

Market Commentary

Period Summary

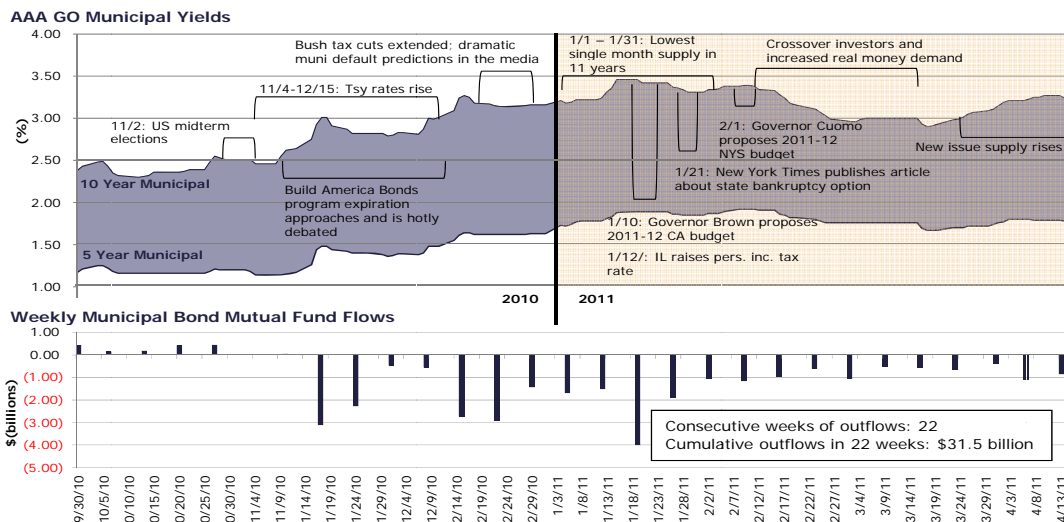
Over the past six months, there was much debate about the state of public finance in America. Select industry pundits made bold predictions about the potential for widespread municipal defaults, inciting fear in retail investors and contributing to a wave of retail redemptions from municipal bond funds. Despite this panic-selling, our fundamental credit analysis led us to conclude that the first quarter of 2011 was an opportune time to be a buyer of high quality, general obligation and essential service revenue municipal bonds. This conclusion was further supported by the expectation of low municipal issuance throughout the first quarter, the attractiveness of tax-exempt yields relative to taxable investments, and the concerted efforts of select municipalities to address fiscal challenges by cutting spending and raising taxes.

Concerns about municipal finances and anemic supply were the primary catalysts behind municipal market volatility over the period. The first quarter began as the fourth quarter ended as press coverage about municipal defaults contributed to a continued municipal market selloff due to default fears, particularly in the longer maturities. The historic levels of withdrawals from municipal bond mutual funds put significant pressure on the market as the funds were forced to liquidate significant holdings to meet the redemptions. By early February, the municipal market began to rally due to a lack of new issuance and what seemed to be diminished default fears, as evidenced by a marked decrease in the pace of fund redemptions during February and March.

The first quarter saw issuance of only \$47 billion, the smallest amount since the first quarter of 2000 and approximately half the amount issued over the same period last year. The scant supply is attributable largely to Congress's decision not to extend the Build America Bond program, which resulted in a surge of issuance at the end of last year by states and cities looking to capitalize on the deep interest rate subsidy. As this quarter came to a close, the municipal rally abated as a result of a slight uptick in supply and quarter-end rebalancing. The highlights that impacted the municipal market during the past six months are illustrated below.

Period Highlights

- In the first months of 2011, media headlines led to fear in retail investors and a wave of municipal bond fund redemptions
- The last six months have been a period of extreme volatility in the municipal markets as the chart below shows



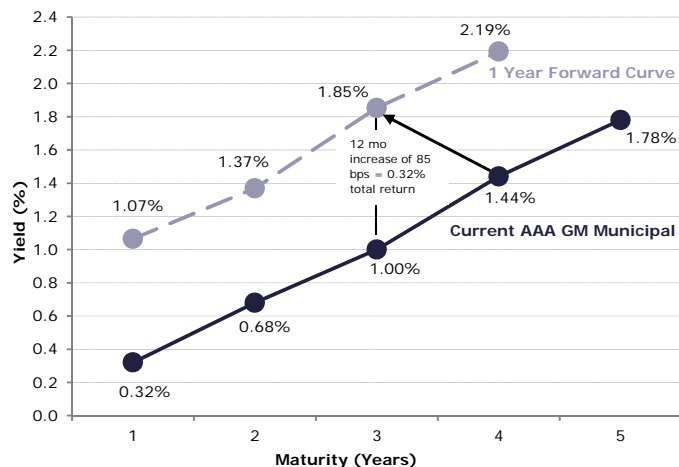
Improving U.S. economic indicators and corporate earnings drove stocks sharply higher throughout most of the first quarter. The disasters in Japan plus the continued civil unrest in North Africa and the Middle East caused stocks to lose momentum in March. The Treasury and municipal markets experienced a brief rally due to a temporary flight-to-quality. We expect this market volatility to persist throughout the remainder of the year as our economy continues to face a number of challenges. A stagnant housing market, depressed labor conditions, higher energy prices, the federal deficit debate and the end of quantitative easing will all weigh on investors and consumers in the months ahead.

We believe that the increase in bond yields that began last September has the potential to continue through the year despite, or perhaps because of, the Federal Reserve's continuing easy monetary policy. If the Fed were on the verge of aggressively tightening rates to curtail a rapid increase in economic growth and inflation, a more defensive rate posture would be warranted. However, we believe there is a low probability of the economy overheating over the next year and the Federal Reserve has been quite clear about its intention to maintain a stimulative posture. The more likely scenario is for a gradual increase in rates that would support positive returns for intermediate maturity bond investors with a 12 month horizon.

Investors preferring short maturities (one year or less) due to their concern about an increase in interest rates should be aware of the opportunity cost of remaining so short in a very steep yield curve environment. For example, an investor has a choice of either locking in the return of the current 1 year AAA rated municipal at 0.32% during the next 12 months or investing in a 4 year AAA rated municipal at 1.44% (a yield pickup of 1.12%). The longer maturity may experience principal fluctuation due to changes in interest rates. The question is how high can rates increase over the next 12 months before the 1 year municipal would have been the better investment?

The chart below of the 1 year AAA municipal forward curve represents the breakeven yield increase where an investor would be indifferent on a total return basis (principal plus income return) between an investment in the 1 year municipal and the other maturities along the current curve.

1 Year Forward AAA General Market Municipal Yield Curve (as of 4/12/11)



- Global concerns at the end of the first quarter led to a temporarily flight-to-quality and a rally in the Treasury and municipal markets
- We believe there will be a gradual increase in rates over the next year
- Investors who prefer short maturities due to a concern of rising rates should be aware of the opportunity cost of staying short given today's steep yield curve

At the end of a one year period, a 1 year bond will generate only income, while a longer issue could experience price changes. One of the components of price change occurs as a bond ages, for example from 4 years to 3 years. When the yield curve is steep, the aging causes price appreciation as short yields are lower than longer yields.

The 4 year municipal would have a higher one year total return than the 1 year municipal if the yield on the 3 year municipal one year from now is less than 1.85% (an increase of 85 bps over today's 3 year municipal yield). The total return would be lower if the yield is greater than 1.85%. Therefore, it would make sense for an investor to remain short if their expectation was for rates to rise in the 3 year part of the curve by more than 85 basis points over the next 12 months.

We believe that average portfolio maturities from 3 to 5 years represent the best reward versus risk in the current yield curve and interest rate environment. We have maintained a duration posture with a defensive orientation toward the respective benchmark indices, as we expect rates to gradually increase throughout the year. We also began the first quarter with a barbelled yield curve structure to take advantage of the extraordinarily steep municipal curve. The curve flattened dramatically from late February to early March, faster than warranted by fundamentals and we took that opportunity to gradually moderate our barbell, with the expectation that the curve would steepen again to a level more consistent with Fed policy, rising inflation expectations, and fears of municipal supply. This yield curve strategy helped us generate a comparable return with less interest rate risk than the benchmark while using high quality instruments at a time when many investors were concerned with both a rise in rates and deterioration of municipal credit quality. Higher quality bonds outperformed lower quality ones and our higher quality strategy was a positive contributor to a healthy return for the period.

- Samson's higher quality approach has offered comparable returns to the benchmark with less risk

April 15, 2011

Data Sources: AMG Data Services, JP Morgan, Thomson, Bloomberg®

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