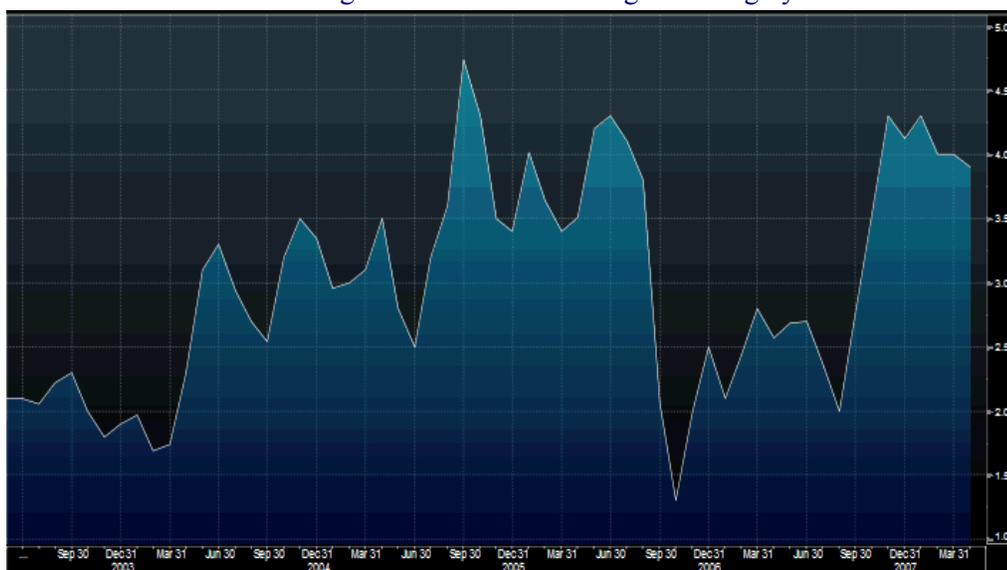


Figure 1. Headline CPI (Core CPI + food/energy) over the past five years

Source: Bloomberg

steady at 2.00%. The Fed likely wants to determine how the seven previous rate cuts or the approaching fiscal stimuli help rejuvenate consumers and alter the pessimistic economic outlook currently held by many on Main Street and Wall Street.

Inflation is a real concern – it is steadily moving to the forefront of our economic landscape as growth and employment data have remained relatively stable. The Core Consumer Price Index (CPI) is still

other commodities hovering near all-time highs, even on an inflation-adjusted basis.

This summer marks the third year of the U.S. housing downturn, but regulatory changes and borrower remedies are beginning to surface. Although the timing of the turnaround in the housing market is still an unknown, a turnaround is inevitable; and it is a key variable in the overall health of the economy. As housing prices continue their decline and foreclosures

Highlights:

- INFLATION BECOMING AN ECONOMIC CONCERN AS FOOD AND ENERGY PRICES RISE
- FEDERAL OPEN MARKET COMMITTEE CUT FED FUNDS RATE 25 BASIS POINTS BUT HINT AT UPCOMING RATE PAUSE
- CAPRIN MAINTAINING TARGET DURATION CLOSE TO 5 YEARS, NEUTRAL TO LEHMAN 7-YEAR MUNICIPAL BOND INDEX
- BONDS WITH 2 AND 10-YEAR MATURITIES OFFERING VALUE IN CURRENT YIELD CURVE ENVIRONMENT

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escalate further, the true nadir of the housing market and a recovery of any kind could be many months away. While the beleaguered housing market has stressed our financial and consumer markets, it is important to recognize that our resilient economy has

remained in fairly reasonable shape. Financial markets too seem to be healing in recent weeks as earnings reports from major lenders and investment firms have not been as dire as in previous quarters.

Caprin Strategy

Our last newsletter highlighted the exceptional values offered in the Municipal Bond market relative to Taxable Bonds during the early months of 2008. At that time, we were able to capitalize on those opportunities and improve returns in our client accounts as market conditions subsequently became more normal

during March and April. Simultaneously, returns in Taxable Bonds were challenged as sellers drove prices lower in a reversal of the flight to quality. Current conditions are such that Municipal Bond

yields are more in line with historical relationships to their Taxable counterparts.

Given higher inflation tendencies and the Fed's indication of a wait-and-see bias, Caprin's strategy is to remain neutral to our benchmark and continue to manage to a target duration of roughly five years.

These market biases have also reoriented where we see value in various Municipal Bond maturities. Currently, we favor bonds maturing in 2 and 10 years, and the overall portfolio maturity structure is more evenly

distributed along the yield curve relative to other structures we have utilized in the past. This 'neutral' position allows portfolios to distribute risks across multiple maturity targets, an approach that is appropriate for our assessment of market conditions over our strategy horizon.

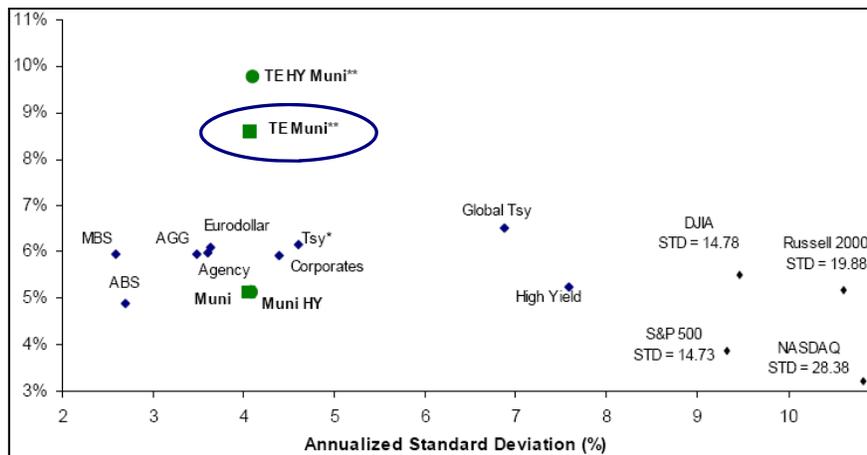


Figure 2. Comparison of Tax-Equivalent Yields and Volatility vs. Other Asset Classes
Source: Lehman Bros. - Municipal Index & Strategies Group—May 2008

As a pro-active bond manager, Caprin has many techniques for generating returns in shifting interest rate and economic conditions. Over the course of the past 18 months, our strategies have positioned maturities in a 'barbell'

that emphasizes short and long maturities as well as in a 'bullet' where maturities are concentrated in the 5- to 7-year range. Each strategy is driven by our assessment of which maturities are most likely to generate favorable returns over our horizon. More importantly, our discipline evaluates and sets our strategies so we can shift these maturity positions and reposition portfolios for expected return opportunities. This approach is central to Caprin's philosophy of managing volatility and risk while striving to maximize performance.

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