Caprin Asset Management, L.L.C.

Caprin Asset Management's disciplined investment process is dedicated to helping investors navigate the complexities of the fixed income markets by preserving and enhancing investor wealth through thoughtfully constructed, professionally managed portfolios.

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Municipal Bonds

2004 was a year that surprised everyone in the fixed income world. We anticipated that the Fed would start raising short-term interest rates, and practically every strategist on the street expected all interest rates to rise. Instead, we were all surprised that the ten-year and longer maturities rallied through year-end. Two important forces weighed in creating this effect, including larger than expected purchases from foreign sovereignties and a slowing of the economy from rising oil prices. These dynamic undercurrents have continued into 2005, and we expect interest rates to be higher at year-end. From this macro-economic view point, our strategy is to be more conservative, or short, of the S&P Investortools Trust Index while the bulk of the increase in rates occurs, but we plan to use the increase as an opportunity to lengthen duration to be more neutral to our index. We have chosen a fairly conservative index and expect to be able to produce positive returns for the year.

Caprin's Investment Committee also believes that the Federal Reserve is being successful in its effort to oversee an orderly return to less accommodative interest rates, knowing this is Mr. Greenspan's goal as his retirement approaches. The Investment Committee recently set a new duration target at 92% of the index to take effect after rates rose over 4.25% on the 10 year Treasury, up from 3.98%. We anticipate that the 10 year will rise to 4.75% by September 30th. Should the move to 4.75% happen sooner and fundamentals remain in line with our forecast, we will reconvene our Investment Committee to determine yet again the process to bring accounts to a duration target equal to that of our benchmark index. Presently, however, setting a duration target defensive to that of our benchmark should help our accounts outperform our index and fare well in a rising interest rate environment.

One of the biggest reasons we are focusing our discussions on the 10 year is that, in this rising interest rate environment, we expect the short-end to be pushed up more than longer maturities, creating a flatter yield curve. The incremental yield we can earn now in the longer-maturities, coupled with a less significant rise in rates from current levels warrants owning some positions in that 10 year area. According to the Federal Reserve, core inflation has been overstated in the current statistics, and they calculate it to be hovering around 1%. At a 4.65% yield, the real rate is sufficiently above long-term historical averages and does not need to rise as significantly as we thought it might have last year when short-term rates were overly accommodative.

Cash Management

During the first three months of 2005, the Fed continued its march toward higher rates, posting two 25 basis point increases to bring the Fed Funds rate to 2.75%. The May 3 meeting is expected to bring yet another increase.

However, recent corporate announcements and economic news have produced new perspectives for us to consider. After a positive economic tone in the last quarter of 2004, which gave rise to inflation concerns and the possibility of more aggressive Fed rate increases, economic indicators have been more mixed. The pace of new job creation has moderated, energy and commodity prices have leveled off or even declined in some instances, and inflation remains manageable. While this could prove to be a temporary "soft spot" such as we experienced in the fall of 2004, longer term interest rates have reacted downward over worry that it could signal a more modest rate of economic growth than was previously expected.

The spread between Fed Funds and the two-year Treasury, which had widened to over 125 basis points in early March, now stands at about 80 basis points. Our allocation to short term investments (maturities in the 30-45 day range) remains at 25 - 30% on the expectation the Federal Reserve has not yet halted its rate increases. We will maintain these levels and, although the yield enhancement has narrowed, continue to investigate selective opportunities in the 12-15 month range. Additional indications that the Fed's work may be nearing an end will result in a more aggressive extension of maturities as we strive to generate competitive current yields.

Equities

Equity market participants were quite sanguine in late 2004 about continuing positive market returns this year. On the way to Dow 11,000, market participants finally decided to address and recognize economic issues that have been ignored for months- moderating economic growth and rising inflation. A series of lower top line revenue growth at some of our country's largest companies has led to a much needed and, we believe, garden type variety correction in all the major averages. Market sentiment as expressed in the American Association of Individual Investors readings is only 16% bulls, which is the lowest reading since 1992, and the four week averages are consistent with levels that have been reached at all meaningful market bottoms over the last two decades. We remain constructive towards <u>high quality</u> equities and look for a resumption of the market's upward bias in due time.

Thank you again for your continued trust in Caprin. Please do not hesitate to contact us should you have any questions.