

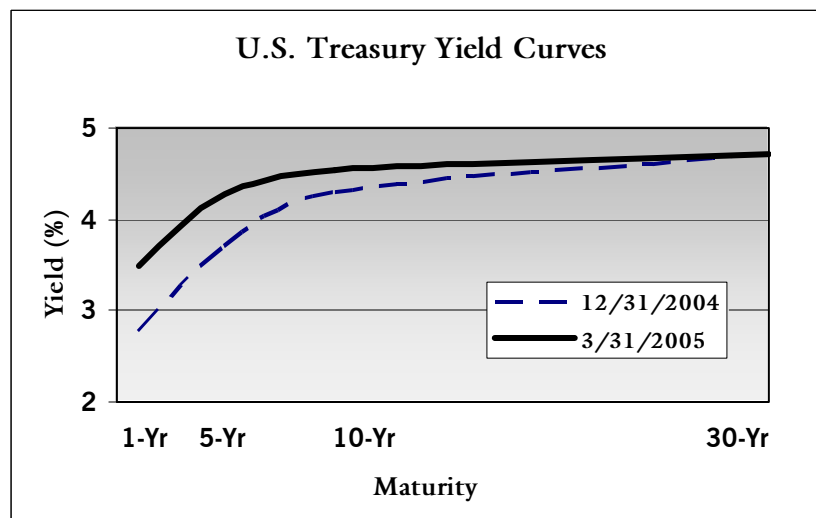
FIXED INCOME COMMENTARY LETTER FIRST QUARTER 2005

Overview

- The bond market delivered slightly negative returns in the first quarter, reflecting the impact of rising short and intermediate term interest rates on security prices.
 - The Federal Open Market Committee (Fed) continued its march toward a “neutral” federal funds interest rate at a “measured” pace, raising the rate 0.25 percent at both meetings.
 - Inflation indicators ticked up during the quarter, renewing concerns about inflation going forward. February’s Producer Price Index (PPI) and Consumer Price Index (CPI) numbers came in above both prior month’s readings and market expectations. Additionally, text released by the Fed subsequent to the latest interest rate hike included new language, which alluded to an increase in inflationary pressures.
-

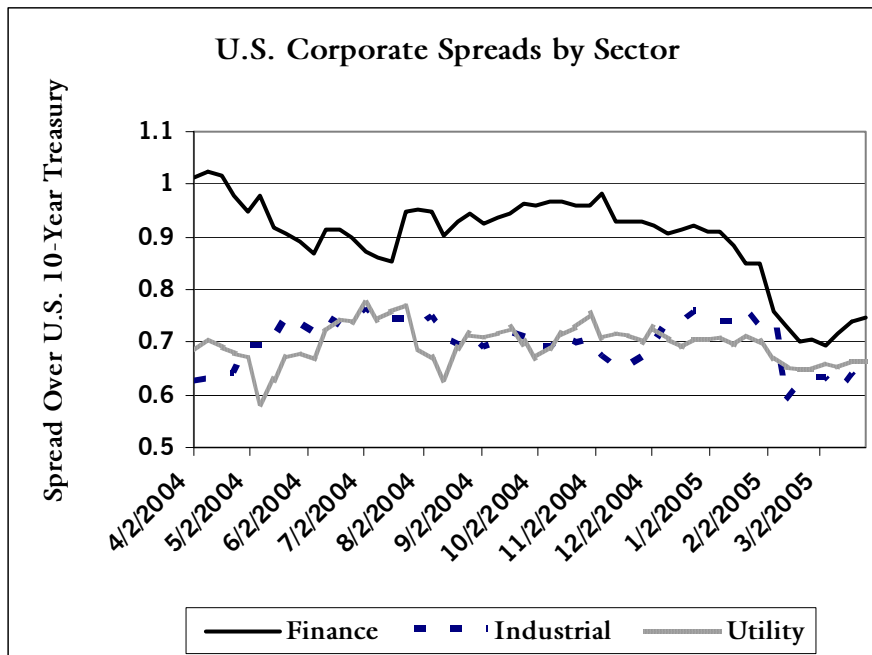
Interest Rates

- The Lehman Brothers U.S. Aggregate Bond Index returned a negative 0.48 percent in the first quarter after a 2004 fourth quarter in which the index returned a positive 0.95 percent. Over the past 20 years, the first quarter has been, on average, the worst performing calendar quarter of the year for the bond market.
- Twice during the quarter, the Fed raised its target for the federal funds interest rate, bringing the rate to 2.75 percent. In his testimony to the Senate Banking Committee on February 16, Federal Reserve Chairman, Alan Greenspan, called the combination of rising short-term rates and declining long-term rates a “conundrum.” This conundrum was apparent in the U.S. Treasury yield curve, which flattened during the quarter.



Sector Updates

- The Lehman U.S. Agency sector performed in line with Treasuries during the quarter, recording a negative total return of 0.42 percent. Agency performance was supported by stable yield spreads to Treasury bonds, in spite of continued regulatory and media attention to Fannie Mae and Freddie Mac.
- On March 31, Fannie Mae announced that the Office of Federal Housing Enterprise Oversight (OFHEO) would delay its scheduled quarterly capitalization report due to pending information. The delay instills doubt regarding the current level of capitalization at Fannie Mae. We believe most of the bad news surrounding Fannie Mae has been released into the marketplace.
- The Lehman Credit (corporate) Index underperformed Treasuries during the quarter due primarily to duration differences (the credit index has a longer duration). This underperformance occurred despite the tightening of corporate spreads. Of note, yield spreads for the Financial Services sector tightened sharply relative to other corporate sectors. The chart below illustrates spreads over the last twelve months for ten-year A-rated bonds in the three major corporate sectors.



- Late in the quarter, General Motors announced negative earnings revisions for the first quarter and slashed earnings projections for 2005 by more than fifty percent. General Motors' debt was subsequently lowered to Baa3—the lowest investment grade rating issued by Moody's in early April, and the outlook remained negative. Fear of a possible further downgrade to junk status caused many investors to shun the credit. Another issuer that had its debt lowered to junk status was Sears, following completion of its merger with Kmart.

- Record volume for first quarter municipal bond issuance helped to keep municipal yields attractive relative to their taxable counterparts. The estimated \$96 billion surpassed the previous first quarter record of \$87 billion, set in 2004, despite higher borrowing costs. This pace of issuance suggests that interest rates appear to be a minor factor in government financing decisions. The ratio of municipal yields (insured general obligations ten-year maturity) to Treasury yields (ten-year maturity) ended the quarter at 88 percent, above the average ratio for the last ten years of 85 percent. Higher ratios make municipals attractive to a greater range of taxpayers.
-

Looking Ahead

- Little has changed with investor sentiment in the bond market remaining bearish. To illustrate this point, cash in bond funds has risen to 9.4 percent of assets, thus remaining at levels not seen since the 1980's. This cash on the "sideline" could reduce pressure in a selling environment and add to it in a buying environment, a bullish indicator to the contrarian's viewpoint.
 - Federal Reserve sentiment regarding rate increases going forward suggests policy will increasingly key off of economic data as Alan Greenspan seeks to solve the interest rate "conundrum." Key indicators going forward should be the rate of jobs growth and inflation data. Strong job growth combined with high levels of inflation could lead to aggressive tightening, while weaker job growth and low levels of inflation might cause the Fed to end its tightening campaign sooner rather than later.
 - Corporate holdings will continue to be monitored closely, as narrowing spreads change the risk/reward relationship from an investor perspective. Caution remains a theme as widespread U.S. business fundamentals and individual debt issuer strength continue to be a month to month story. General Motor's aforementioned developments highlight the necessity of prudence in the current market environment.
 - In summary, we applaud the Fed's efforts in its current campaign to balance economic growth and inflation risks. We believe inflation should remain in check, while the U.S. economy will continue its moderate expansion. Additionally, bearish sentiment among the majority of bond managers could prove beneficial to the bond market. As always, we continue to monitor portfolios closely in an effort to optimize positioning within the ever-changing market.
-

We request that clients advise ICM in the event that there are any changes in their investment objectives, financial situation, or whether they wish to impose or modify restrictions on the management of their account. Please call ICM at (800) 488-4075 or visit our Web site, www.icmasset.com, if you have any questions or need additional information.

