

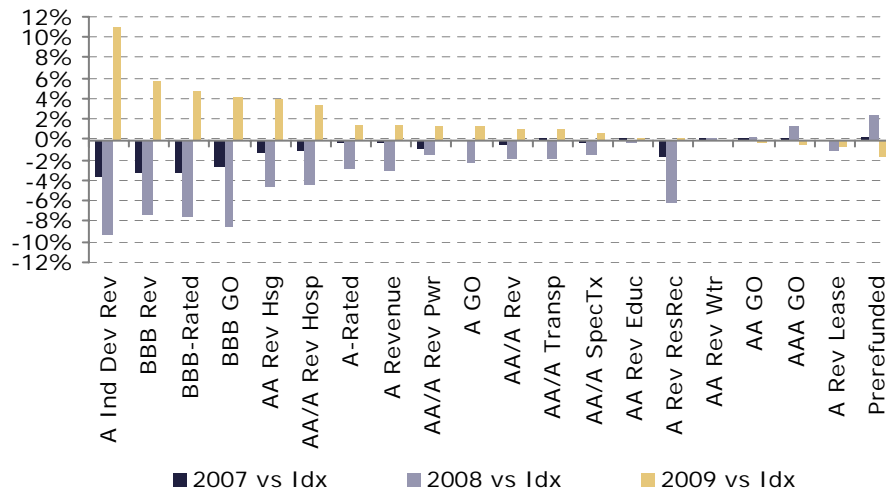
Market Commentary

Period Summary

The municipal market staged a dramatic recovery in 2009, along with equities and most risk sectors in the capital markets. In fact, the riskier the security, the better was the performance, as top quality municipal bonds outperformed US Treasuries and agencies and lower quality municipal bonds outperformed top quality municipal bonds. While Samson was bullish on municipal bonds in the first half of 2009, our view changed to moderately bearish with concerns about rich valuations during the second half of the year. Several key factors contributed to the strong performance of municipal bonds (e.g., Build America Bond issuance coinciding with diminished tax-free bond issuance, strong retail demand and heavy inflows into mutual funds), but most of them were related to supply and demand pressures rather than a fundamental strengthening of the market. Our view was that municipal bonds had rallied too far and too fast by the summer, and that narrowing credit spreads were inconsistent with the continuing credit challenges in the market and the likelihood of a prolonged period of weakness.

The best performing municipal sectors during 2009 were those that started the year with the highest yields and the most perceived credit risk (see the chart below). This strength in lower quality credits is a result of the supply/demand imbalances discussed above, as well as the perception that the improving national economy reduces the credit risk of lower quality municipal sectors. Our view of weaker municipal credits is not as sanguine and we increased our allocation to pre-refunded municipals as the year developed and increasingly emphasized the highest quality state general obligation bonds and essential service revenue bonds as well. We expect the pressure on state and local governments, as well as on public service issuers, to continue to grow well into 2010. Even if the national economy is improving towards normal growth, which is an optimistic assumption, municipal budgets lag the national economy by 12-18 months and relatively severe budget contraction will be an important theme during the next year. According to a recent survey of state budgets, next year's gap – or shortfall – is on the order of \$175 billion across the states.

Sub-Indices Performance vs. the Barclays 5 Year Municipal Index



Period Highlights

- The market staged a dramatic recovery in 2009
- Supply and demand pressures contributed to the strong performance of municipal bonds
- Municipal budgets lag the national economy
- In 2009, the weaker credits and sectors outperformed, while higher quality and more liquid bonds outperformed the previous two years

The rich valuations in the municipal market also coincided with an extraordinarily low nominal Treasury yield environment. This is particularly disconcerting since, historically, municipal yields have generally been unable to follow Treasuries when yields fall to extreme lows. As a result of our concern about extremely low interest rates and rich municipal valuations in the low rate environment last year, we maintained conservative duration positions in our strategies for most of the second half of 2009.

Much of the municipal market's relative strength has occurred in shorter-maturity bonds and, as a result, the 5-year sector became one of the richer areas of the yield curve in the second half of 2009. Typically our strategies focus on maturities between 1 and 12 years. Presently, we feel the middle of the curve is overvalued, therefore, where appropriate, we are targeting a barbelled strategy using shorter maturities and the 8-12 year range. Emphasizing 8-12 year maturities allows us to reduce risk of losses that could occur in 5-year maturities as well as to garner higher incremental yields as a result of the steepness of the yield curve. The yield differential between the 5 and 10 year sectors is currently near historical highs. The objective of our yield curve strategy is to reduce portfolios' vulnerability in the event of a market sell-off, but also potentially add positive returns in the form of higher income and greater price appreciation as investors pursue higher yielding 10-year bonds instead of lower yielding, 5-year issues.

We expect the market to find a level that once again entices yield starved investors into bonds. Over the past several months, the yield curve has been artificially capped by aggressive bond buying by the Federal Reserve and other central banks. The period ahead of us may be somewhat complicated by the potential unwinding of Fed support. Although there is some evidence that the steep yield curve engineered by the Federal Reserve is doing its job, the Fed does speak of "headwinds" of unemployment and real estate as we move into 2010 and we think it is unlikely that the Federal Reserve will increase rates meaningfully anytime soon. We are concerned about the strength of consumers as they continue to rebuild their balance sheets in the wake of high unemployment levels and a housing market that may now have to deal with higher mortgage rates.

Samson's client portfolios are positioned for principal preservation in this low-yielding, steep curve environment. In our view, it is more likely that we will see an increase in interest rates and a less positively sloped yield curve than an even steeper curve with a further decline in rates. Therefore, we are targeting a barbelled portfolio structure with a more conservative interest rate exposure that is designed to outperform as the curve flattens and to protect against the potential of higher rates. We also look to include pre-refunded municipal bonds, state tax-exempt agencies and, in some cases, Treasuries in portfolio allocations as municipals may underperform relative to these sectors in certain parts of the curve.

January 29, 2010

Data Source: Bureau of Labor Statistics and Bloomberg®

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

- **The 5-year sector has become one of the richer areas of the yield curve**

- **A barbell yield curve strategy will benefit from a flattening curve**

- **Purchases of U.S. government debt by the Federal Reserve are helping to keep yields low**