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

# Caprin Asset Management, L.L.C.

1802 BAYBERRY COURT, SUITE 202, RICHMOND, VA 23226
804.648.3333 WWW.CAPRINBONDS.COM

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## FOMC Summary: Cautiously Optimistic

Following its two-day meeting on April 27th, the Federal Open Market Committee left the Fed Funds target rate unchanged (0-0.25%) at its long-standing December 2008 target. Fed Chairman Ben Bernanke acknowledged the economy would continue to require support via the Fed's accommodative monetary policy over the short-term despite signs of employment sector improvement and indications of broader economic traction. The Fed still expects the current round of quantitative easing to expire as scheduled on June 30th. However, the language used in the Fed's statement and the special post-meeting Q&A held by Bernanke seemed to leave the door open for further Fed stimulus (QE3) if necessary.

The Fed's statement was also cautious when detailing the economy's recent improvement and prospects of continued growth. Federal Reserve policymakers maintain that inflationary pressures (especially in food and energy prices) are temporary and are a result of an improving economy. However, the same anchors that have hampered a more rapid recovery are still at work - namely, the weak housing and real estate sectors.

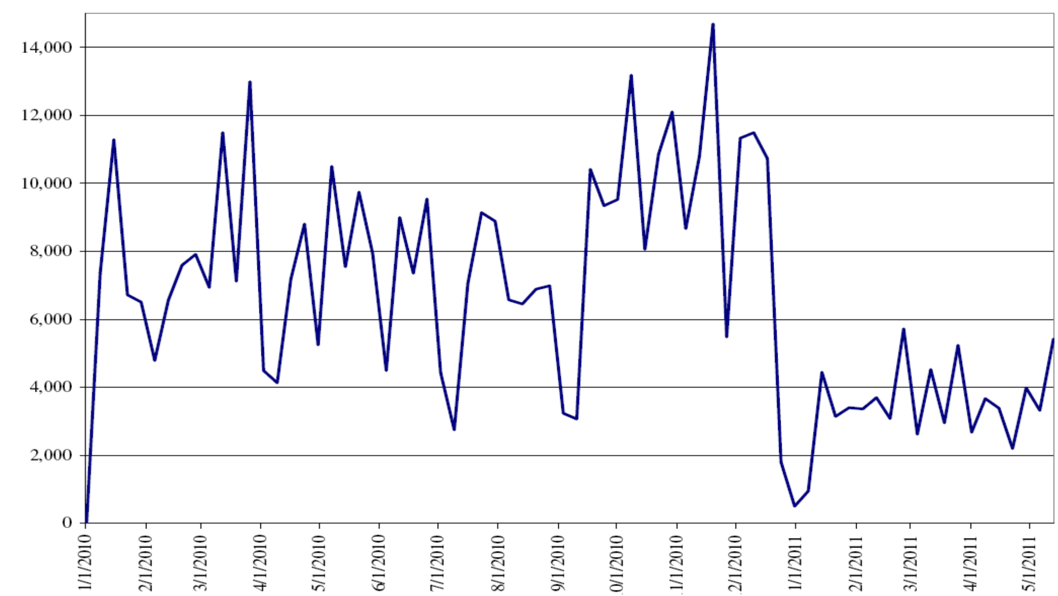


*Figure 1. New Muni issuance from 12.31.09 through week of 05.13.11* **Source: Bloomberg**

### Highlights:

- Fed maintains 0-0.25% Fed Funds rate; QE3 still a possibility
- Fed maintains inflationary pressures are temporary; housing and labor markets continue to disappoint
- Record-low Muni supply cannot keep pace with strengthening demand in the Municipal space
- Caprin portfolios maintian neutral target duration; continuing selective yield purchases

*"2011 might just produce the lowest volume of new supply in over a decade."*

## Muni Market Dynamics: Demand Overwhelms Supply

In 2011, Municipal Bond supply has been severely constrained (*Figure 1*), and demand for tax-exempts has outweighed availability for the majority of the year. The reasons have been well-documented in our previous commentaries and include: 1) accelerated issuance at the end of 2010, 2) state and local budget constraints, and 3) volatility in Municipal Bond pricing. The new issuance drought has now dragged on longer than many initially predicted, and Muni market forecasters again are scaling back total 2011 issuance expectations. General consensus now foresees 2011 issuance in the $200-250 billion

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range, which might be less than the amount maturing, suggesting a slight contraction in total tax-exempts outstanding. 2011 might just produce the lowest volume of new supply in over a decade.

This supply-demand imbalance created a sharp rally in Muni prices over the past several weeks as market participants 'reached' for bonds as the supply picture became increasingly thin. The Caprin Intermediate State-Specific Composite participated in the rally, returning 1.60% in the month of April, even more notable given the typical underperformance of Municipals around 'tax time'.

Strength in tax-exempts persisted despite anxiety over budget shortfalls among Municipal issuers and Municipal Bond fund outflows ongoing for the 25th consecutive week. Yields now sit at their lowest levels (highest prices) of the year. We expect them to remain low in the near-term as the market catches its breath and reassesses the prospects for an improved supply picture. Any meaningful uptick in new Muni supply in the coming months would move yields higher but those prospects seem unlikely at present.

## Caprin Strategy

***Caprin Intermediate Strategy***

Caprin is maintaining a neutral duration target and continues to build portfolios with a fairly laddered (evenly distributed) maturity structure emphasizing the 2- to 14-year maturity range. This structure served our portfolios well over the past month by capturing the strength in the tax-exempt market without extending maturities where investors were not compensated for higher risks.

To help offset the historically low tax-exempt supply, Caprin continues to use out-of-state opportunities where the value offsets the tax impact the purchase may have for the investor. Our out-of-state focus generally reflects our footprint bias, but improving conditions in select names, particularly in higher quality, actively traded issues, should allow for an expansion of this opportunity set. In addition, we continue to focus on healthcare, power, transportation and education bonds to inject yield into portfolios. We will continue to purchase bonds in these sectors, expecting incremental performance as strength returns to the economic landscape. Higher quality positions such as AAA/AA-type G.O. and essential purpose revenue bonds still remain the cornerstones of our liquidity strategy and allow us to proactively reposition portfolios and seize value opportunities when warranted.

***Caprin Short Maturity Strategy***

Our strategies for Short Maturity portfolios remain largely intact given no expected change in Fed policy in coming months. Portfolio investments remain distributed over the target three-year horizon with a bias slightly long of neutral to maintain income levels. Our strategy also seeks an incremental yield advantage by investing in sector opportunities (albeit with shorter maturities) consistent with our intermediate portfolios. We also expect to add 'improving state' names once our criteria are met. For the near future, our strategies will continue to seek sector and intermittent trading opportunities to maintain or improve yield in this range-bound environment.

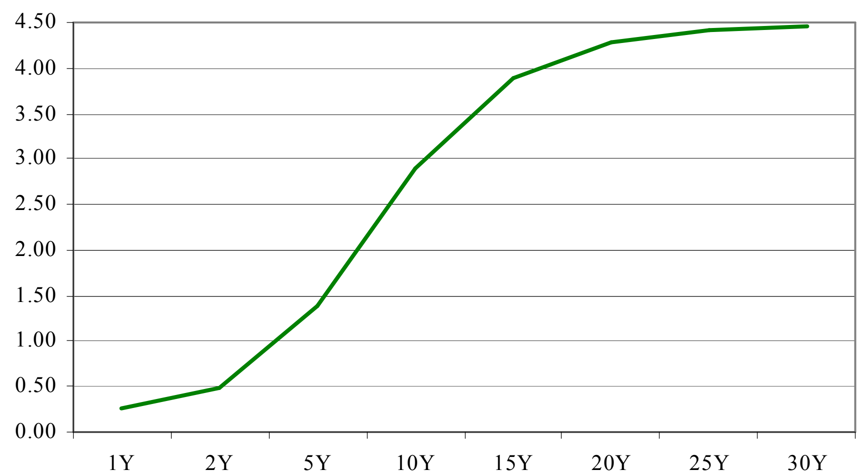


***Figure 2***. *U.S. Muni G.O. AAA Yields as of 05/16/11* Source: Bloomberg

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