



Capital Preservation & Income

Caprin Asset Management, L.L.C.

7100 FOREST AVE., SUITE 303, RICHMOND, VA 23226

November 2007

Housing Tumbles; Commodity Prices Soar

The Federal Reserve Bank Open Market Committee lowered the target for the Federal Funds Rate by a quarter point to

central force behind our economic trials for the past several months and the market clearly has not found the bottom.



Figure 1. Existing home sales in 2007 (in millions)

Source: Bloomberg

4.5% at their October 31st meeting in the face of a slowing domestic economy. Since July of this year, the U.S. economy has maintained a slow yet steady pace of growth; however, through the last quarter of the year and into early 2008, the Fed expects additional slowing as the ongoing housing correction intensifies.

The number of U.S. home foreclosures has doubled since the beginning of 2007, and the foreclosure rate is increasing rapidly. In the same time span, the number of existing homes sold has plummeted, resulting in declining home prices due to the drop-off in demand. The housing market struggles have been the

American consumers also face commodity and energy prices at all-time high levels, with no definitive end in sight to their ascension. Consequently, headline inflation numbers (which include food and energy prices) persist at significantly elevated levels. Recent Federal Reserve Board commentary suggested a balanced view of inflationary and growth risks in setting monetary policy. With that said, financial conditions at a wide range of banking, investment, and insurance institutions deteriorated during November suggesting a fresh look at prevailing assumptions might be warranted.

Highlights:

- HOUSING MARKET STRUGGLES REMAIN MAIN DRAG ON THE U.S. ECONOMY
- FEDERAL OPEN MARKETS COMMITTEE CUT FED FUNDS RATE 25 BASIS POINTS IN RESPONSE TO MIXED SIGNALS
- CAPRIN MAINTAINING TARGET PORTFOLIO DURATION IN ANTICIPATION OF FURTHER MARKET FLUCTUATIONS
- CAPRIN CONTINUES TO FOCUS ON PURSUING CREDITWORTHY BONDS WITHOUT RELYING ON INSURANCE

“The broader economy has the strength and resilience to avoid slipping into a true recession.”

Caprin Asset Management, L.L.C.

Caprin Strategy

It is likely that economic growth will decelerate over the next six to eight months, increasing the need for additional cuts in the Fed Funds Rate. But we think the broader economy has the strength and resilience to avoid slipping into a true recession. Furthermore, based on the timing of the economy's continued downturn, it seems the main stretch of the presidential campaign might closely coincide with 2008 economic struggles. Extra attention paid to U.S. economic issues on such a large stage could provide the political pressure needed to create more optimistic outlooks and a positive shift in the economic cycle.

Regardless, until inflationary pressures are reduced and the housing correction moderates, the U.S. may continue to experience high relative volatility in both the bond and equity markets. The weakening U.S. dollar, restricted credit resources and a general lack of consumer and business optimism are prime examples of some of the factors clouding economic forecasts. Caprin will maintain its target portfolio duration of 4.5 years for clients' municipal bond portfolios in the face of the current market fluctuations in order to uphold our conservative approach to the preservation of capital.

No Credit Concerns for Caprin Investors

A mainstay feature of the Municipal Bond Industry has been the ability to enhance the credit rating of bonds via a third party guarantee from a select group of insurance companies. Since mid-October, negative press on these insurers has increased as their exposure to mortgage-related structured investments has been disclosed. How did this "problem" come about? Quite simply, these bond insurers stepped into a non-traditional market for them by agreeing to insure some of the exotic structured products we have read about, (i.e. CDO's, SIV's, TOB's).

Though the insurers in the Muni industry may go through a period of stress, these outside influences should not affect the integrity of the insured bonds we own in our client portfolios, for several reasons. First and foremost, Caprin has always made it a policy to primarily consider the rating of the underlying municipality in those cases where bond insurance is present. This holds true for bonds transferred with new accounts and bonds being considered for purchase. In that way, we view bond insurance as a bonus, not a requirement.

In June, before any of the recent 'bad' news hit the wires, Caprin examined every holding with bond insurance. We refreshed our assessment of the purpose of each bond as well as its underlying rating. The findings of this investigation coupled with the widely held view that the creditworthiness of municipal bonds compares favorably to similarly rated corporate bonds reaffirmed our decisions regarding these bonds.

Lastly, Caprin has not and will not purchase bonds that are or could be construed as structured products. Securities in this class have risk characteristics that are inconsistent with our capital preservation and income missions. We continue to monitor this evolving situation closely, and we regularly review client holdings. And while the market experiences volatility because of the issues associated with the insurance "problem," there will be opportunities for Caprin portfolios. In the end, clients need not worry about their 'insured' holdings because of our fundamental processes and our proactive initiatives.

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.