CAPRIN
Asset Management, L.L.C
Capital Preservation & Income

Caprin Asset Management, L.L.C.

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

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Uncharted Waters, Unprecedented Action

The Obama administration's much-anticipated stimulus package received Congress' stamp of approval on February 13th, committing the United States to an unprecedented $789 billion plan in the hopes of reinvigorating a badly bruised American economy. From the first iteration to the finalized draft, the stimulus package has been downsized roughly $70 billion in last minute efforts to trim spending levels below the $800 billion mark. Various provisions supporting new home and car owners were scaled back as several members of the Senate deemed the allotments excessive; and Obama's tax cuts for individuals and families were reduced 20%. However, the vast legislation focusing on U.S. infrastructure projects remained intact, with close to $100 billion dedicated to building and improving highways, railways, and public facilities. This should create thousands of new job opportunities and help arrest rising unemployment statistics which most recently rose to 7.6% of the workforce. The effectiveness of Obama's stimulus package will depend on its ability to spur measurable, long-term growth and to create newfound confidence in Washington's ability to craft and execute economic policies. If global markets and investors deem the U.S.'s enormous spending plan ineffective or futile, our economy is at risk of worsening, and at a great cost.

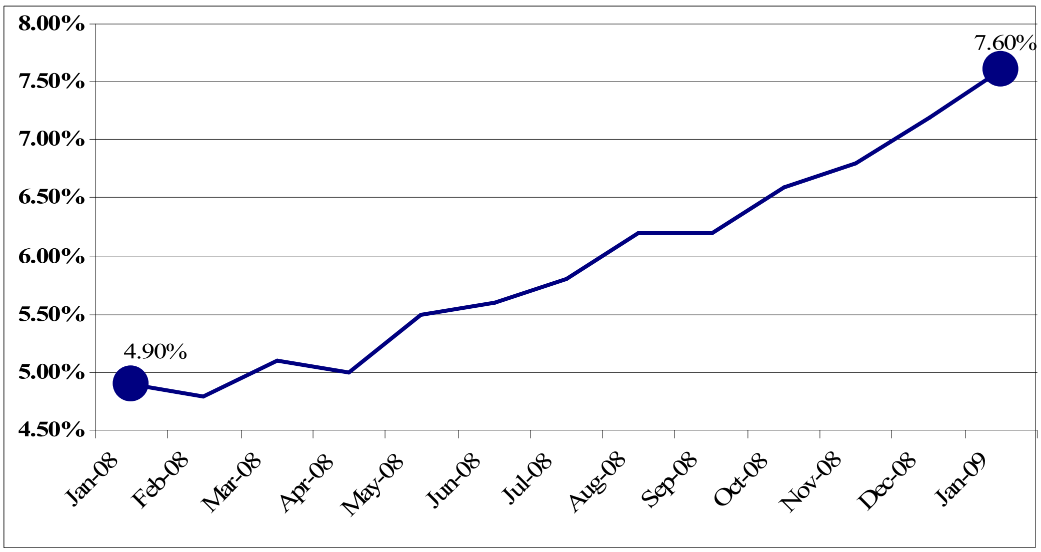

Figure 1. *Monthly U.S. Unemployment Rate since January 2008* *Source: Bloomberg*

Simultaneously, Secretary of the Treasury Timothy Geithner unveiled a broad sketch of the Administration's $500 billion Economic Stability Plan (ESP). The ESP calls for federal investment in the struggling banking sector, a strategy that will hopefully unfreeze the credit markets and jump-start lending to businesses and consumers. The plan seeks to purchase toxic assets from banks' balance sheets and inject sufficient amounts of capital to

Highlights:

- UNPRECEDENTED STIMULUS PACKAGES CREATE MANY UNCERTAINTIES IN INVESTORS' MINDS; MARKETS
- ANXIETY AND VOLATILITY WILL CHARACTERIZE EQUITY AND BOND MARKETS OVER THE NEAR TERM
- CAPRIN MAINTAINING TARGET DURATION CLOSE TO 5 YEARS, NEUTRAL TO TARGET INDEX
- CAPRIN CONTINUES TO FOCUS ON HIGH-QUALITY POSITIONS, 10- TO 15-YEAR MATURITIES

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stabilize them. In response, the Administration hopes more readily available loans for homes and auto purchases will resurrect those battered sectors. However, many questions remain unanswered. Will banks have enough capital to remain independent lenders? Will the plan help slow the rate of foreclosures in a timely manner and stabilize the decline in housing prices? Since the aforementioned primary announcements, the Administration has disclosed additional programs and clarifications to help fill in some of the uncertainties that had caused initial discomfort in many sectors. Investors can expect anxious and volatile markets in the coming months as the uncertainties evolve into realities.

Caprin Strategy

A pertinent question for Caprin clients is, "How will the new stimulus package affect the municipal market?" Over $200 billion has been designated to help states cope with their sizable fiscal shortfalls and fund various work projects across the country. Clearly stabilizing state and local operating cash flow shortages is an important first priority. Longer-term, state governments will likely reflect on their fiscal budgets and the reality of debt servicing capabilities in the post-credit crisis world. It is possible the $200 billion provides state officials with breathing room for their current operating budgets, and 'capital' projects funded through municipal bond issuance can be restarted. A more conservative approach suggests state governments 'wait and see' on new projects and debt issuance until a clearer view of an economic recovery materializes.

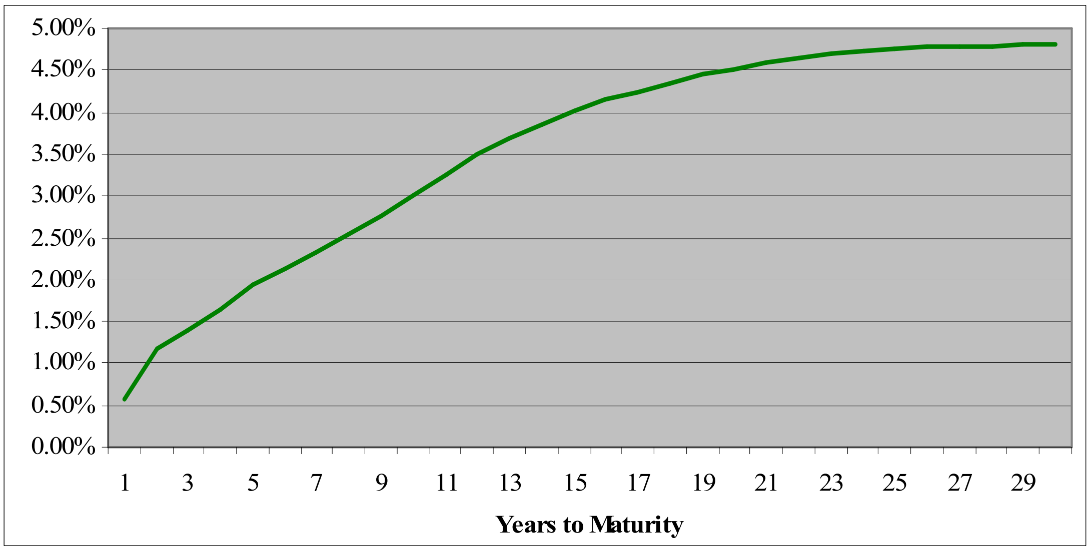

Figure 2. Municipal Bond Yields from 1- to 30-Year Maturities as of February 20, 2009 *Source: MMD*

In either case, Caprin's proactive approach to navigating the evolving municipal market environment will seek attractive investment opportunities while maintaining our capital preservation and income foundation. Currently, we find value in bonds in the 10- to 15- year maturity range, where investors continue to be compensated relatively well despite the recent decline in yields. To complement investment allocations in this range, we are purchasing bonds with shorter maturities to maintain our overall 5-year duration target. The shorter maturity bonds provide investment value by having less price risk and by generating maturity cash flow to reinvest in appropriate maturity ranges when interest rates begin to rise. As always, our focus will continue to be on purchasing high-grade bonds that provide our clients with liquidity and security in their fixed income portfolios amidst the recent volatility dominating today's headlines.