Tax Efficient Fixed Income

4th Quarter 2005 Review and Outlook

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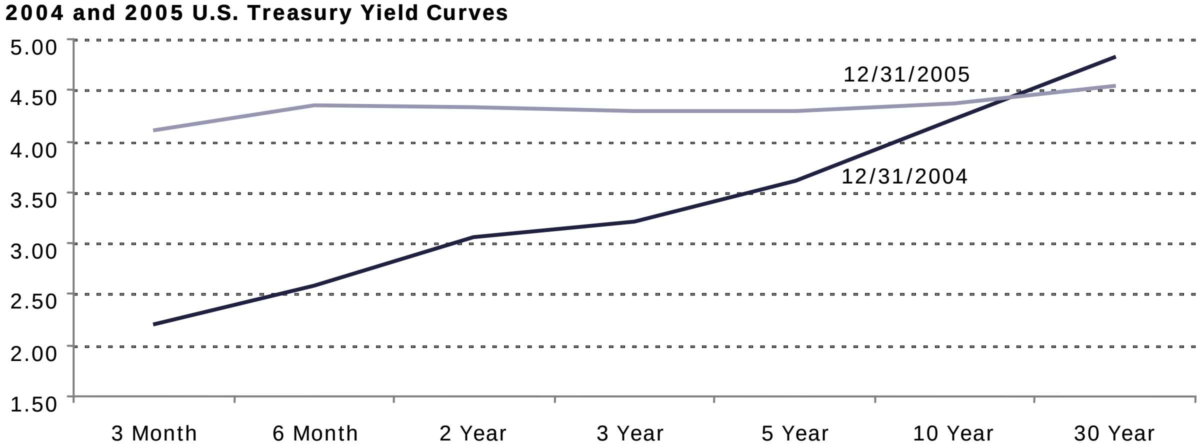
The most remarkable fact about the fixed-income markets for 2005 is that, despite a 200 basis point increase in the Fed Funds rate, from 2.25% to 4.25%, virtually all sectors of the fixed income markets – both taxable and tax-exempt – showed positive returns. These returns may not have been especially robust, but they were competitive with some major stock indices, such as the DJIA and NASDAQ 100. Throughout this period of low interest rates, Samson has worked to protect portfolios' principal and flexibility to be in a position to enjoy higher returns when rates peak. We believe that returns in 2006 will be better than those of 2005, in part because 2005 ended with short and intermediate-dated interest rates significantly higher than where they began the year.

The bond market in 2005 was all the more remarkable given the strong growth of the U.S. economy, which built on an economic rebound that began in earnest in the last half of 2003. That economic strength continued despite the occurrence of some of our worst natural disasters ever – Hurricanes Katrina and Rita; the continuation of extremely expensive wars in Iraq and Afghanistan; the spike in energy prices; and the continued accumulation of large fiscal and trade deficits. The major factors in capping long rates as the Fed drove short rates higher were tame core inflation and purchases of U.S. bonds by foreign investors and central banks. A recent study by the Federal Reserve claims that ten-year U.S. Treasury rates would be 150 basis points higher without foreign demand; this would have potentially caused a steeper yield curve. Presented below is a graph of the U.S. Treasury yield curves as of year-end 2005 versus year-end 2004.

2004 and 2005 U.S. Treasury Yield Curves



Economic resilience and growth were not confined to the U.S. economy. Especially noteworthy are the emergence of India as a major world player, and large purchaser of U.S. Treasuries, and the re-emergence of Brazil as a diversified economic powerhouse (agriculture, heavy and light manufacturing), now working to pre-pay much of its International Monetary Fund borrowings. Just as noteworthy is the recent ascendance of Spain, like Ireland, a model for much of the "new" Europe, with a population of 40 million, whose GDP surpassed that of Canada with a population of 32 million.

Last year also saw a continuation of sharp increases in commodity and energy prices, spurred by a combination of increasing global demand and limitations on production and shipment capacity. So far, these higher costs have had a muted effect on domestic and global inflation levels and even less effect on economic growth. The housing market also continued to be robust, lending considerable support to consumer spending. However, by year end, there were indications that growth in that sector, although still positive, was losing some of its upward momentum.

In response to our assessment of good economic growth and continued Fed rate hikes, Samson adopted two major positions during the course of the year. During the first half of the year we favored a barbell structure, designed to protect principal with the shorter holdings, yet earn a reasonable rate of return with intermediate and longer dated holdings. For most of the second half of the year we focused on a bulleted strategy, as intermediate rates rose to their highest levels in several years and most of the Fed tightening was behind us. In both strategies, we held the average durations shorter than that of the benchmark. These portfolio decisions were most responsible for our added value for the year.

Going forward, we believe that the first quarter will be somewhat similar to the last half of 2005. Economic growth will continue at current levels, and energy prices will remain volatile but manageable. There may be upward pressure on inflation, in part due to the weakening of the dollar after its surprising strength last year. We note that intermediate and long-term rates remain attractive enough to encourage economic activity, both here and abroad. The bond market is now priced for one or two more 25 basis point tightenings, based on the Fed's own minutes of their recent meetings. Whether economic data support that assumption will be the major determinant of market direction in the first quarter of 2006.

In addition to our focus on the direction of interest rates, we are also mindful of the way credit tightening frequently sparks credit calamities. Current indications are that these would be manageable, but we note the limited effect that Ford's and General Motors' descent into junk status had on the overall bond market. Whether this is due to a healthy economy or investor complacency remains to be seen, but narrow credit spreads offer little room for error.

While bond rates, short and intermediate, have increased significantly over the past year, we have no immediate plans to lengthen portfolio duration. The case for continued low rates remains conditioned on support from foreign bond buyers, quiescent inflation and moderate economic growth. We will continue to monitor these and other important factors as 2006 unfolds.

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