Capital Preservation & Income

# Caprin Asset Management, L.L.C.

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## Strong Muni Demand Driving 2009 Performance

Through September 30th, Caprin's intermediate duration municipal bond portfolios in our State-Specific Master Composite* returned 8.29% gross (8.04% net) year-to-date. Municipal bonds as an asset class have performed extremely well this year as the credit crisis abated and strong investor appetite pursued an inadequate supply of desirable investments – a classic supply-demand imbalance.

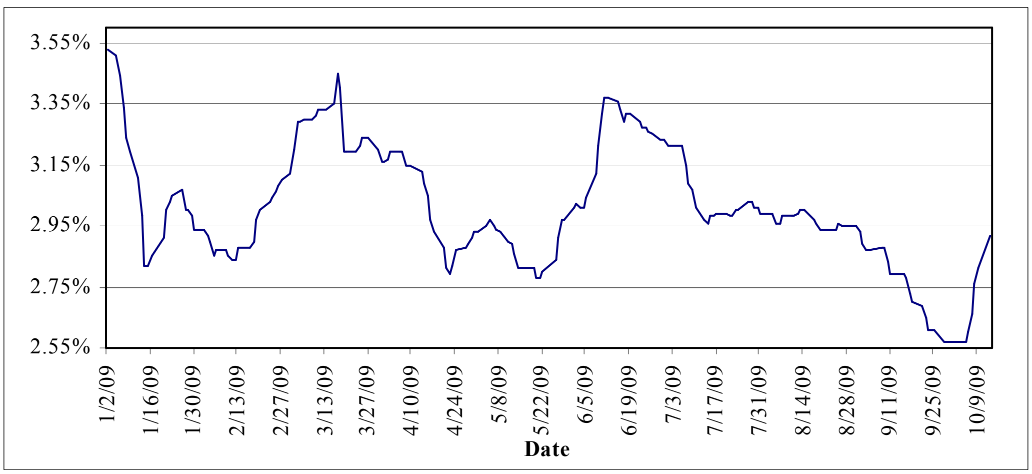


***Figure 1. 10-Year*** *Muni Bond Yields since the beginning of 2009* *Source: MMD*

The high demand for municipal bonds began to unfold earlier this year as investors' risk appetites emphasized quality, liquidity, and less volatility. Municipal bonds offered all three, and as a result, prices went higher and yields were forced lower as demand grew. Despite the six-month stock market rally, this trend continued through September, pushing tax-free yields to near a 42-year low. Investors preferred the safety of municipal bonds in the midst of wariness over an equity market pull back.

Issuance of municipal bonds was down roughly 10% through the third quarter, thus limiting the supply of investments in the face of growing demand. States and localities across the nation cancelled or postponed new infrastructure and essential purpose projects as the recession worsened in early 2009, decreasing the need to borrow funds via new debt. In an effort to invigorate public works projects and create jobs, the Obama Administration introduced Build America Bonds, a form of taxable municipal bond that provides the issuer with a 35% federal subsidy towards the interest cost of new taxable debt. This new type of security provides issuers a cost-saving alternative to tax-exempt municipal bonds and continues to be an influential factor in lowering the volume of new tax-exempt debt.

Strong performance year-to-date has not been without pullbacks, though, and municipal bonds are experiencing higher trending yields as we enter the fourth quarter. Why the sudden reversal? The foundation was laid in late August and September when investors began chasing

### Highlights:

- Historic muni performance through September 30th as investors seek quality and safety
- Performance further propelled by decrease in new municipal bond offerings
- Caprin maintaining target duration of 4.75 years

*"Municipal bonds have performed extremely well this year as the credit crisis abated and strong investor appetite pursued an inadequate supply of desirable investments."*

** Please refer to accompanying Performance Disclosure and Composite Definition* yield in hopes of obtaining a satisfactory return. For example, an investor in mid-August purchasing a 10-year maturity General Obligation Muni would have secured a 3.00% yield. As more and more investors pursued limited supply, prices rose and yields dropped, and that same investor on September 30th would have found only 2.57% for a 10-year GO and the elusive 3.00% yield was available at a 15-year maturity (see Figure 2).

Late September's low interest rate environment enticed municipalities to issue debt before rates rose again. New debt issuance increased dramatically, and this rush to issue continues in mid-October. The supply-demand balance has now changed in favor of the buyer and not surprisingly, municipal bond yields are rising. As of October 13th, investors could earn 2.92% on a 10-year maturity municipal GO, a dramatic 35 basis point increase in just eight trading days.

Environments like the past two months require patience and experience to execute strategy in the face of changing market conditions. Our last newsletter highlighted our August decision to shorten gradually our portfolio maturity targets, as we believed interest rates were unjustifiably low and likely to trend higher. September's interest rate rally ran counter to our longer-term outlook, but provided an opportunity to sell certain call structures and sectors at the year's highest prices as we position portfolios for the future. On the buy side, we were selective given the market environment, preferring bonds offered in the secondary markets at yields above corresponding market levels.

## Caprin Strategy

The Federal Open Market Committee left the target Federal Funds Rate unchanged for the sixth straight session retaining the range of 0.00% to 0.25%. Fed Chairman Bernanke continued to stress that rates would remain low for an "extended period" despite the fact that the global economy continues to improve. Domestically, the housing market and the unemployment rate continue to be the main drags on an economic rebound. Foreclosures are still abundant. More importantly, consumer spending continues to be constrained by fear of job loss and lingering concerns over the restoration and stabilization of wealth lost in real estate and equity markets.

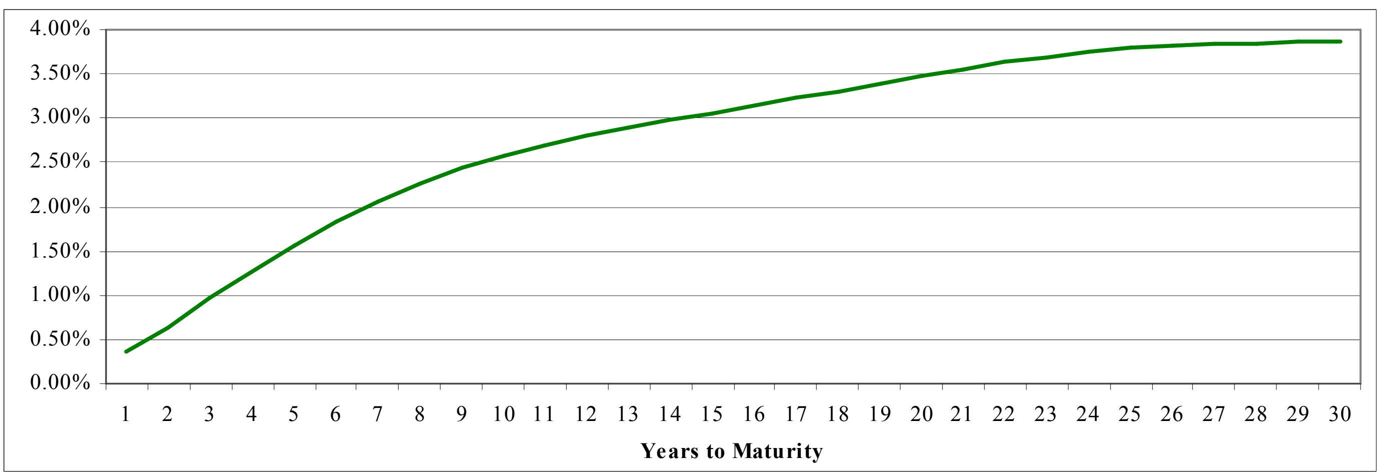


***Figure 2.*** *Muni Bond Yields from 1- to 30-Year Maturities as of 09/30/2009* *Source: MMD*

As economic indicators improve, and the recovery gains traction next year, we expect interest rates to increase and volatility to persist in the financial markets. Investors overreacting to periods of extended optimism and likewise to unwarranted pessimism will drive markets in corrective directions until a new equilibrium is achieved. The renewal of a solid economic base is a process. We will remain proactive in monitoring market trends and will continue to position portfolios to benefit from opportunities consistent with our longer-term outlook. Six weeks ago, Caprin's Investment Committee approved a 4.75-year duration target to prepare for a better economy in 2010, and this target was reaffirmed at our most recent meeting. Maintaining a conservative strategy will be important as we navigate the environment we anticipate during our economic recovery.

# Caprin Asset Management, L.L.C.

**Performance Disclosure**

**Background**

**Definition of Firm**: Caprin Asset Management, LLC. (hereinafter "Caprin"), founded in 1997 in Richmond, Virginia, provides fixed income portfolio management services to individuals, family offices, corporations, endowments, foundations and governmental entities. Caprin, which is employee owned, is an independent, autonomous investment management organization providing advisory services on a separate account and sub-advisory basis. This performance disclosure statement applies to Caprin, as just defined, and encompasses all fee-paying, discretionary portfolios managed by Caprin and aggregated into performance composites as further described herein. A listing and description of Caprin's performance composites is available upon request.

**Composite Construction** All composites have been created from accounts that are fully discretionary, strategy specific and size appropriate given the specific strategy. Size requirements are due to concentration and diversification constraints.

Subject to composite construction criteria, each composite of portfolios represents 100% of the total assets that are managed according to the investment objective of the respective composite.

New portfolios are added to a respective composite in the calendar quarter following the first full calendar quarter under management. Exceptions to this criterion are as follows:

Terminated portfolios are included in their respective composite for all periods up to and including the quarter preceding the quarter of termination. Terminated portfolios will exit the respective composite on the first day of the month during which such notice was received.

Portfolios affected by a change in investment strategy are removed from their current composite on the first day of the month during which the strategy change was implemented. Such portfolios will be assigned to their new composite effective the first day of the calendar quarter following the first full calendar quarter the respective portfolio is managed according to the new investment strategy or upon determination of qualification by the portfolio manager.

Portfolios become non-discretionary under the following situations: quality restrictions, maturity restrictions, erratic cash withdrawals, pre-approval for transactions, or restricted access to custodial data. This list is not comprehensive.

**Investment Strategy: State Specific Municipal**

**Investment Strategy**: Caprin's State Specific Master Composite reflects information from all similar municipal bond accounts of at least $500,000 and carrying total return and state specific municipal bond investment guidelines. Portfolios will be concentrated among securities issued by the state or entities within the client's state of domicile. The State Specific Master Composite and constituent portfolios will be benchmarked against the **Barclays Capital 7 Year Municipal Index.** This index, which is produced by Barclays Capital to measure the returns of general obligation bonds, revenue bonds, insured bonds and pre-refunded bonds that mature between 6-8 years is unmanaged, not investable and does not reflect the deduction of management or other fees that would normally reduce performance of an actual client portfolio. Composite results are US dollar-based, measured internally based upon trade date accounting, and include the reinvestment of dividends and interest. Results for the full historical period are time weighted. The portfolio returns are asset weighted using end-of-month market values. Quarterly, annual and annualized periods are calculated based upon geometrically linked monthly returns.

**Calculation of Returns**

**Fees**: Gross of Fees: Gross returns do not reflect the deduction of management fees or other costs that will reduce the actual experience of the client portfolio. Net of Fees: When noted, all returns reflect the deduction of Caprin's investment management fees and include cash and transaction costs. Additional fees may apply; please consult your financial advisor or custodian for additional information.

**Methodology**:

Dollar-weighted total rate of return using monthly valuations calculated in U.S. dollars and geometric linking of full precision period returns. Prior to June 30, 2000 returns were calculated on a quarterly basis only. Beginning June 30, 2000 returns are calculated on a monthly basis.

Full accrual of interest and dividends.

No derivatives or leverage is utilized in client accounts.

**Performance and Fees:** Gross returns do not reflect the deduction of investment advisory fees and therefore the client's return will be reduced by the advisory fees and any other expenses it may incur. For instance, if a client's portfolio returns 5% in a single year and is charged a fee of 0.5% annually, the net result for the client would be reduced by the amount of the fee charged and result in a net result of approximately 4.5%.

**Investment Management Fee Schedule:** Annual fees for managing accounts in this strategy range up to 50 basis points (0.50%) on accounts less than $5 million and 45 basis points (0.45%) on accounts greater than $5 million but less than $10 million. Fees are based upon total account size and are not tiered. Caprin's investment management fees are fully described on Part II of Form ADV, which is available for review upon request.

**Other Performance Disclosures**

**Composite Dispersion**: Caprin relies upon Standard Deviation as the primary measure for determining and analyzing dispersion among accounts included in any composite.

**Required SEC Disclosures**

**Consultant's Use of Performance Data:** Any use of Caprin's performance data should be accompanied by the required SEC disclosures contained herein.

**Disclaimer**: Past performance is no guarantee of future results. All investments carry a certain degree of risk; it is important to review objectives, risk tolerance, liquidity needs, tax consequences and any other considerations before choosing an investment style or manager. An investment in any bond portfolio should be made with the understanding of the risks involved in investing in municipal bonds such as interest rate risk, credit risk and market risk, including possible loss of principal. The value of the portfolio will fluctuate based upon the value of the underlying securities. The information provided herein should not be construed as a recommendation to purchase or sell any particular security or an assurance that any particular security held in a portfolio will remain in the portfolio or that a previously held security will not be repurchased. Securities discussed herein may not represent a portfolio's entire holdings. It should not be assumed that any of the security transactions or holdings discussed herein have been or will prove to be profitable or that future investment decisions will be profitable or will equal or exceed the investment performance of the securities or strategies discussed.

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Please remember that past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product made reference to directly or indirectly in this piece, will be profitable, equal any corresponding indicated historical performance level(s), or be suitable for your portfolio. Due to various factors, including changing market conditions, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion of information contained in this piece serves as the receipt of, or as a substitute for, personalized advice from Caprin Asset Management. To the extent that a reader has any questions regarding the applicability to their situation of any specific issue discussed above, they are encouraged to consult with the professional advisor of their choosing. A copy of our current written disclosure statement discussing our advisory services and fees is available for review upon request.