PRESIDENT'S LETTER
MUNICIPAL MARKET UPDATE

I used to think if there was reincarnation, I wanted to come back as the President or the Pope or a .400 baseball hitter. But now I want to come back as the bond market. You can intimidate everyone.

--James Carville, February 1993

The good news is that financial markets, for the moment, have stabilized from last week's uncertainty and volatility.

That said, I'm afraid we have not seen the end to this financial market seesaw.

As I wrote in my July 2007 bond market update, "establishing accurate prices for the infrequently and illiquid securities that comprise many of the underlying hedge fund investments is difficult and has created problems that may well worsen. This fact is magnified if the hedge fund's lender seeks additional collateral for its loan to the fund or worse, demands payment. If sales occur, they are at deep discounts translating into big losses for the funds."

This is exactly what occurred last week at a number of well known and highly respected financial institutions; market players that were believed to be far too astute to fall victim to such a scenario. The result was significant losses for fund investors and their sponsors.

Yes, U.S. Government bonds rallied (higher prices, lower yields) last week. But taking comfort in that fact is a bit misplaced.

Prices on average and below average quality bonds plummeted; it was difficult to get a good bid on quality bonds as liquidity dried up on Wednesday and Thursday of last week. Only scavenger bidders were present and that is never a good market to sell into.

Yields on quality municipal bond issues actually increased last week even as the yield on the 10-year taxable Treasury bond dropped to 4.60 %. This disconnect between the Treasury market and the municipal market has created value in the municipal bond market. Currently, good quality municipal bonds yield approximately 90%-95% of long maturity Treasury bonds.

Last week's events were an unprecedented experience for me. In nearly 30 years of bond market experience, I do not recall witnessing what unfolded last week in the bond markets.

On Friday, the Federal Reserve Bank lowered the discount rate. This has stabilized the bond market and sends a needed signal that the Fed is encouraging banks to re liquefy the financial system.

This action has stabilized the credit markets and will help ease some of the strain on the bond market. It will be interesting to see how the situation evolves in the coming weeks.

What did we learn (again!) from the events of last week?

1. A derivative is a derivative is a derivative.

Remember this: owning a derivative is not the same as owning a share of stock in a corporation or owning a bond issued by a municipality with a fixed coupon rate and a set maturity date. It may have some of the same features as these boring (stable) investments, but is not the same and it will behave differently. It can and will, at times, exhibit greater volatility.

No, derivatives are not all bad. However, highly leveraged derivative products are problematic and can result in significant loss.

Remember Orange County, California and all of its problems a few years back? Last week's events were different, of course. However, the circumstances that created the events were eerily similar to what happened to Orange County years ago.

A complicated investment that was sliced and diced into too many parts. When it came time to sell, the parts comprising the whole simply were not worth the supposed "paper value" of the whole.

Leverage and the fact that many other investors were attempting to simultaneously dump similar holdings into the marketplace exacerbated an already bad situation.

Our advice continues to be: understand your investment (or at least make sure your portfolio manager understands it and can explain it to you). If it cannot be adequately explained, it is most likely something to avoid.

2. Selling an investment when many others are trying to sell similar investments is a place best not to be. Sell when you want to, not when you have to. Invest your money accordingly.

Separate Account portfolio management better assures that you are able to avoid the above situation.
We strongly believe that an investor's interests are better served when they have the financial wherewithal to construct their own high quality, bond portfolio. If one was not forced to sell bonds last week, the portfolio has already recovered somewhat making last week's market turmoil much less significant.

The events of last week remind us of this fact again and are a primary reason why our separately managed client portfolios have better held their value.

3. "Buy grapefruits when every one else seems to be buying oranges."

Invest in market anomalies when possible and avoid or at least temper the buying of what the rest of the pack is buying.

This won't entirely eliminate the negative consequences to your portfolio when the market collapses. It will greatly temper potential damage however.

Please call us if you have any questions or concerns. We will review your portfolio with you if that would be helpful.

Please forward this market update to a friend or colleague you feel might benefit from reading it.

We greatly appreciate your continued confidence.

Sincerely,
Ronald P. Bernardi
President and CEO
August 20, 2007