Reversal of Fortune 5/4/2009

For the last several weeks, municipal bond yields have declined with the strongest performance generated in lesser-quality bonds and thirty-year maturity bonds. In this environment, we have witnessed the total rate of return of our "Market Duration" composite Portfolio fall behind that of the index. This underperformance can be attributed to a couple of factors.

Based on recent AMG data, cash flow into municipal bond funds has been quite strong. Drilling down further, it shows that the high yield sector has attracted a larger percentage of the cash flow than the previous trend. This infusion of capital into the high yield arena has led to increased demand for the lower quality sector of the market in which we do not invest. This renewed investor interest is causing the yield differential between lower-rated and higher quality bonds to narrow and seems to be following the same trend that is occurring in the taxable corporate bond market. Said another way, yesterday's rubbish are today's gems. During this current distressed economic environment, we continue to believe that credit selection is of upmost importance. Preservation of capital and long-term stable returns trumps the riskier return currently offered in the high yield sector.

Another effect of this strong cash flow into the bond funds is the increased demand in the 30+ year part of the curve. Traditionally, the bond funds are the largest purchasers of the longest maturity bonds. As a reminder, RSW invests in a small segment of the market: namely high quality premium coupon callable bonds that mature in 10-to-15 years. The Barclay's Index on the other hand is comprised of bonds that mature in one–to-thirty years with a wide dispersion of sectors, states, and credit quality. In contrast, we tend to avoid the riskier sectors, such as health care, 30-year maturity bonds, and discount securities. By only investing in a relatively small and concentrated segment of the marketplace, the dispersion of return between RSW's Market Duration Composite and the index can sometimes be high. However, over the long run, we feel that our optimal portfolio structure tends to smooth out the ride that the client enjoys while delivering a superior return to the market (as measured by the index).

Bottom line: although we are witnessing a technical advance in these lower-rated securities that could continue, we view this as a premature move, and thus "a rally in a bear market."

Sincerely,

Robert S. Waas
Managing Member