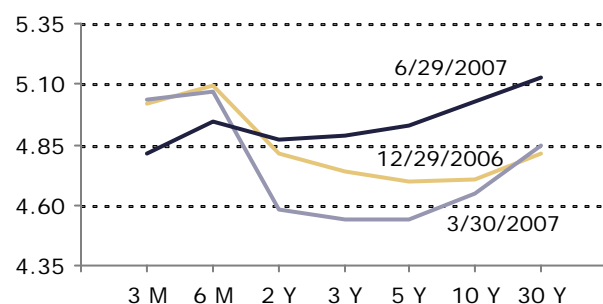


Tax Efficient Fixed Income

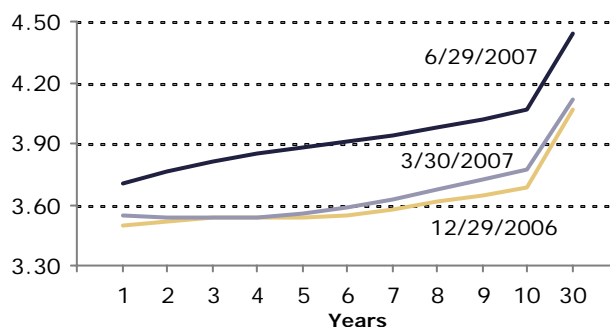
2nd Quarter 2007 Review and Outlook

The second quarter was a difficult one for the bond market and there was little shelter from the storm as interest rates rose across the yield curve. The capital markets continued to be volatile during the quarter, as concerns about sub-prime mortgages, the economy and terrorism ebbed and flowed. By quarter end, bond yields had increased modestly in what can be described as a bear steepener (e.g. long rates increased more than shorter rates). During most of the quarter and year to date we have focused on four key areas that have allowed us to outperform the market: 1) maintaining durations shorter than the market, 2) positioning on the yield curve to benefit from a steepener, 3) favoring high quality sectors and sub-sectors, and 4) favoring municipals over taxable sectors.

U.S. Treasury Yield Curves



AAA GO Municipal Yield Curves



In a reprise of early summer 2006, bond yields rose sharply from mid-May through mid-June before retreating somewhat at quarter-end. The move ended an eight-month period during which yields traded in a narrow range. You may recall that the Federal Reserve implemented its last rate increase one year ago, and bond yields promptly fell, as investors assumed that their next move would be a cut. The economy supported that assumption by slowing significantly last fall and throughout the winter, bringing with it forecasts of lower inflation. The housing market weakened further and the sub-prime mortgage problems attracted the market's attention, keeping bond yields well below money market rates.

As you know from earlier commentaries, Samson has held short the duration of our clients' portfolios in order to protect principal during this period of rising rates. We were convinced that value lay with the higher yields on shorter-dated bonds and that those yields would not be as transitory as the yield curve implied. That approach was rewarded when economic indicators pointed to a rebound in the quarter just passed. Commodity prices stiffened, exports grew, stocks rallied, corporate earnings continued to grow, and credit spreads narrowed, weakening the assumptions necessary to hold bond yields below short rates.

We are not certain that economic conditions point to a higher Fed Funds rate, but we have consistently believed that the Federal Reserve is sufficiently concerned about inflation to hold the rate at 5.25% for far longer than implied by forward curves and futures markets. If the Fed is proved right about that, then Treasury bond yields will likely move to levels higher than the Fed Funds rate and municipals will likely follow suit. Conversely, if it becomes apparent that the problems in the sub-prime sector and the US housing market are flowing into the broader US economy, then the path of the Fed and US interest rates would likely be lower. It is too early to tell which path is more likely, so we are keeping our durations near the benchmark and maintaining a high quality bias in the meantime.

July 24, 2007

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