

Market Commentary

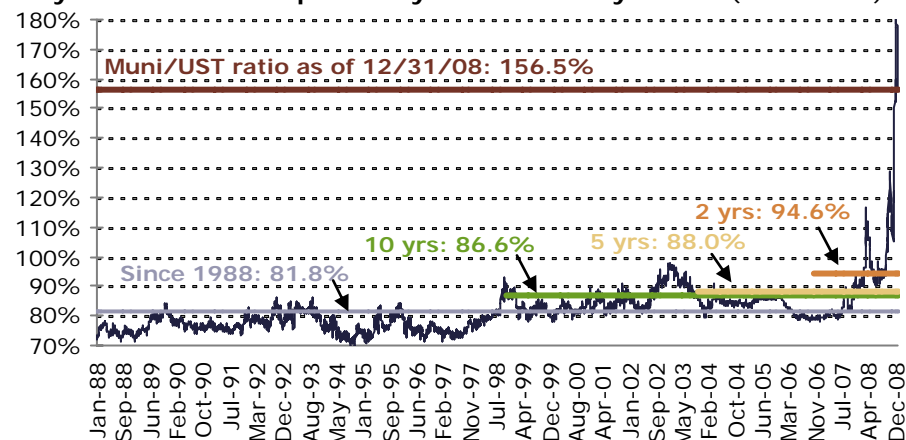
Period Summary

To the relief of almost everyone, 2008 is over. You are probably tired of reading about the meltdown in the stock market, the excesses and the bailouts. For the first time in 28 years, the world is in the midst of a consumer-led recession. The cause, put simply, was the unprecedented availability of inexpensive credit used to excess in certain markets and in certain industry sectors such as housing. The sources of that credit – primarily large commercial and investment banks – mispriced credit by under-assessing risk. These and other mistakes put the world's entire financial system at risk, to the point where the governments of free market countries had to take unprecedented steps requiring staggering amounts of taxpayer funds.

We note the irony in the out-performance during a credit crisis of bonds issued by the world's largest borrower. The U.S. Treasury will have to fund a deficit estimated at over \$2 trillion in 2009, while refinancing 40% of the existing debt scheduled to mature this year. Despite this daunting task, desperate global investors drove yields on short-dated Treasury issues to zero and to 2.65% on the long end. The reason, as you know, was the sudden switch of investor focus from investment returns to principal preservation. We are skeptical that their focus will remain unwavering, and we remind ourselves that duration can be an especially cruel master for investors in bonds carrying very low coupons or yields.

Treasury yields usually underpin all other yields, with the bonds of municipal, corporate and mortgage issuers frequently quoted in relation to Treasuries of similar maturity, and with yields typically moving in the same general direction. All of the historic relationships were blown away during 2008. Municipals, for example, are usually quoted in yield and shown as a percentage of Treasuries, with the yield on ten-year, AAA-rated municipals historically hovering around 80%. The yield on such municipals actually exceeded 180% of Treasuries in November – creating a windfall for investors with clear heads and seeking tax efficient returns – before settling at 157% at year-end.

10 yr AAA G.O Municipals/10 yr U.S. Treasury Ratios (1988-2008)



Period Highlights

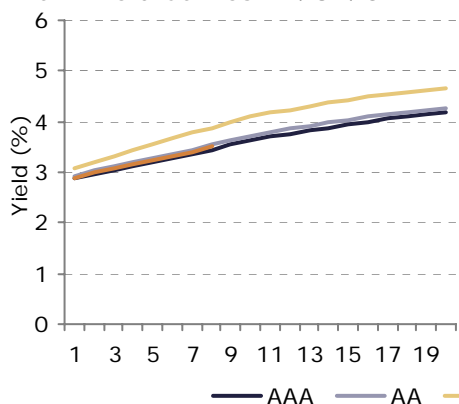
- Governments take extreme steps in 4th quarter 2008 to address financial market dislocation
- US Treasury bonds outperform despite ballooning deficit
- Investor focus on principal preservation
- Historical relationships between Treasuries and other sectors fall apart in 2008

This stunning anomaly was caused by many factors, including the sharp decline of Treasury yields, the exaggerated fear of deteriorating municipal credit quality, the fall of the bond insurers, the forced de-leveraging of municipal arbitrage funds, and the dramatic reduction of capital committed to municipal market makers.

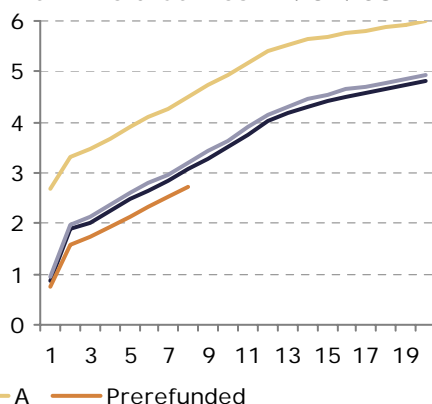
You may recall the recurring theme of these commentaries over the past four years: Investors have been poorly compensated for risk. Risk – whether term risk, inflation risk, geopolitical risk or credit risk – offered little incremental return in the bond market, and so we declined on behalf of our clients to assume it. Risk tolerance changed with a vengeance after Labor Day. Not only did municipal yields rise in relation to Treasuries, they also increased in absolute terms. Long-dated municipal yields increased to levels substantially higher than those in 2006, when the economy was growing and inflation was the country’s primary economic concern. With investors throwing away risk and sacrificing any prospects for real returns in exchange for principal preservation, our Investment Committee decided to extend duration as longer bond yields increased. Municipals rallied sharply during the last three weeks of December, but nonetheless finished the year with cheap valuations relative to Treasuries, with a very steep yield curve, and with historically wide credit spreads.

- Widening spreads reflect a new investor attitude towards risk

Muni Yield Curves 12/31/07



Muni Yield Curves 12/31/08



The new year begins with yields on short-dated, high grade municipals below one percent, and with yields on longer dated paper well above five percent. We continue to hold an optimistic view of municipals over the short term, and believe that cheap valuations will support municipal prices when Treasury prices begin their inevitable decline. Unlike Treasury yields, municipals offer yields comfortably above prospective inflation, and about in line with the long-term, after-tax returns on stocks. By orchestrating a sharply steep yield curve and almost no return potential for riskless assets, the Fed is attempting to stimulate borrowing while driving yield-starved investors out of their safe havens and back into more permanent investments. They have always succeeded, and they will likely do so again this time. This is not a trivial issue, as investors have hoarded \$8.85 trillion in cash equivalents, according to a study of Federal Reserve data conducted by the Leuthold Group and Bloomberg News. Domestic investors will soon tire of earning nothing on this pool, and undervalued municipals are sure to catch the eyes of many. Our portfolios are positioned to protect income from a period of low rates,

- Fed seeks to drive investors back to more permanent investments

without subjecting them to the large price swings experienced by long-dated bonds.

We are also mindful of the difficult financial condition in which many states and municipalities find themselves as a result of declining tax receipts and the weakened economy. However, states have a lot of flexibility in handling projected budget gaps, and states are required by law to balance their budgets. Further, the federal government is expected to direct much of its pending stimulus plan through the states, including increased aid to Medicaid (state/federal health program) and infrastructure expenditures. Still, these are treacherous times, and Samson's credit team continues to focus on the underlying credits; our objective is to have high quality diversified portfolios. We also continue to anchor portfolios with a substantial allocation to prerefunded municipals.

With good in-house security research and cheap valuations, we expect a good year for municipals, and will maintain a duration longer than usual for the time being for our core intermediate portfolios.

January 16, 2009

Data Source: Bloomberg®

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Inherent in any investment is the risk of loss. Past performance is not indicative of future results.

- States are required by law to balance budgets

- Samson's objective is to have high quality, diversified portfolios