

Caprin Asset Management, L.L.C.



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

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Who would have thought that the end of 2002 would see interest rates at their lowest level in over 40 years? In the beginning of the year, it appeared that the economy was growing, albeit slowly, that, after 11 Federal Funds reductions in 2001, we were sure to have some rebound in the equity markets. Instead, we witnessed a deterioration in confidence and destruction in the integrity of many corporations considered too big to fail. The war on terrorism continued, and war on a new front now appears inevitable. These concepts brought fear to the market place. With fear comes increased volatility. And increased volatility inherently generates many opportunities for active managers.

For the third year in a row, the investment grade, fixed income markets were the darlings of Wall Street. Long U. S. treasuries turned in total returns in excess of 20%, and total returns for intermediate treasuries (7-10 year maturities) were double digit. While the municipal market posted a very solid year with long bonds up 10%, relative under-performance came from two fronts: a 25% increase in new issue supply and a general concern over State budget deficits. Close to home, North Carolina saw its Aaa credit rating cut to Aa1, and Virginia was placed on negative credit watch for a possible downgrade by Moody's.

During this volatile time, we positioned portfolios more conservatively. Our focus was on **Capital Preservation** and **Income** generation. We realize you entrust us with your "sleep at night" funds, and, unlike many investors who reached for the yield in lower quality bonds, we chose to pass. Our reticence to chase yield was a wise one as similar maturity, high grade municipal bonds outperformed lower quality bonds by as much as 4% for the year.

We expect more modest returns for the municipal market in 2003 as interest rates stabilize and revert to higher levels. The Federal Reserve's easy monetary policy should stimulate economic growth. War may begin. The US Dollar may begin its fall from glory. Gold and oil prices are rising. These and others are among the many factors that will affect the markets during the year to come. Our approach of investing in high quality portfolios that have a high degree of liquidity will offer us opportunities to take advantage of the volatility we expect to continue. In order to protect portfolio value should interest rates start to rise, we have focused on buying higher coupon bonds and emphasizing the 5-9 year portion of the yield curve, where the current steepness offers substantial income pick-up.

Caprin had an exceptional year in 2002 as we saw assets under management increase from \$64.7 million to \$125.2 million. In addition, we added two new Managing Partners. Eddie Horner, a national figure in the municipal industry with over 25 years of municipal bond experience in trading and underwriting, helped us open our Lynchburg office. Mark Sisisky, who was President of Lee Distributing, the Anheuser Busch distributor for Southside Virginia, sought his true passion, investment management. Mark served as Chief Investment Officer of his family investment partnership for over 15 years. Adam Plotkin joined us to work with Cheryl in support of portfolio management, and Ellen Wiley joined Eddie in Lynchburg to provide client support and assist with new client assimilation. These additions will continue to support our efforts to stand vigilant over our clients' portfolios. To those of you who are our clients we thank you for your continued trust in Caprin. We are working to do something good for every client every day.

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