



**CAPRIN**  
Asset Management, L.L.C.

Capital Preservation & Income

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## Recent Price Stability Eases Short-Term Worries

The Federal Open Market Committee did not surprise at its two-day meeting on April 29th as it unanimously voted to leave the target Fed Funds rate unchanged in a range of 0.00-0.25%. Heading into the FOMC's session, Wall Street was hoping for a little insight on when it might expect to see signs of recovery from the economy's current state. No such timeline was

Most economists agree that policymakers' actions are aggressive and likely necessary to prevent a catastrophic economic downturn over the course of the next few years. Current actions are indeed dramatic, and the longer term may produce other meaningful consequences. Many have spoken about inflation risk given the enormous amount of stimulus in the

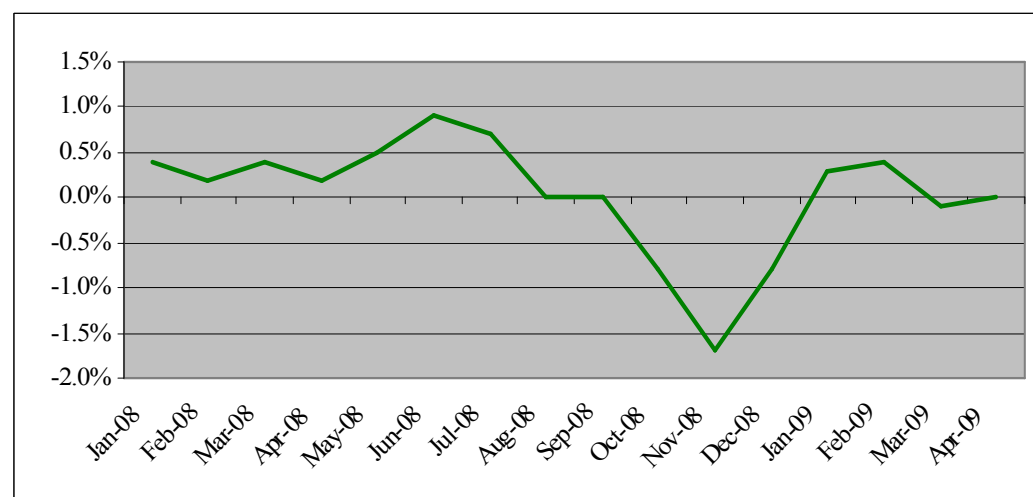


Figure 1. Consumer Price Index (CPI) Month-to-Month since January 2008

Source: Bloomberg

laid out; however, the FOMC issued a statement acknowledging the economy's slowing contraction – the economy continues to worsen, just not as quickly as in prior months. Compared to some of its most recent statements, the FOMC's tepid comments were viewed favorably. The Committee's comments alluded to the waning risk of inflation, and the Fed continues to focus on using any and all weapons in its arsenal to help stabilize the economy. These weapons include maintaining the effectively zero Fed Funds rate and continuing to directly purchase mortgage-related debt and Treasuries, known as "quantitative easing."

system. Yet over the short-term, job losses and falling consumer demand have kept prices from rising and the risk of inflation low, which the Fed recognized at its last FOMC meeting. When the economy heals, though, the Fed will need to withdraw the monetary stimulus strategically to avoid intensifying inflationary pressures. Murmurs of deflation began circulating in the second half of 2008 as price measures were showing weak year over year results. Fortunately, the Consumer Price Index (CPI) reported May 15<sup>th</sup> showed stable prices in April, thereby helping to alleviate the concern of persistent price declines for now.

### Highlights:

- ECONOMY'S CONTRACTION IS SLOWING, STRUGGLES CONTINUE
- CONSUMER PRICE INDEX REPORTED STABLE PRICES IN APRIL EASING DEFLATION WORRIES FOR NOW
- CAPRIN MAINTAINING TARGET DURATION CLOSE TO 5 YEARS, NEUTRAL TO TARGET INDEX
- INVESTORS STILL BEING NICELY COMPENSATED FOR OWNING BONDS IN 10-YEAR PLUS MATURITY RANGE

*"The economy continues to worsen, just not as quickly as in prior months."*

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## Caprin Strategy

We still maintain a 5-year duration target in our municipal portfolios, a posture that is relatively neutral to our benchmark. Over the long-term (12 months and longer), we believe interest rates will trend higher as the economy stabilizes and investable resources are reallocated to riskier asset classes. But in the short-term, the potential for capital market volatility remains high as industry regulations and market sentiment evolve in the wake of the financial crisis. Accordingly, we have decided to remain neutral in our maturity structure and seize attractive yield levels in specific maturities and sectors as opportunities arise.

In our April newsletter, we highlighted our focus on bonds in the 10- to 15-year maturity range due to the relative value we saw at that time. Since that newsletter, those high quality bonds performed extremely well, creating positive returns and supporting the “value” conclusions we developed. Although performance in this part of the maturity structure may have run its course, the yield curve remains steep, and investors continue to be compensated well for owning bonds in the 10-year plus range.

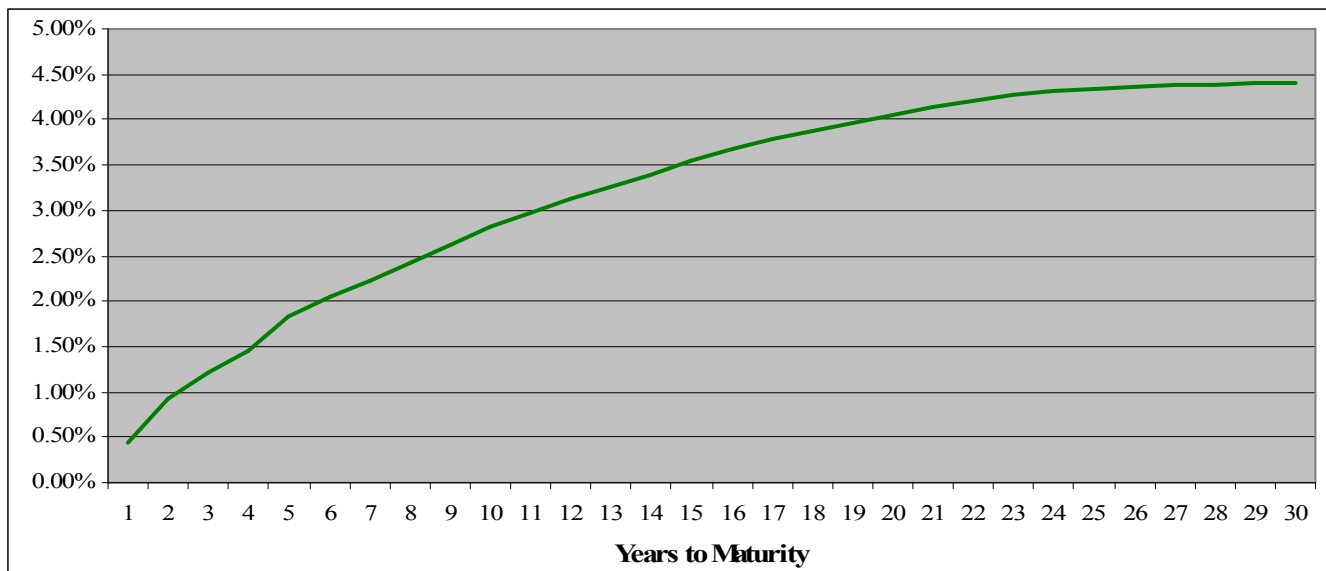


Figure 2. Municipal Bond Yields from 1- to 30-Year Maturities as of May 18, 2009

Source: MMD

We expect yield and income levels offered by the bond market to evolve as policymakers seek to shore up an economy the likes of which we have not seen in over 70 years. We trust our capital preservation and income philosophy remains a valuable strategic component for your overall asset allocation amidst unprecedented uncertainty. Our priorities in these times reflect that mission as we continue favoring high quality bonds supported by strong tax bases or dedicated to essential purpose projects. The resulting portfolios are positioned with lower risks and greater liquidity to assist our clients during these challenging markets.

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