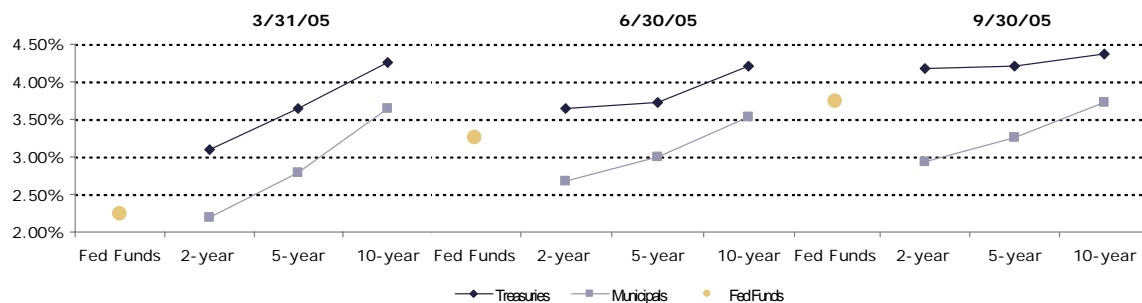


Tax Efficient Fixed Income

3rd Quarter 2005 Review and Outlook

The Federal Reserve continued its campaign to increase short term rates in September resulting in the end of the resistance of long rates to the Fed actions. Surprising some who thought they may skip a turn in deference to the destruction brought about by Hurricane Katrina, Fed governors continued its program of one-quarter point increases in the overnight bank rate. They assumed that while the resulting disruptions to employment and consumption would be temporary, “higher energy and other costs have the potential to add to inflation pressures.” We continue to monitor inflation pressures to determine if the current environment reflects a temporary phenomenon or the beginning of a longer trend.

In the 3rd Quarter, short and intermediate rates were driven higher in a continuation of the two-plus year trend. Longer-dated rates – and here is a new development – finally broke higher, a sign perhaps that investors have also grown more concerned about inflation and about the serious deterioration in our nation’s balance sheet. Even with the upward adjustment in ten-year rates, one must assume that the Fed is close to the end of its credit tightening program in order to get very excited about present yields, and we are not.



For most of 2005, we maintained a barbell position with respect to the yield curve, purchasing bonds on the short and longer end while avoiding the middle part of the curve. This approach outperformed as the yield curve continued to flatten. We changed our yield curve strategy at the end of August, when Samson’s investment committee decided to move our portfolio structure away from the barbell and toward a more bulleted approach – focusing our new purchases in the middle of the range, and funding those purchases with sales of shorter and longer bonds. We are taking these steps because our analysis of the yield curve suggests that the curve is unlikely to flatten further, and that the risks are growing for a portfolio structure that emphasizes longer maturities.

As our earlier commentaries highlighted, we continue to be concerned about complacency in the bond market. The yield differential between low risk and high risk assets – with risk defined in terms of credit or duration – has deteriorated. There is little margin for safety in a world where the reasons to seek safety are multiplying daily. As yields return to more normal spreads, lower rated or longer dated bonds will suffer poor returns.

While Samson portfolios outperformed the market in the third quarter, we take no pleasure in beating the bond index (and stock indices too, for that matter) when the absolute return is so low. Our first obligation is to protect principal while capital market rates continue to work their way back to compensatory levels. In this environment, we have managed portfolios defensively over the past year. We are presently positioned to take advantage of the higher interest rates.

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