Caprin Asset Management, L.L.C.

7100 FOREST AVENUE, SUITE 303, RICHMOND, VA 23226
804.648.3333
WWW.CAPRINBONDS.COM

Capital Preservation & Income

May 2010

First Steps Toward More Normal Fed Policy

Through the end of April 2010, the US equity markets enjoyed an 11-week rally reflecting momentum spurred on by economic optimism and a relatively positive earnings season. However, in the first week of May, fears over the debt crisis looming in Greece, Spain, and Italy and the lack of confidence in European legislators led to a large, multi-day decline in the Dow. What originally started as concern over the small country of Greece being able to meet its debt obligations evolved into more widespread anxiety over the effects such distress would have on the broader economic system in Europe and beyond. These developments serve as a stark reminder of the volatility, fear, and uncertainty still present in global markets despite some positive economic signals at home. The coincidental rally in US Treasuries reflects that Treasuries remain the "flight-to-quality" investment of choice.

On April 28th, the Federal Open Market Committee left the Fed Funds rate unchanged in the zero to 0.25% range, vowing to keep the benchmark rate at exceptionally low levels for an "extended period." Despite some improvements in consumer data, the Fed continues to cite high unemployment, slow income growth, tight credit, and damaged wealth in the U.S. as drags on the domestic recovery. It is notable that the Fed is crafting into its statement more positive observations on both consumer and business aspects of the economy. Fed meeting minutes also reveal that a dissenting vote has emerged from one FOMC member concerned about the potential effects of a prolonged near-zero interest rate policy. Caprin believes that the slight adjustments the Fed is making to its statements are part of the progression, albeit a glacial one, toward the inevitable tightening of monetary policy ***(Figure 1)***. We will continue to carefully monitor the language coming out of the Fed and the evolving stance on interest rates.

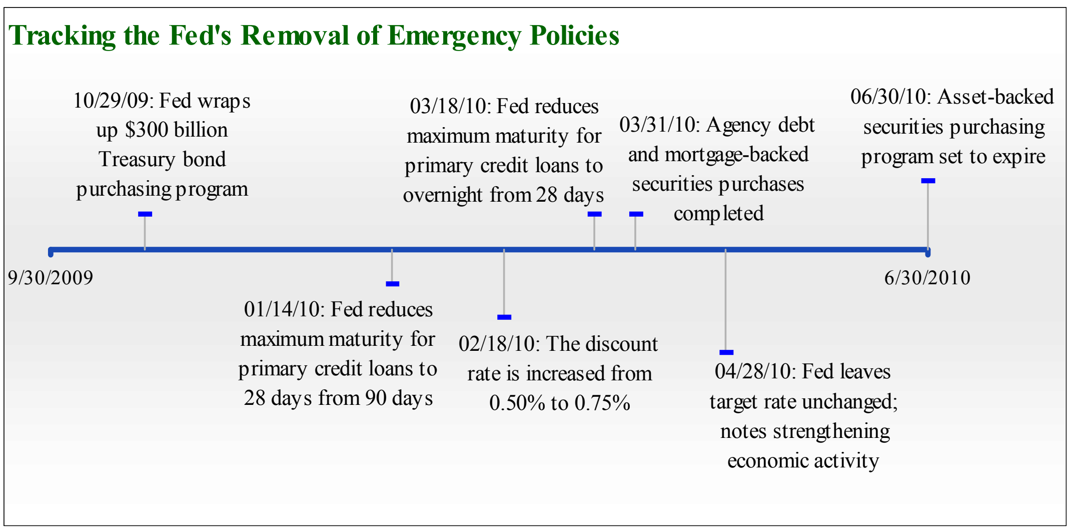

Figure 1. Notable Fed action to remove emergency policy over previous nine months

Highlights:

- FED MAINTAINS 0-0.25% FED FUNDS RATE FOR ELEVENTH CONSECUTIVE SESSION
- CAPRIN BEGINNING TO DEFENSIVELY POSTURE INTERMEDIATE PORTFOLIOS AGAINST POTENTIAL RATE HIKES
- CAPRIN BUILDING PORTFOLIOS WITH A "BARBELL" STRUCTURE, EMPHASIZING LONGER AND SHORTEST MATURITIES
- CAPRIN MANAGING TO A NEUTRAL TARGET DURATION OF 5.0 YEARS

"The slight adjustments the Fed is making to its statements are part of the progression, albeit a glacial one, toward the inevitable tightening of monetary policy."

Caprin Asset Management, L.L.C.

Caprin Strategy

Despite the aforementioned headwinds, broad macroeconomic data continue to show signs of improvement in the consumer and business segments of the economy. Caprin believes that the Fed will have an increasingly difficult time maintaining a near-zero interest rate target. The Fed has steadily removed several of the emergency accommodations put in place to combat the "great recession," including the discontinuation of treasury and mortgage purchases and the raising of the discount rate. If the Fed exits the asset-backed securities market as scheduled effective June 30, 2010, the Fed Funds rate target emerges as the next likely policy tool. Accordingly, economic surveys and the interest rate futures market reflect an increase in expectations for Fed action by the end of the year.

While direct action by the Fed may be months away, Caprin is proactively looking to take steps today to position accounts for that possibility. History suggests that as we approach Fed action, the most likely result will be a flattening of the yield curve. Given the current significant steepness of the yield curve, we believe it makes sense for our

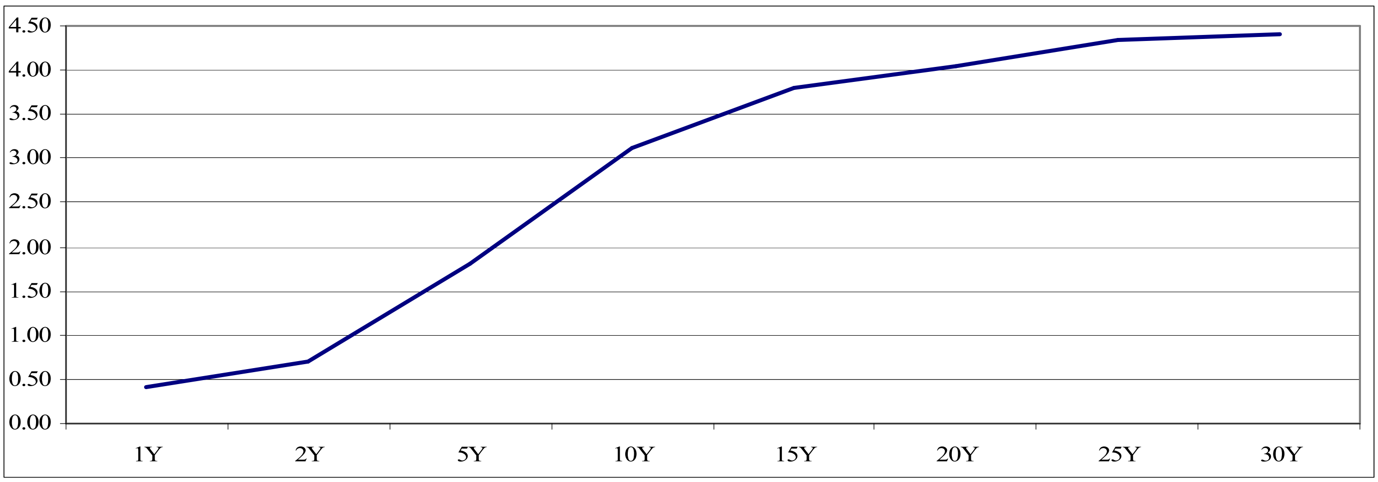

Figure 2. *U.S. Muni G.O. AAA Yields from 1- to 30-Year Maturities as of 05/07/2010* *Source: Bloomberg*

intermediate accounts to lighten up exposure to maturities in the 4- to 8-year window. These maturities may be particularly vulnerable to a flattening curve. Caprin would replace these intermediate maturities with greater weighting in both short and long maturities, maintaining a neutral duration exposure to the market. Selling out of the middle of the yield curve and buying longer and shorter maturities is known as a barbell trade.

Caprin believes that the long end of the municipal yield curve remains relatively anchored by favorable supply/demand fundamentals. Overall, municipal demand is expected to remain strong as investors, anticipating higher taxes, seek out tax-efficient investment vehicles. Tax-exempt supply in the long end continues to be constrained, cannibalized by Build America Bonds, which offer issuers a cheaper taxable-equivalent financing option.

As far as duration management, Caprin believes the ongoing weakness of both housing and employment will keep the Fed from aggressively raising rates so long as inflation indicators remain benign. Recent geo-political driven volatility also highlights the importance of remaining invested until further reassurances of more prevalent growth and stability emerge. Therefore, the barbell trade is intended to soften the blow of unexpected Fed action or the market "front running" the Fed and resulting curve flattening. Our neutral duration stance keeps our accounts invested in the market until we get closer to the next tightening cycle.