Ramifications of the Eroding Health of the Monoline Financial Insurers —1/30/08

In order to continue keeping you informed of the latest developments in the Municipal bond market, we would like to alert you to the following:

A short term financing problem in municipal bonds is causing upward pressure on long-maturity yields.

Historically, the municipal yield curve has been upward sloping. This trend which has created opportunities for leveraged entities to profit as money was borrowed in the short-term floating rate market and re-invested in longer maturity debt. To maximize their profits, we believe that these non-traditional investors concentrated their tax-exempt holdings in bonds maturing beyond 25 years.

A key ingredient in this transaction has been the ability of the financial guarantors to put their "AAA"-rated stamp on the short term floating rate security. Now however, with the most recent downgrade of AMBAC's credit rating to "AA" by Fitch, the cost to finance the floating rate position has escalated. Anticipating a downgrade by the other rating agencies (Moody's and S&P) money market funds are now reluctant to purchase this short-term debt issued by the leveraged players.

In essence, this is the classic de-leveraging that we have referred to on many occasions. The leveraged players may be forced to liquidate their positions if they fail to obtain the financing for their longer term bonds by way of the floating rate marketplace. Just as an aside, this same phenomena appears to be occurring in other segments of the fixed income marketplace.

Although prices of bonds maturing between 10 and 15 years have been somewhat weakened by this episode, we have seen this event inflict significantly more pain on long term bond holders. Additionally, we anticipate this trend to continue. The open and closed end mutual funds are just two classes of investors who have been hit particularly hard due to their heavy participation in longer-dated securities. Lastly, should the credit ratings of the financial guarantors continue to erode, we expect any additional pressure to be confined predominately to the longest dated bonds.

Bottom-line: Munis are just a microcosm of a much bigger issue in that the implications of the monoline insurers losing their AAA by Moody's and S&P could be even more severe in other sectors of the fixed income markets. Said differently, we've never seen the fate of so many rest on the backs of so few (financial insurers).

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