



MARKET COMMENTARY

July 2010

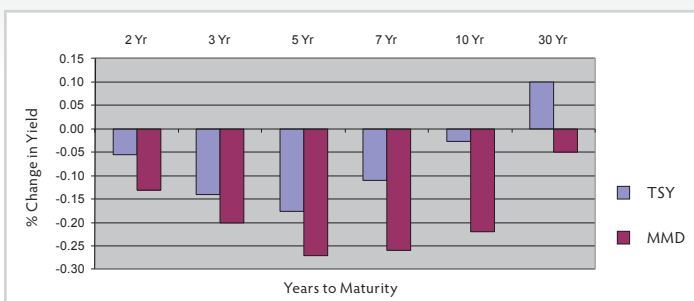
ANOTHER MONTH OF POSITIVE-FIXED INCOME RETURNS A Quest for Yield

Equity and fixed-income markets stabilized and rallied in July after the European bank stress tests revealed no alarming information. With the exception of 30-year Treasuries, most fixed-income sectors posted positive returns.

Yields declined to record lows. For example, the two-year Treasury note declined to an all-time low yield of .55 percent. Low yields reflect investor reaction to weaker than expected economic data, as well as strong cash inflows into fixed-income funds. In response to the weaker data, the Fed reiterated its intention to keep short rates at extraordinarily low levels. Fed Governor Rosengren also noted the risk of deflation outweighs that of inflation; thus fanning investor deflationary fears. More importantly, Fed Governor Bullard, known as a long-time inflation hawk, recently wrote a research paper arguing for aggressive Fed action in the face of increasing deflation expectations.

Despite renewed fears that the economy may be weakening and could possibly "double-dip", the decline in yields did not seem driven by a flight to quality. Instead it seemed to be driven by a quest for yield. Yields on money-market funds have declined to levels that are unacceptable to many investors. In the search for higher yields, fund flows out of money-market funds into longer maturity funds continued to be strong. The search for higher yielding assets pushed many investors into lower quality bonds, resulting in lower quality outperforming higher quality during the month.

1-MONTH YIELD CHANGES FOR MUNICIPAL AND TREASURY YIELDS, SOURCE: BLOOMBERG/MMD



TAX-EXEMPT MARKET REVIEW Intermediate Maturities Benefit

In July, the tax-exempt market was again characterized by strong demand and low supply. Low municipal-bond issuance helped drive yields down as demand outstripped supply. Intermediate maturities in the three- to 15-year range declined the most. In a continuation of the trend we have seen all year, a high percentage of longer maturity tax-exempt issuance was replaced by Build America Bond issuance, providing further support to tax-exempt yields.

Yield ratios versus Treasuries remained relatively high, although they declined from the very high levels reached in June. Munis continue to look attractive versus Treasuries, especially in light of expected 2011 tax increases.

TAXABLE MARKET REVIEW Lower Rates, Tighter Spreads

Like tax-exempt bonds, intermediate taxable bonds outperformed during July as the Treasury yield curve steepened. Thirty-year Treasury yields rose, producing negative total returns for the month.

For the most part, corporate earnings announcements produced positive surprises, causing corporate bond yield spreads to narrow. With strong balance sheets and even stronger investor demand, corporate bonds outperformed other taxable bond sectors during the month.

Yield spreads on taxable municipal bonds also slightly narrowed. However, further tightening was limited by continued uncertainty over the future of Build America Bonds, as well as negative municipal credit headlines.

BRECKINRIDGE STRATEGY Sharpen Our Pencils

Breckinridge continues to target a slightly longer duration than the benchmark given our view that interest rates will remain at low levels for quite some time. However, despite low yields and narrow yield spreads, we have not compromised our objective to invest in higher quality bonds. We believe that the high level of fiscal stress at the state and local level, combined with an overriding weak economic recovery, makes it even more important to invest in more stable, higher quality issuers. It is not the time to "reach for yield" in lower quality or illiquid bonds that may be trading at historically narrow spreads. We maintain our defensive strategy and continue to closely monitor portfolio holdings for signs of weakness.

BRECKINRIDGE STRATEGY, CONT'D.

With these thoughts in mind, we have issued a **Special Commentary, [An Update on State and Municipal Fiscal Conditions](#)**, which outlines the current fiscal condition of state and local governments and describes some of the significant reforms that have already been affected. Outsized budget deficits pose daunting challenges to state and municipalities. Fiscal recovery will likely be a multi-year process. Importantly, public frustration

with the status quo may spur more significant reform. Breckinridge believes that investors will reward governments that implement reforms quickly and aggressively, while punishing the laggards. In fact, we may be witnessing the beginnings of large-scale change in how state and local governments do business.

DISCLAIMER: The material in this document is prepared for our clients and other interested parties and contains the opinions of Breckinridge Capital Advisors. Nothing in this paper should be construed or relied upon as legal or financial advice. An investor should consult with an investment professional before making any investment decisions. Factual material is believed to be accurate, taken directly from sources believed to be reliable, such as the U.S. government, official financial reports, academic articles, and official trade organizations. However, none of the information should not be relied on without independent verification.