Performance Matters Winter 2001

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Every handful of years bond market professionals like ourselves find we are in the enviable and unfamiliar position of having outperformed our colleagues operating in that "other" market. Well, the first year of the new century was indeed the year for the "bond people". The 30 year taxable Treasury returned 14.85%, while a 10 year Treasury returned 10.00%. Municipal bond indices also produced attractive positive returns, while the NASDAQ, DJIA and S & P 500 indices suffered the inevitable declines that were long overdue. The Lehman 3 year municipal bond index returned 6.23 % and the 5 year municipal index returned 7.72%. The Bernardi short maturity composite returned 6.38%, while the Bernardi intermediate composite returned 8.72%. Naturally, we are quite pleased with these results. These portfolios are managed to maximize after-tax total return, subject to each client's specified risk level with most of the total return produced in the form of tax-exempt income. So before our fifteen minutes of fame expire we thought we would briefly review this past year and share our outlook into the year ahead.

The year was a good one for municipal bond portfolios. Yields on 15 year "AA-A" rated bonds declined from 5.50% to 4.87%. Yields on 20 year "A" rated bonds fell from 6.08% to 5.29% during the year. This appreciation translates into a 9.59% return above the coupon rate for a total return of 15.67% for the year. Much of this is free from Federal income taxes. This in a year when most stock portfolios declined in value.

In our Spring Quarterly 2000 (Volume 4 issue 2), we commented on equity market volatility and our uneasiness with the market. We continue to advise our clients to review their equity portfolio asset allocation relative to other asset classes.

The 12.5% drop in new issue municipal bond volume was a major story for us this past year and indeed an important factor helping to increase prices and lower yields during the year. This trend should begin to reverse itself in 2001 as smaller municipal budget surpluses coupled with increased refinancing activity bring more issuers to market in the year ahead.

High quality tax-exempt municipal bonds performed nicely throughout the year as many retail investors rotated out of equities and into more predictable bonds. The high yield bond market suffered through another dismal year and we were all reminded again of the importance of well structured, high quality portfolios and the need to be adequately compensated for credit and call risks.

We have long believed and continue to believe equities provide for long term, better than inflation rate, portfolio growth. We also continue to believe, in spite of the spectacular stock market performance for much of the 90's, that bonds are complementary to investors' stock portfolios. This past year has proven this.

We realize it is unlikely that an investor will achieve similar returns from a bond portfolio as from a stock portfolio over an intermediate time horizon. This is not the purpose for a well structured bond portfolio. A well structured bond portfolio provides an investor with diversification, liquidity, and a predictable income stream. All three attributes are important to a well rounded portfolio especially when equity markets lose their upward momentum as they did this past year.

We believe in asset allocation with the bond portion of your portfolio representing your "mattress money". Bond investments should be the conservative portion of your total investment portfolio. Preservation of capital, while producing better "net" after tax returns are primary goals.

We believe in knowing and following the municipal credits that we recommend and place into our separately managed accounts. Our team of credit analysts and our credit analysis process is thorough and continuous. It is a process that has been refined over many years and one that enables us to uncover and place quality, undervalued, higher yielding securities into our managed portfolios.

The manner in which our composite portfolios outperformed comparable indices this past year reassures us once again in the soundness of our philosophy and our approach.

Please call us with any questions or comments. We invite you to our office to meet with your Investment Specialist and a portfolio manager to review your portfolio and plan for the year ahead.

We thank you for your confidence and belief in our team. We look forward to working with you in the New Year.