

## Tax Efficient Fixed Income

### Period Summary

2007 was a year of historic significance for municipal bonds. Many of the assumptions that served as the foundation of the municipal market had been compromised. The events of 2007 highlighted the importance of a disciplined risk management process. The year began with tight spreads, investor complacency towards credit risk, and a market operating on the assumption that the work of bond insurers and credit ratings agencies could protect investors from risk. As a result credit risk was mispriced, and yield differences between higher and lower quality rated instruments was minimal. Furthermore, many securities rated AAA truly did not deserve this designation as experience would show. Investors learned they could not rely solely on rating agencies and bond insurers to preserve their principal against credit risk and spread volatility.

Samson maintained a disciplined approach during a period of increased volatility and uncertainty. Throughout the year Samson sought to increase the quality of the portfolios as we believed that lower quality instruments were overvalued. We purchased prerefunded securities and highly rated municipal bonds that met our credit research standards. We limited our exposure to bond insurers as part of our risk management approach. Furthermore, we structured our portfolios around the 5-year part of the curve, as we believed the probability of a steeper yield curve was greater in an environment where the Federal Reserve could continue to ease. This proved to be the best part of the curve for both municipals and treasuries. The table to the right summarizes the Lehman Municipal Index returns across the yield curve

The trigger for this onset of economic and market turmoil was, of course, the aggressive mortgage lending that fueled what now appears to have been a real estate bubble. The resulting losses at major banks and investment firms have hurt confidence in the credit quality of major market participants and hurt the liquidity so essential to the financial markets. Samson's portfolios had no exposure to the sub-prime mortgages that lay behind much of the market angst. Other casualties of 2007 were confidence in municipal bond insurers and rating agencies. We do buy insured municipals for our clients, but not without first assuring ourselves that the underlying credit quality is sound. Also, for diversification purposes, exposure to individual insurers is limited. We expect the municipal market to again reward the lost art of security selection, as investors learn that they cannot rely on rating agencies and bond insurers to preserve their principal.

Treasury bond rates have now fallen to levels that discount an additional 0.75% easing in the Fed Funds Rate and a significant weakening in economic activity. While some slowing in the economy is at hand, the weaker dollar, lower interest rates and a stable, though weakening, labor market should provide a floor to economic activity. Much of the worst

### Period Highlights

- 2007 was a period of market dislocation
- Importance of disciplined risk management process is highlighted
- Samson adheres to fundamental credit research
- Avoided exposure to the main drivers of market angst

### Index Return Comparison

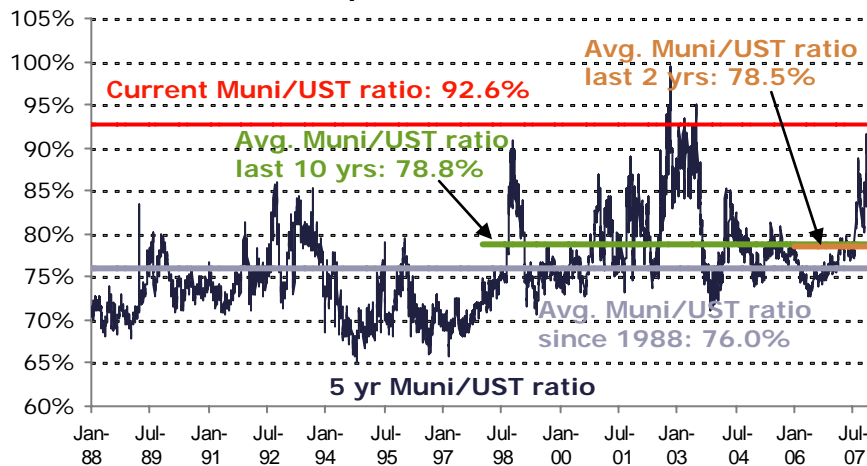
Lehman Municipal Index	2007 Return
Lehman Muni 1 Year Index <sup>®</sup>	4.37%
Lehman Muni 3 Year Index <sup>®</sup>	5.00%
Lehman Muni 5 Year Index <sup>®</sup>	5.15%
Lehman Muni 7 Year Index <sup>®</sup>	5.06%
Lehman Muni 10 Year Index <sup>®</sup>	4.29%
Lehman Muni 15 Year Index <sup>®</sup>	3.32%
Lehman Muni 20 Year Index <sup>®</sup>	2.29%
Lehman Muni Long Bond Index <sup>®</sup>	0.46%
Lehman Muni Aggregate Bond Index <sup>®</sup>	3.36%

Data Source: Lehman<sup>®</sup>

loans and mortgage securities have been written off, which should permit the nation's lending function to gradually reopen. Corporate and bank credit spreads remain well above levels of a year ago, but they are also below the peak set in November, providing some evidence that the credit freeze is beginning to thaw. Although absolute yields are low, municipals are relatively attractive and that should support portfolio performance as rates trough.

Many factors influenced the municipal market's performance this year. In addition to the factors described above, the growing influence of the municipal arbitrage fund community played a significant role in curve performance and spreads. The municipal sector was once viewed as a solely domestic market and immune from the influence of the global investors. However, municipal price movements were influenced this year not only by domestic market forces, but by global forces due to the linkages created by a variety of municipal derivative instruments, including credit default swaps, and municipal interest rate swaps. The chart illustrates that the ratio of municipal yields to treasury yields is historically high.

### 5 Year AAA G.O Municipals / 5 Year UST Ratios



As credit risk is repriced during 2008, we will look for opportunities to add value to the portfolios we manage in a manner consistent with our fundamental credit research process and our rich/cheap valuation process. We plan to be active looking for undervalued opportunities due to the dislocation in the market for insured bonds, where the insured bond is trading cheaper than the same issuer's uninsured bond. We expect presidential elections and rising global tensions abroad will foster a continued a period of uncertainty.

At present the durations of Samson's tax efficient fixed income portfolios are in line with performance benchmarks. If yields became more attractive on an absolute basis we would be inclined to lengthen the portfolio but given the present rate environment where the 7-10 year municipal yields remain below 4%, we have chosen to retain the overweighting of the portfolio in 3-7 year maturities.

Data Source: JP Morgan®

- Economy is weakening, but a floor could be created by lower rates and weaker dollar
- Indications suggest credit freeze thawing

### Municipal Market Outlook

- Municipals historically attractive
- Change in broad market view of Municipals, given new market influences

### Samson Strategy Outlook

- Maintain sound research
- Look for undervalued opportunities
- Focus on intermediate part of the yield curve