Portfolio Management Techniques Focused on Maximization of Yield / Utilization of Alternative Investments

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Portfolio Structure in Dynamic Markets

The Fixed Income Markets over the Last 15 Years …

1990

- US in a recession
- S&L bailout
- High interest rates
- Restrictive Fed — Starting to ease
- High credit default rates
- Interest rate anticipation primary driver of bond portfolio returns

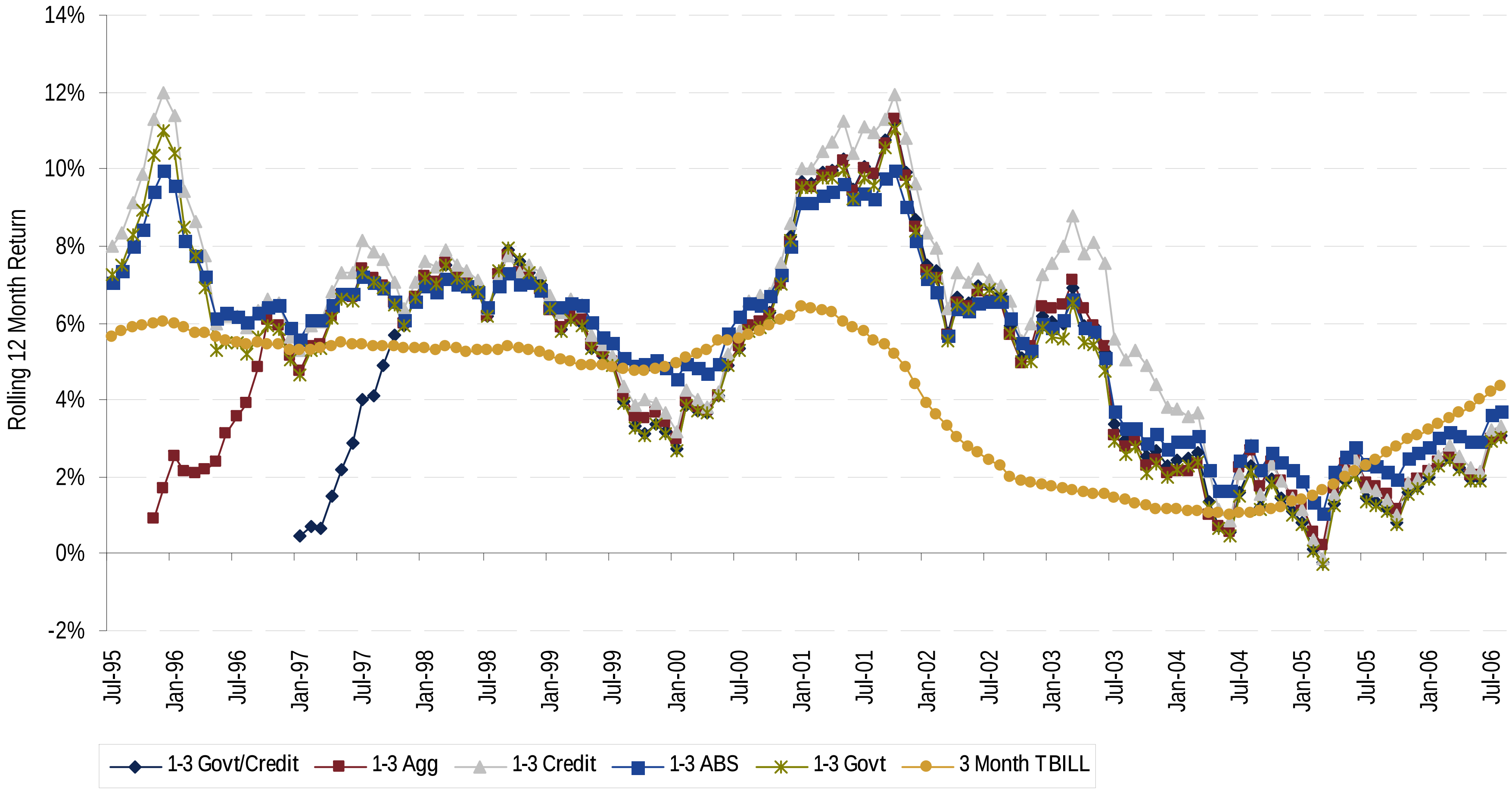
1995

- Lower interest rates
- Steeper yield curve
- Lower spread volatility
- Better quantitative modeling in fixed income
- Sector rotation and security selection main drivers of excess returns
- Treasuries accounted for 47% of the Lehman Aggregate Bond Index

2005

- Improvements in technology results in substantially better information transfer
- Demand for price transparency
- Increased market efficiency
- Higher spread volatility
- Fewer Treasuries in the index (only 24% versus 47% in 1995)
- Lower average excess returns in Active Bond portfolios
- Global demand for assets
- Proliferation of the credit derivatives market

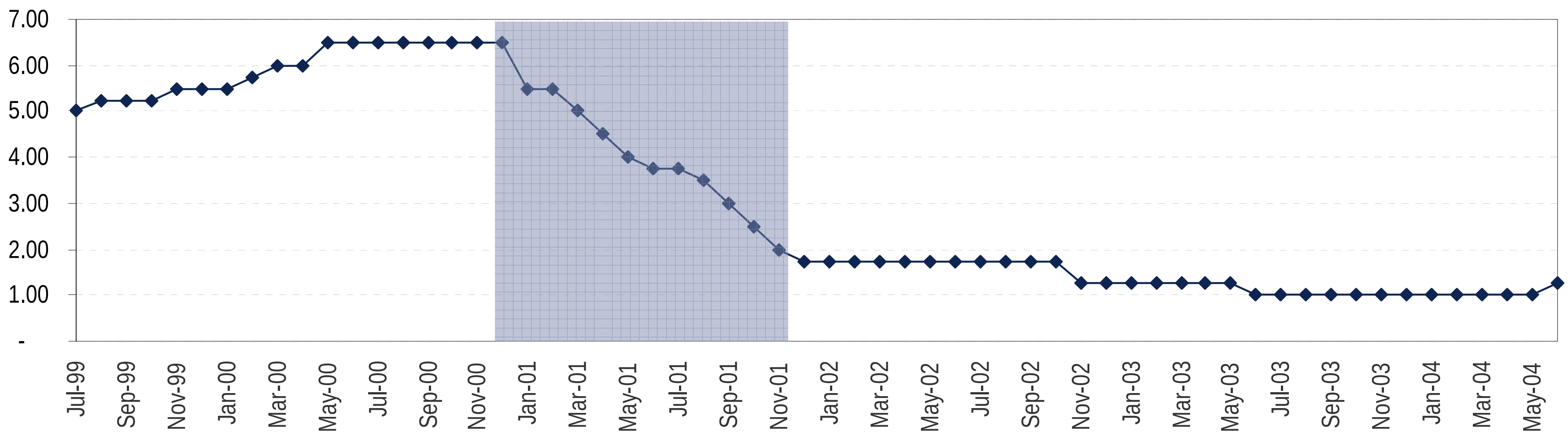
Index Returns



Breaking It Down

Correlations During A Falling Rate Environment

Fed Funds Target Rate (July 99—June 04)



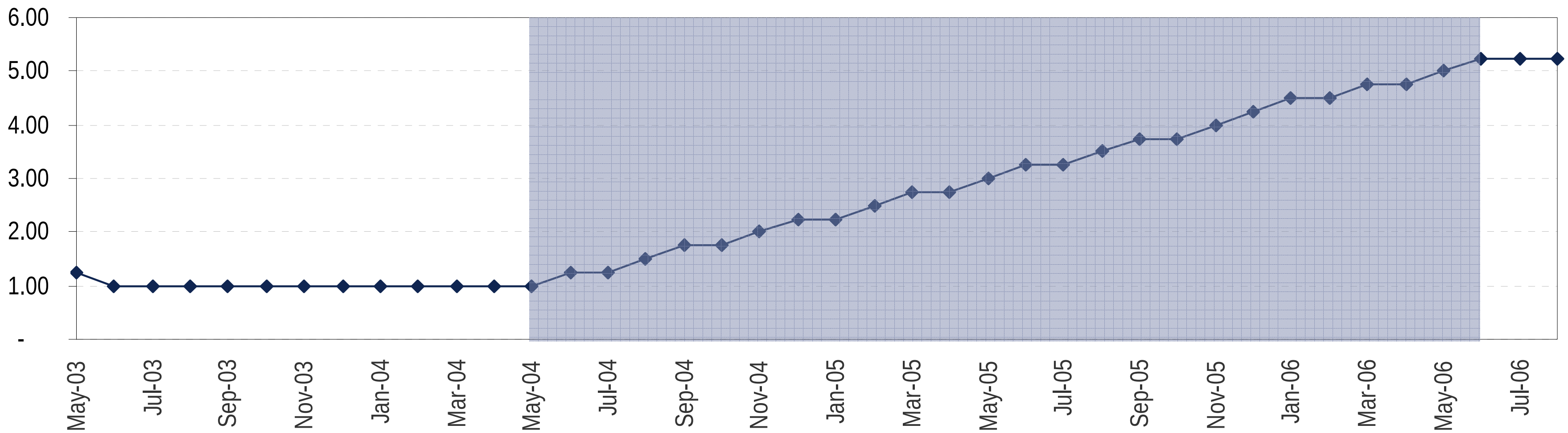
11/30/00–12/31/01 Falling Rate Environment (Rates 6.5% --> 1.75%)

	1-3 Treasury	1-3 Gov/ Credit	1-3 Govt	1-3 Credit	ABS	ABS-HE	MBS	1-3.5 MBS	1-5 Muni	1-5 TIPS
1-3 Treasury	1.000									
1-3 Gov/ Credit	0.990	1.000								
1-3 Govt	0.999	0.992	1.000							
1-3 Credit	0.898	0.950	0.902	1.000						
ABS	0.956	0.969	0.957	0.927	1.000					
ABS-HE	0.950	0.962	0.951	0.919	0.992	1.000				
MBS	0.935	0.957	0.939	0.928	0.984	0.973	1.000			
1-3.5 yr CMBS	0.952	0.972	0.956	0.941	0.986	0.968	0.975	1.000		
1-5 Muni	0.659	0.717	0.659	0.805	0.758	0.774	0.768	0.729	1.000	
1-5 Yr TIPS	0.287	0.359	0.280	0.526	0.283	0.308	0.321	0.289	0.367	1.000

Breaking It Down

Correlations During A Rising Rate Environment

Fed Funds Target Rate (May 03—August 06)



05/31/04–07/31/06 Rising Rate Environment (Rates 1.0% --> 5.25%)

	1-3 Treasury	1-3 Gov/ Credit	1-3 Govt	1-3 Credit	ABS	ABS-HE	MBS	1-3.5 MBS	1-5 Muni	1-5 TIPS
1-3 Treasury	1.000									
1-3 Gov/ Credit	0.996	1.000								
1-3 Govt	0.999	0.998	1.000							
1-3 Credit	0.978	0.992	0.984	1.000						
ABS	0.949	0.960	0.955	0.961	1.000					
ABS-HE	0.923	0.933	0.929	0.931	0.988	1.000				
MBS	0.778	0.802	0.791	0.816	0.884	0.871	1.000			
1-3.5 yr CMBS	0.971	0.981	0.976	0.979	0.990	0.975	0.842	1.000		
1-5 Muni	0.829	0.851	0.837	0.872	0.922	0.899	0.890	0.894	1.000	
1-5 Yr TIPS	0.679	0.670	0.675	0.652	0.668	0.673	0.534	0.649	0.595	1.000

The Fixed Income Markets over the Next 3 Years …

2006

- Downshifting transition year
- 3.5% GDP in 2006
- Core Inflation remains above Fed's comfort zone
- Oil settles into $65–$75 range
- 10-year Treasury trades in a 4.50%–5.30% range
- Fed on hold as inflation and growth move in opposite directions

2007

- "Soft Landing" – period of growth that is positive, but sufficiently slow to lift the unemployment rate
- GDP forecast of 2.4%
- Inflation initially stabilizes and eventually moderates
- Oil softens slightly on slower global growth
- Fed on hold but poised to lower if "soft landing" threatens to become "harder"
- Treasury trades with bid tone but upside limited by Fed holding the line on funds target

2008

- Growth reaccelerates
- Inflation settles near top of Fed's comfort zone
- Oil prices stabilize at lower levels on higher production capacity
- Fed continues to hold the line, but becomes ready to prevent reacceleration of inflation
- Treasuries lose their bid and yield curve turns positive

So Now What Do We Do?

Broadening Your Yield Arsenal

- It's a Hostile Environment
    - High correlation among standard spread sectors
- But There Are Some Sensible Alternatives
    - Today's Alternatives
        - Structured Products
        - Treasury Inflation Protected Securities
        - Municipal and Crossover Strategies
    - Tomorrow's Investments
        - Credit Default Swaps
        - Collateralized Debt Obligations
        - Absolute Return Strategies

Diversify your Investments

Expanding and Adjusting Sector Exposure Diversifies Risks and Generates Higher Returns

Portfolio	Total Return	Govt/Credit Portfolio	Diversified Portfolio	Optimized Risk vs Return	Optimized Return
1-3 Treasury	4.28%				
1-3 Gov/ Credit	4.64				
1-3 Govt	4.42	70%	45%	39%	10%
1-3 Credit	5.22	30	35	41	50
ABS-CC	6.04		5		10
ABS-Auto	5.07		3	10	
ABS-HE	5.60		5	10	10
MBS	6.06		4		10
CMBS	5.72%		3%	10%	10%
Portfolio Total Return		4.65%	4.96%	4.93%	5.39%
Annualized Risk		1.62%	1.75%	1.66%	1.92%

Annualized values for period 7/29/99 through 8/31/06

Today's Alternatives …

Structured Products

Structured Products — ABS/CMBS

Pros

- Structured products offer less volatile, more attractive opportunities for yield than the corporate bond market
- Secured market
- Issuance continues to grow in both floating rate and fixed rate instruments
- Supported by market technical's (growing CDO market)

Cons

- Smaller in size than corporate market
- Need for surveillance
- More complex analysis than traditional — Specific deal analysis

Asset Backed Securities

- Outlook for Credit. Impact of various collateral types.
    - Degree of borrower leverage
    - Property market valuations
- Underwriting standards and creditworthiness of all collateral performance participants
    - Originator, servicer/special servicer and trustee
- Anticipated collateral performance
    - Delinquency, default and recovery projections
- Types and levels of enhancement
    - Subordinator/over-collateralization
    - Third party guarantee
- Determination of comfort level within capital structure

Commercial Mortgage Backed Securities

- Positive Convexity
- CMBS credit remains rock solid
  - Decreasing credit enhancement levels has led to new tranche structures
- General economic conditions
  - Rising rates and the impact on multi-family
  - Strengthening labor market conditions could spell relief for some office sectors
- Market size
  - At $450 billion in outstanding issuance, CMBS is now roughly 15-20% of the commercial real estate market. Issuance has skyrocketed
- Expanding capital structure and borrowers

Treasury Inflation Protected Securities

Treasury Inflation Protected Securities

Pros

- Perfect hedge against inflation
- Diversification
- Good technical support — More demand than supply

Cons

- Market technicals — Less liquid than treasury issues
- Accounting issues
- More complex analysis — understanding accruals and seasonality to the bonds

Treasury Inflation Protected Securities

- 14% of total Treasury debt supply
    - 20 Issues in the TIPS Universe with continued issuance
- TIPS have outperformed Treasuries by over 0.90% annualized since 02/97
- Non-Credit Sensitive
- Market is maturing and more efficient
    - Auctions
    - Seasonality
    - Break-even trading

Crossover Strategies

Municipal Crossover Strategy

Pros

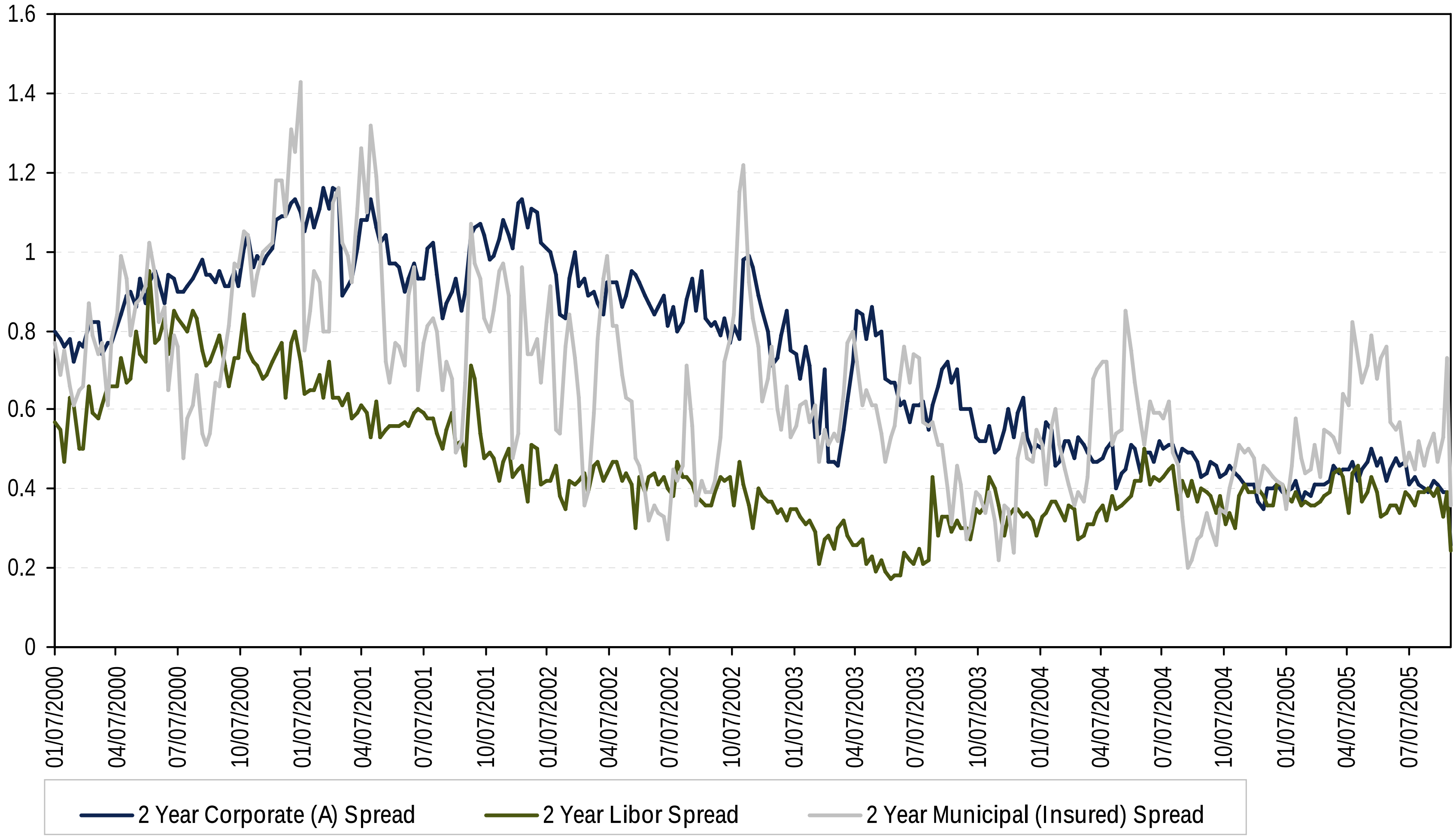
- Diversification
- Low correlation with the US Treasuries
- Periods of trading subjectivity
  - Quarterly/annual tax issues (seasonality)
- Tend to be a “retail” sector
- Avoid the impact of arbitrageurs and hedge funds

Cons

- Periods of relative extremes
- “Negative carry” on a nominal basis
- Liquidity

Taxable Equivalent Municipal Spreads vs. Corporates & LIBOR

- Tax-exempts do not trade in "lockstep" with taxable securities
- Municipals experience relative over/under valuation to taxable securities



Tomorrow's Investment …

The New Frontier

Pros

- Access to markets
- Better matching of cashflows and returns with cost of capital rate
- Large, liquid markets

Cons

- Accounting issues
- Headline risk
- Over the counter- negotiated market

Credit Default Swaps

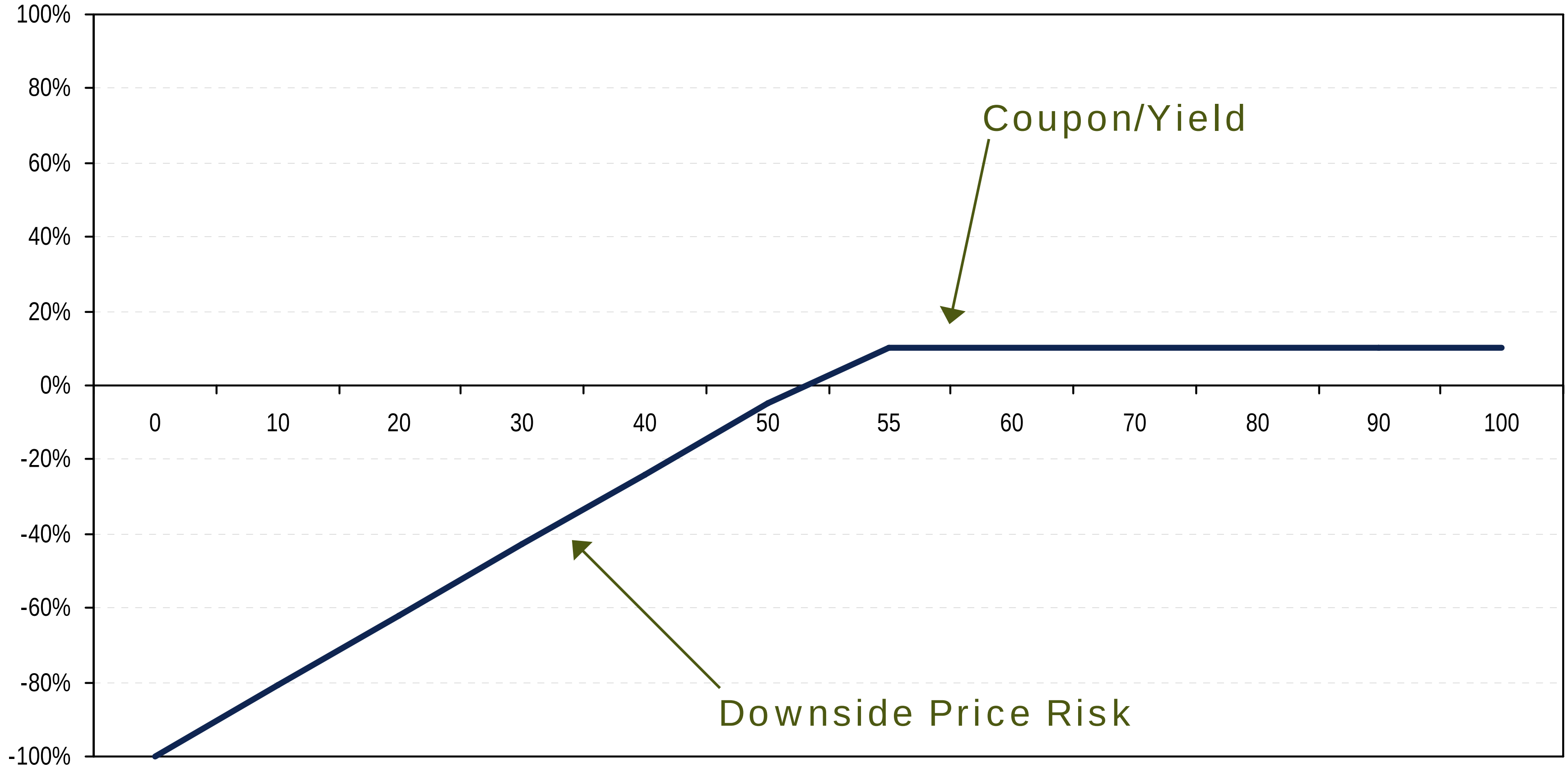
The Buy-Side Dilemma in Credit

- Lehman Credit index is comprised of 2721 issues
- Most buy-side managers cannot actively short bonds
- Most cash bonds are “out of the market”

    Some markets are over-subscribed

Corporate Bonds and the New "Credit Trap": The Painful Lesson of the Risk/Reward Tradeoff

- "Long" investors can make a little or lose a lot



Credit Default Swaps (CDS)

- Growth in debt restructurings, defaults and high profile bankruptcies has increased the need to manage credit exposure
- CDS provide for an easy way to transfer existing credit risk
- Liquid market where investors can actively short credit
- Market has grown from $631 billion in 2000 to over $17 trillion at the end of 2005. (data from www.isda.org)

Credit Default Swap

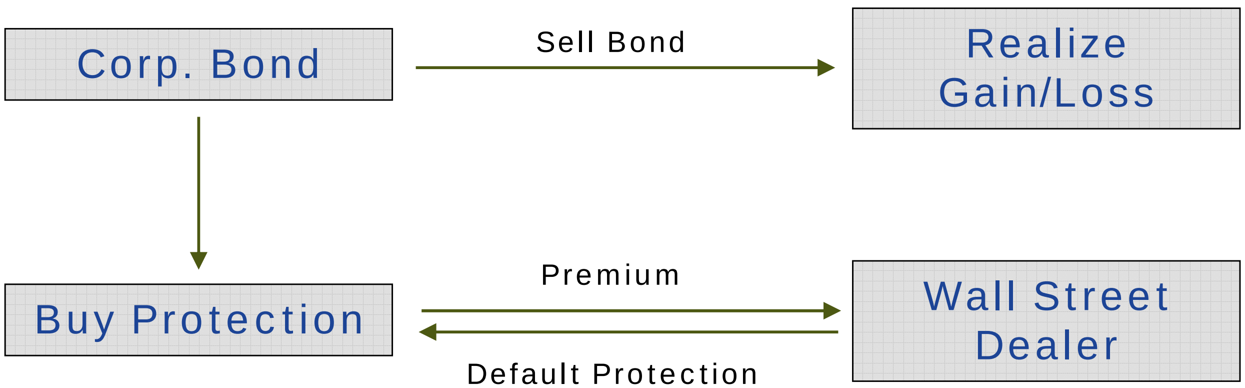
Opening next frontier in the evolution of the ABS and Corporate market

Favorable Market	Unfavorable Credit Market
Buy Bond	Sell Bond
or	or
Sell Protection	Buy Protection

Credit Default Swap in Action

Goal: Reduce Corporate Exposure

Investment Portfolio



Collateralized Debt Obligations

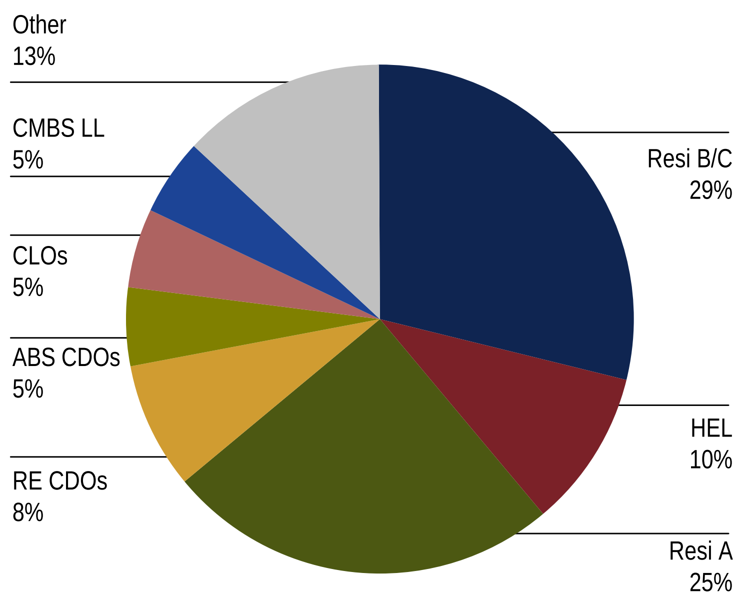
The Collateralized Debt Obligation Market

- Allows investors to outsource market expertise within a portfolio context
- Maintain high diversification
- Customized risk profile through tranche selection
    - AAA risk down to equity exposure
- Least mature, highest yielding sector of the ABS market per unit of credit risk

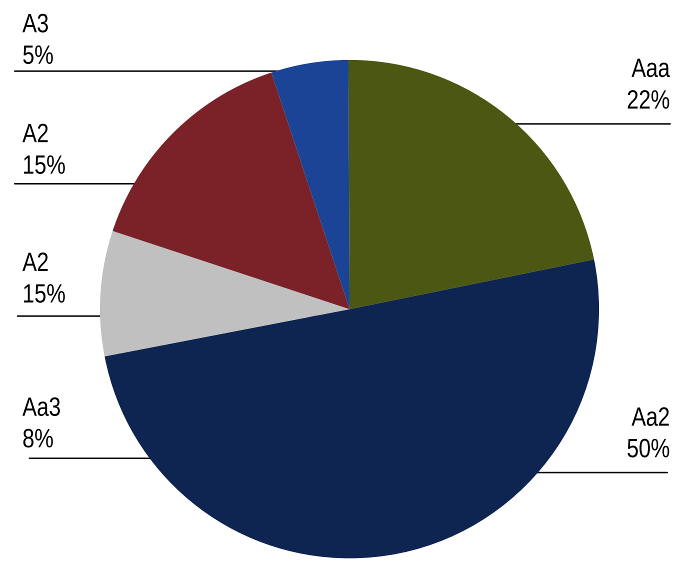
CDO Asset Composition

- Typical "High Grade" Structured Products CDO asset composition is as follows:

Industry Stratification



Moody's Rating Stratification



Weighted Average Spread	70
Weighted Average Rating Factor	40
Diversity Score	22
Weighted Average Life	5.0 years
% Floating Rate	100%

Absolute Return Strategies

Absolute Return Strategies

- Redefining asset needs provides investment opportunies
- Main driver of the growth in fixed income derivatives
    - Assets have grown from $490 billion in 2000 to 1.2 trillion in 2005
- Seek to earn a total return in excess of a cash financing
- More accommodating vehicle structures