



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

Capital Preservation & Income

# Caprin Asset Management, L.L.C.

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September 2007

## Reassessing Risk

Since our last newsletter, financial markets have continued to digest a range of economic and financial data, with volatility and uncertainty increasing in response to daily headlines about mortgage foreclosures, lower home sales, and now a slowing of new job creation.

Financial markets over the past three plus years had developed, in our opinion, an ever-increasing complacency toward 'risk' with

strong economic activity and relatively low interest rates. A substantial amount of money needed investing as the world economy expanded, creating substantial demand for attractive returns. Wall Street responded with sophisticated fixed income instruments, corporate mergers, and leveraged buyout activity. All was well until defaulting 'sub-prime' mortgages reminded the markets and investors that risk does exist.

The heightened market reaction to sub-prime's troubles started with the

investment funds that own them through financial conduits such as 'structured investment vehicles'. In many cases sophisticated investors bought these vehicles because of their AAA rating,

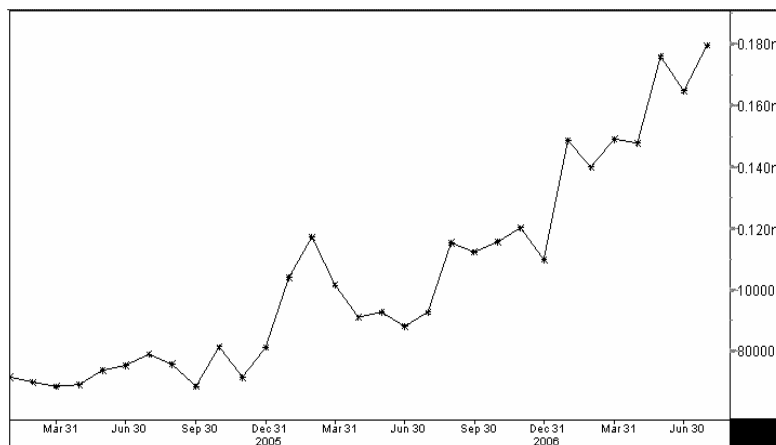


Figure 1. Quarterly housing foreclosures over past three years (in thousands)

Source: Bloomberg

not on a complete understanding of how the investment was actually structured. Now these investors are reassessing what they own and are, in many cases, trying to sell the more risky investments and move to the safety of US Treasury and Agency bonds.

Markets are thus struggling with stress on Main Street from homeowners confronted with mortgages they can no longer afford, and a nervous Wall Street wondering about the value of certain investments. Legislative and monetary policy makers are focused on the poten-

### Highlights:

- MARKET VOLATILITY INCREASES IN RESPONSE TO SUBPRIME MORTGAGE DIFFICULTIES
- INVESTORS SEEK SAFETY OF HIGHER QUALITY INVESTMENTS
- MUNICIPAL BOND PORTFOLIOS HELPING INSULATE CLIENTS FROM MARKET UNEVENNESS
- RESILIENT U.S. ECONOMY HAS BOUNCED BACK FROM SIMILAR MARKET CHALLENGES IN THE PAST

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tial economic difficulties that may arise and are promising steps to restore stability and confidence. The Federal Reserve has already lowered its lending rate so member banks can more readily borrow funds. And Chairman Bernanke has indicated that the Federal Reserve stands ready to take additional steps should matters demand it.

Financial markets go through periods of ‘cleansing’ to work out excesses built up over time. This happened in 1994 (derivatives), 1998 (hedge fund/currency), and 2002 (tech stocks), and in each case the resiliency of the US economy got us back on

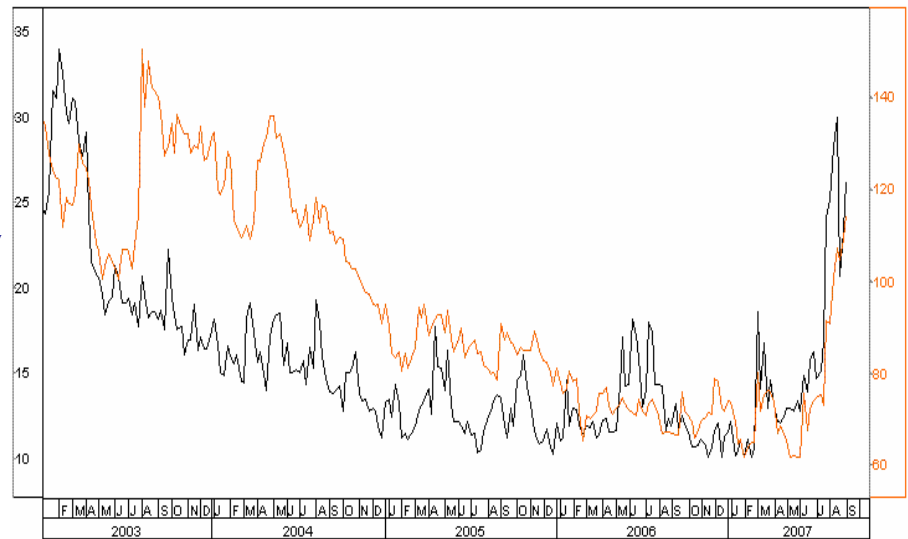


Figure 2. **Interest Rate Volatility** and **S&P Index Volatility** increases in second half 2007

Source: *Bloomberg*

track. We have confidence this recent episode will pass in due course as business financials remain strong, inflation has moderated, and the economy continues to grow.

### Caprin Strategy

Caprin’s investment products seek Capital Preservation and Income, which serves as the foundation for our firm’s name. Our clients have entrusted us with their capital in pursuit of these objectives—especially for times like we are experiencing this summer. Our client accounts invest in direct issue bonds from issuers we follow and understand, not in derivative or structured products. As a result, our positioning and strategy have insulated our client accounts from much of the recent market volatility and helped smooth out some of the unevenness experienced from other investments that clients may own.

The influences driving recent market conditions have actually created intermittent opportunities to add

value to client portfolios. We have seen circumstances where investors desire to sell low risk assets such as municipal bonds in order to generate funds for other objectives. As selling occurs in a volatile interest rate environment, certain groups or issues of bonds may be offered at higher yields to make the sale, creating favorable purchase opportunities for Caprin client accounts. Our team of traders constantly scrutinizes transaction flows from our universe of 65+ dealers, looking to capitalize on attractive offers when they surface. Our conservative fixed income approach coupled with this value-oriented buy discipline continues to position Caprin investment portfolios defensively against broader market uncertainty.

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.