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Municipal Market Update: 8/20/07

As fear eclipses greed as the dominant emotion of investors, rare long term investment opportunities begin to form. But in this tenuous environment, not even Municipal investors are safe from the increasingly volatile markets. WHY NOT?

In this market, tensions are running high. The sub-prime mortgage mess which was classified by the Federal Reserve as "well contained" just last week, is spreading throughout the capital markets. With a financial system that is apparently starved for liquidity and the global markets in turmoil, many brokerage firms are trying desperately to maneuver through a difficult period. This has caused Wall Street firms to shift capital to where they need it most: the worst performing areas of securities trading. This cash infusion is not due to some new source of capital, but is being generated internally by firms who are selling the highest quality and most liquid securities. For example, some Municipal traders who trade on behalf of broker/dealers are being directed to sell tax-exempt positions in order to "free-up" assets on the organization's balance sheet.

"Non-traditional" market participants have also exerted upward pressure on tax-exempt yields. While it is true that individuals remain the dominant investors in the Municipal bond arena, the number of leveraged players, such as hedge funds, has quickly and quietly escalated. Here too, in the tax-exempt market, these entities fly under the radar until a blood letting occurs.

In the latest craze for safety, investors have been flocking to the Treasury market. During this "flight-to-quality" episode, Treasury yields declined sharply while yields in other fixed income categories actually rose. This inflicted huge losses on the leveraged managers who were invested in tax-free bonds, and used short instruments, such as Treasury bonds, in order to hedge their interest rate exposure. With the value of their long position falling and the value of the short position increasing, they panicked and executed a "get me out" trade. This action put further pressure on a market that is experiencing a buyers' strike from individuals, as they have been virtually sidelined by the extreme market volatility.

Bottom line: Recent selling pressure in the tax-exempt marketplace has caused Municipal bond yields to rise to historically attractive levels relative to those of Treasury bonds. Historically, when 10-year "AAA-rated" municipal bond yields reach 85% of Treasury bond yields, they are considered to be extremely undervalued. Today, the Municipal-to-Treasury ratio stands at 86.44%, with 10-year tax-exempts now offered at 4.15%, and like maturity Treasury debt priced at 4.80%.

We have witnessed these "cheaper" relative valuations in the past, and we believe that this is a unique long-term investment opportunity. After all, if you are paying a 35% Federal tax rate, you are supposed to say thank you very much for the recent bout of Municipal bond price weakness, and concentrate your attention on the market's taxable equivalent yield[1] of 6.63%.

[1] *The taxable equivalent yield to worst of the Lehman Brothers 10-Year Municipal Bond Index assuming a Federal income tax rate of 35%.*

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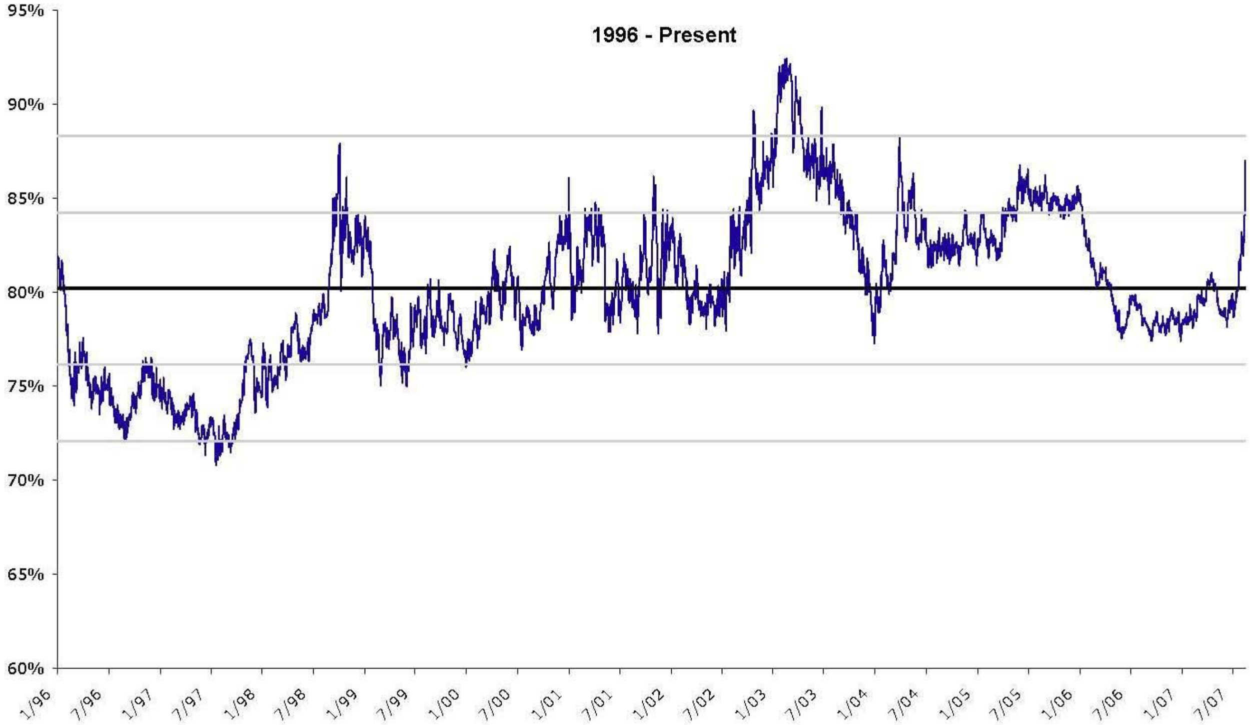
10-year AAA Municipals vs. 10-year Treasuries



Source: Citigroup Global Markets Inc.