FIXED INCOME MARKET UPDATE
Written Wednesday, September 1, 2010

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FIXED INCOME MARKET UPDATE

- For the month ended August 31, 2010, the Barclays Capital Aggregate Bond Index (BCAGG) returned +1.29%.

- U.S. Treasuries (+2.01%) realized positive returns during the month as the Federal Reserve indicated it would use the proceeds from the mortgage and agency securities in its portfolio to invest in the Treasury market. Long Treasuries (+6.80%) outperformed intermediate Treasuries (+1.26%) as the yield curve shifted in a bull flattening fashion with the yield on 30-year Treasuries declining nearly 50 basis points during the month to 3.52%, its lowest level since March, 2009.

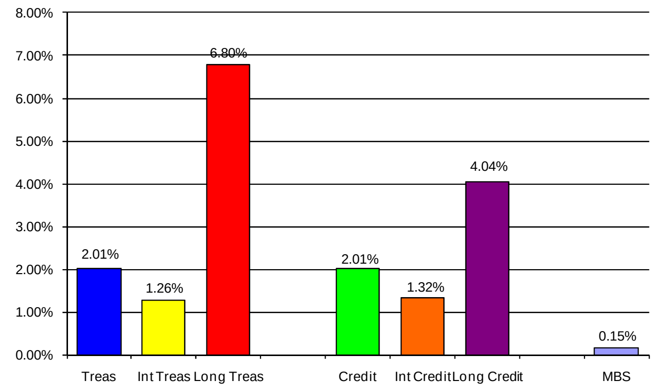
- Mortgage-backed securities (+0.15%) underperformed duration-matched Treasuries by 23 basis points of excess return in August as the Fed announced its intention to focus on Treasury purchases to reinvest proceeds of MBS redemptions and paydowns. The OAS of the Barclays Capital U.S. Mortgage Backed Securities Index reached an intra-month wide of 38, before ending the month at 15, 20 basis points wider than month-end July.

FIXED INCOME MARKET UPDATE (continued)

- Corporate bonds (+2.01%) underperformed duration-matched Treasuries by 55 basis points during the month, as the OAS of the Barclays Capital U.S. Credit Index widened 9 basis points to end August at 170 basis points. Despite steeper spread curves, long credit (+4.04%) outperformed intermediate credit (+1.32%) by 272 basis points.
- Utilities (+2.64%) outperformed on an absolute basis due to their longer duration profile. Financials (+1.52%) were the best performing credit subsector on a duration adjusted basis, outperforming both utilities and industrials (+2.16%) by 50 basis points of excess return.
- Higher quality investment grade credit outperformed on a duration adjusted basis during August. AAA rated securities outperformed AA, A and BBB rated securities by 107, 74 and 38 basis points of excess return, respectively.

SECTOR, QUALITY & TERM STRUCTURE RETURNS FOR THE MONTH ENDED AUGUST 31, 2010

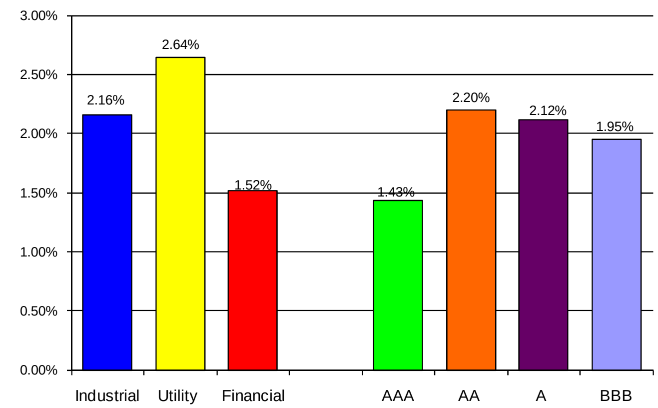
U.S. Fixed Income Sector and Term Structure Returns



Longer dated securities outperformed as the yield curve flattened during the month. Credit and mortgages underperformed as spreads widened during the month.

U.S. Credit Subsector and Quality Returns

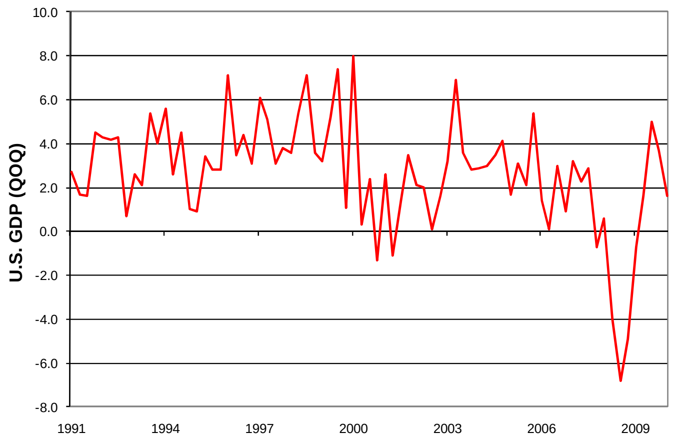
Utilities outperformed on an absolute basis due to their longer duration profile. Quality returns were mixed during the month.

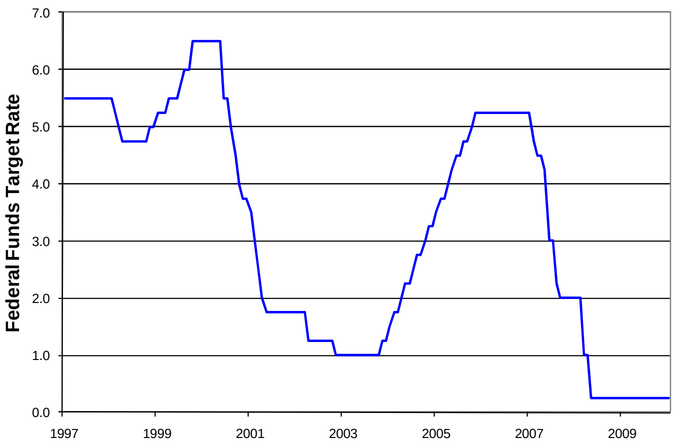


Source: Barclays Capital

UPDATE ON THE U.S. ECONOMY

During the second quarter of 2010, the U.S. economic growth rate decelerated from 3.7% to 1.6% as inventory accumulation slowed sharply in response to waning final demand and a widening trade gap reduced overall growth by 3.4%. While consumer spending remains constrained by weak labor and housing markets, as well as rising financial market volatility, personal consumption expenditures rose modestly from 1.6% to 2.0%.



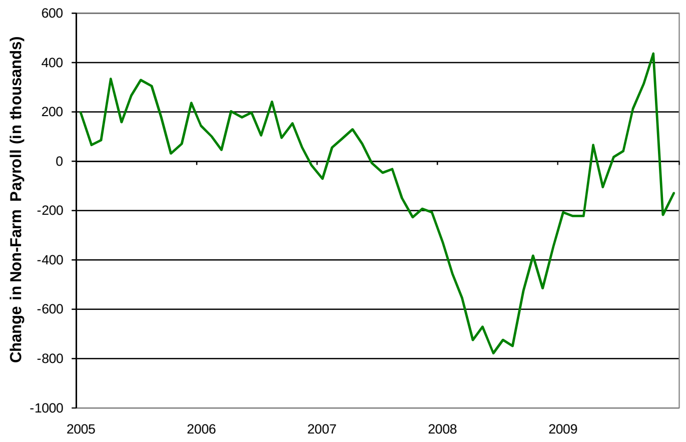


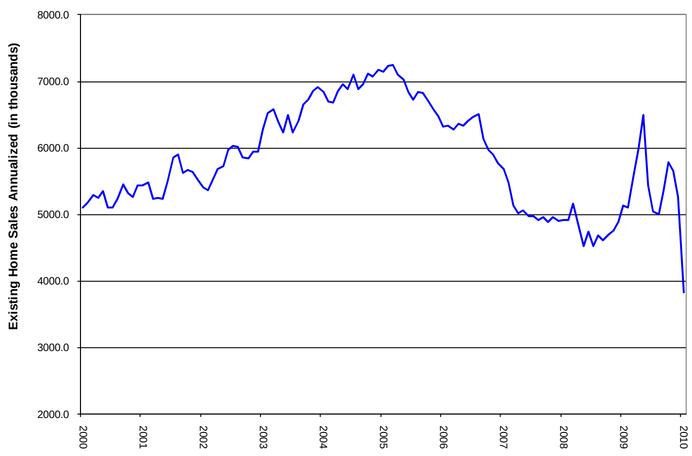
Following the August 10th meeting of the Federal Open Market Committee (FOMC), the Federal Reserve kept its targeted range for the fed funds rate at 0 - ¼% and reiterated the expectation that the benchmark lending rate will remain "exceptionally low… for an extended period." The Fed also emphasized its view that "the pace of economic recovery is likely to be more modest in the near term than had been anticipated."

Source: Bureau of Economic Analysis & Bloomberg

UPDATE ON THE U.S. ECONOMY (continued)

In the minutes of the FOMC meeting (released 8/31), the Federal Reserve stated that "the pace of recovery remained sluggish… (as) private payrolls and consumer spending had risen less than expected". In July, non-farm payrolls declined for a second consecutive month as the build-up in census workers reverses itself, and private payrolls grew a modest 43,000, while the unemployment rate held at 9.5% as the labor participation rate declined. According to the Fed, businesses have hesitated to expand their workforce as "uncertainty about future taxes, regulations, and health-care costs made them reluctant to expand their workforces… (and) structural factors… were contributing to the elevated level and long average duration of unemployment."





Following a brief recovery earlier this year, the housing market has weakened sharply, suggesting sluggish growth in final demand. In July, both new and existing home sales plummeted to the lowest levels on record. According to the Fed, "large inventories of vacant and unsold homes, along with continuing foreclosures that would increase the number of houses for sale, likely would continue to damp residential construction, indicating that a sustained upturn from very low levels was not imminent".

Source: Bureau of Labor Statistics and National Association of Realtors

ECONOMIC AND MARKET OUTLOOK

- In the minutes to the most recent meeting of the FOMC (released 8/31), the Federal Reserve stated that "downside risks to the U.S. economy have become somewhat larger". A slow labor market recovery and a retrenchment in housing following the expiration of the federal tax credit suggest muted growth in consumer spending. According to the Fed, there exists "a greater risk that private demand for goods and services might not grow enough to offset waning fiscal stimulus and a smaller impetus from inventory restocking". The potential pullback in final demand comes on the heels of economic revisions that demonstrate the consumer has already increased its savings rate over the past three years suggesting "households are seeking to raise their net worth more substantially than previously understood, or to build greater precautionary balances in what they perceive to be a more uncertain economic environment, with the result that growth in consumer spending could remain restrained for some time".

- Following the conclusion of the Federal Reserve's massive $1.8 trillion purchase program that ended on March 31st, the Fed was in a de-facto tightening cycle as security redemptions effectively reduced the size of the Fed's balance sheet. The August 10th announcement by the Fed to "keep constant the Federal Reserve's holdings of securities at the current level by reinvesting principal payments from agency debt and agency mortgage-backed securities in longer-term Treasury securities" reflects a shift to a neutral monetary policy stance to "help support the economic recovery". According to estimates by the Federal Reserve, this equates to nearly $400 billion in Treasury security purchases over the next sixteen months, or close to 9% of the total size of the Barclays Capital U.S. Treasury Index.

- Following the Fed's announcement, U.S. Treasury yields are hovering at or near all-time lows while corporate bond spreads remain wide in an historical context. In our view, valuations along the Treasury curve are discounting deteriorating economic activity and a potentially prolonged period of deflation. We believe the more likely outcome is for modest economic growth coupled with benign, but positive, inflation. In this environment, we expect U.S. Treasuries will underperform.