



Caprin Asset Management, L.L.C.

1802 BAYBERRY COURT, SUITE 202, RICHMOND, VA 23226

804.648.3333

WWW.CAPRINBONDS.COM

April 2011

FOMC Summary: Mixed Economic Outlook

In their most recent statement, The Federal Reserve's Open Market Committee cited positive economic activity and signs of rejuvenation as they announced their decision to hold their target interest rate near zero, where it has been since late 2008. Despite an economy that is now on a "firmer footing" with a gradually recovering labor market, the Fed remains cautious and maintains guidance toward an extended period of accommodative monetary policy.

The reason for the Fed's dovish language and outlook: the U.S. is still combating serious headwinds that are preventing a more robust economic recovery. The labor market and the housing sector are still struggling to gain momentum. Although the labor market contin-



Figure 1. Monthly New Home Sales (000's) since 12/31/07

Source: Bloomberg

ues to show signs of improving (headline unemployment is below 9% for the first time since April 2009), the rate of new hires in the U.S. continues to point to a very slow return to healthy employment levels. As for housing, the data for new home sales remains disheartening (Figure 1), hitting an 8-year low on March 23rd. The glut of foreclosures still needs to be digested before a) new home construction emerges from a multi-year trough and; b) home prices begin to rebound. There are a few bright spots in the current economic landscape, but we still have a long way to go.

The Fed reiterated its intent to see QE2 (round two of quantitative easing) to its planned conclusion on June 30th, by which time the Fed will have purchased roughly \$600 billion in government debt in an effort to increase the money supply. The Fed stated that inflationary pressures still appear relatively benign, freeing up the FOMC to continue injecting money into the system. Recently, geopolitical unrest in the Middle East has resulted in significantly higher energy prices, raising inflationary concerns and the possibility of a

Highlights:

- FED MAINTAINS 0-0.25% FED FUNDS RATE; MOVING FORWARD WITH QE2
- LABOR MARKET SHOWING SMALL GAINS; HOUSING REMAINS A LARGE DRAG
- MUNI BUYERS AND SELLERS PAUSE AMIDST LOW-SUPPLY AND AFTER STRONG RALLY
- CAPRIN PORTFOLIOS SLIGHTLY LONGER THAN NEUTRAL DURATION; CONTINUING SELECTIVE YIELD PURCHASES

"Despite an economy that is now on a "firmer footing"...the Fed remains cautious and maintains guidance toward an extended period of accommodative monetary policy."

Caprin Asset Management, L.L.C.

recovery stall. The Fed pledged to monitor the recent jump in oil and other commodity prices but claims that the recent spikes (i.e. inflationary pressures) are a short-term challenge in the wake of the turmoil. However, oil prices have increased almost 25% since mid-February and the recent consumer confidence measure was lower than expected. Consumer spending metrics will be closely analyzed to see if excess caution persists and begins to jeopardize the recovery.

Municipal Market Dynamics: Light Issuance Ushers in Stability

Since the start of the year, new municipal bond issuance has been very light compared to historical norms. Muni issuance is down roughly 60% versus the same time period in 2010 because: a) many issuers rushed to issue new Build America Bonds before the option was eliminated at the end of 2010; b) state and local budget balancing has put the issuance of new debt on the back burner; and c) some issuers have been hesitant to bring new issues to market given recent volatility in the asset class. Light new issue volume and oversold conditions through mid-January laid the groundwork for a strong muni market rally to close out February and a steady market for the majority of March.

December's much-discussed and melodramatic doomsday predictions for munis drove muni bond fund investors out of the asset class and forced prices lower as we started 2011. Municipal mutual fund outflows reached their highest point ever during the week of January 19th (investors pulled \$4 billion out of funds) resulting in a great deal of forced selling. However, by the end of January, the market stabilized, mutual fund outflows eased, and demand for munis rebounded as investors sought attractive yield opportunities in the wreckage of the previous eight to twelve weeks. The renewed demand for munis began to overwhelm the limited volume of tax-exempts available to muni investors. This imbalance coupled with a flight-to-quality resulting from the Middle East unrest and Japanese nuclear crisis helped generate a muni rally that pushed bond prices to their highest levels (and best performance) in several months.

As of the writing of this piece, a meaningful uptick in supply toward more normal volumes appears, at the very least, absent in the near future. The appetite for munis that appeared in February has recently cooled as market participants have grown a little wary of the lower yields. Once we begin to see more normal flows in new muni issuance, the market should find equilibrium driven more by sector fundamentals and less because of the lack of supply. Until then, many investors remain reluctant to acquire excess holdings in an overpriced market.

Caprin Strategy

Caprin Intermediate Strategy

Caprin's duration structure retains its slightly longer than neutral bias as interest rates remain range bound by the Fed's low-rate policy and an economic recovery seeking better footing. In this low yield environment, Caprin has been carefully pursuing income opportunities for our client portfolios across certain high quality healthcare, power and revenue names. Our view also encompasses an expectation these sectors will outperform in a recovery scenario. In this continually challenging and dynamic credit environment, Caprin's emphasis on credit surveillance and prudent bond selection remain essential to our investment objectives.

As muni supply remains low, Caprin continues to look for opportunities to add national positions to our state-specific portfolios where relative value outweighs the tax impact. This has allowed us to provide clients with well-balanced, diversified portfolios in the face of diminished supply. In some cases, investing outside of one's state of domicile can provide the portfolio with names higher in quality, with better liquidity and an attractive price versus an in-state counterpart. Therefore, the door remains open to such opportunities as they become available.

Lastly, Caprin will continue to focus on fairly evenly distributed maturities in the 2-15 year range. Yields in the shortest maturities are still near all-time lows and moving out the curve even just a few years can provide portfolios with more

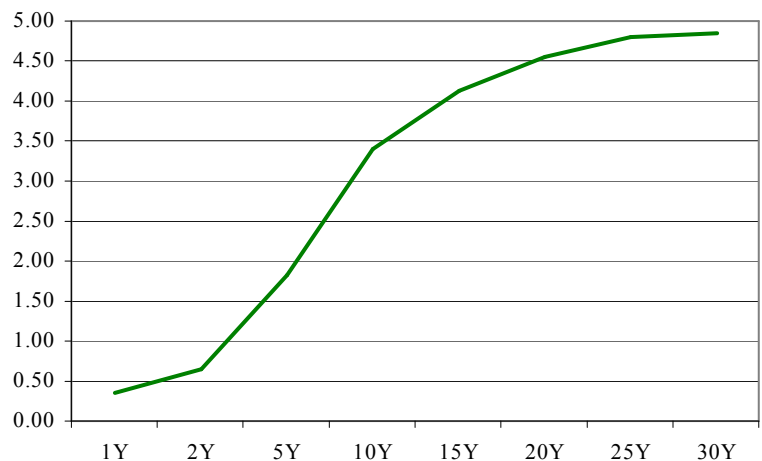


Figure 2. U.S. Muni G.O. AAA Yields as of 04/04/11 Source: Bloomberg

Caprin Asset Management, L.L.C.

attractive yields. Beyond the 15-year area, incremental yield tapers off considerably, inadequately compensating investors for the additional price risk.

Caprin Short Maturity Strategy

Fed expectations continue to anchor our short maturity strategies. Portfolio investments remain distributed over the target three-year horizon with a bias slightly long of neutral to maintain income levels. Our strategy also seeks an incremental yield advantage by investing in sector opportunities (albeit with shorter maturities) consistent with our intermediate portfolios. Another yield maintenance technique is the selective sale of bonds within 12 months of maturity and the reinvestment of proceeds to 2+ year maturities at higher yields. For the near future, we expect overall yields in the short maturity space to remain range bound. As such, our strategies will continue to seek sector and intermittent trading opportunities to maintain or improve yield.

Overall, opportunities remain across the municipal spectrum. In the current environment, prudent security selection remains essential to delivering portfolio characteristics consistent with our mandates.

Please remember that past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product made reference to directly or indirectly in this piece, will be profitable, equal any corresponding indicated historical performance level(s), or be suitable for your portfolio. Due to various factors, including changing market conditions, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion of information contained in this piece serves as the receipt of, or as a substitute for, personalized advice from Caprin Asset Management. To the extent that a reader has any questions regarding the applicability to their situation of any specific issue discussed above, they are encouraged to consult with the professional advisor of their choosing. A copy of our current written disclosure statement discussing our advisory services and fees is available for review upon request.