

FIXED INCOME COMMENTARY LETTER

FIRST QUARTER 2008

OVERVIEW

The first quarter of 2008 was again dominated by the fourth quarter's credit crunch, which turned into a full-blown credit/financial market crisis. Conditions deteriorated midway through the quarter, leading the Fed to cut the fed-fund rate to 2.25 percent (from 4.25 in December) and the discount rate to 2.50 percent (from 4.75 in December), trying to stem further deterioration. The boiling point was reached with the illiquidity of broker-dealer Bear Stearns in mid-March. In an effort to avoid subsequent damage, the Fed stepped in and provided secure funding to JP Morgan to acquire Bear Stearns. The Fed's action was variously praised and opposed by market participants and observers alike. Other companies facing similar difficulties have thus far been able to avoid Bear Stearns' fate.

Current market conditions and interest rate cuts, along with the ongoing re-pricing of risk, rate expectations, and volatile economic data led to a strong rally in the treasury market. Investors' demand for more conservative assets caused treasury prices to increase while yields decreased. This buying spree or flight to quality/flight to safety is a typical scenario in volatile times. Overall, credit spreads continued to widen.

A pessimistic outlook on the U.S. economy would be that the current credit/financial crisis, and the persistent negative impacts of the housing market will continue to strain markets and limit economic growth in the months ahead.

U.S. ECONOMY

The final revised GDP (the output of goods and services produced by labor and property located in the United States) for the fourth quarter (data lags by one quarter) showed that the economy expanded but at a much slower pace than in the prior quarter, rising only 0.60 percent between October and December 2007. Final GDP numbers for 2007 came in at 2.50 percent, below the Fed's comfort level of 3.00 percent.

The unemployment rate decreased slightly to 4.80 percent during the first quarter of 2008. Unemployment is expected to increase through 2008. New and continued unemployment claims have been on the rise in recent weeks, in part due to the slowing economy. Unemployment is one of the leading economic indicators, which currently adds more momentum to recessionary pressures since more unemployment slows consumer spending, which in turn accounts for two thirds of GDP. Consumer spending has slowed, growing only 0.10 percent in February and 0.40 percent in January of 2008. Job and wage growth are crucial factors in keeping the economy going.

On the up side, readings on core inflation have improved modestly, but some risk remains due to higher commodity prices. Nevertheless, the CPI index does not tell the whole story-consumers are feeling the crunch in their wallets, gas prices are near record highs and prices in grocery stores have seen double-digit increases over the last year, particularly dairy, fruits and vegetables, and grains.

Overall, economic growth is slowing. The Fed and some analysts are hinting that the economy may have stalled or even contracted during the first quarter. It is only a matter of time until the Fed officially announces that the U.S. economy is in a recession.



HOUSING

The ongoing and painful correction in the housing market and re-pricing of sub-prime mortgages is hurting financial markets and the economy alike. Sales of existing homes continued to decline through January but slightly recovered in February. Nevertheless, existing home sales are at the lowest level in years. Prices of existing homes continued to decline, as did building permits, construction starts, and sales of new homes. Mortgage delinquencies and default rates accelerated during the first quarter of 2008. These delinquencies and foreclosures continue to increase already bloated inventories and increased the negative pressure on house prices throughout the country. The negative trend for the overall housing market is expected to continue through 2008 before a gradual leveling-off and recovery in mid-2009.

INTEREST RATES

Deteriorating credit/financial market conditions led the Fed to cut the fed-fund rate in three steps (two scheduled, one unscheduled) during the quarter to 2.25 percent from 4.25 in December 2007. The Fed also cut the discount rate to 2.50 percent from 4.75 in December. In total, the Fed has lowered the fed-fund rate by 300 basis points (3.00 percent) since September 2007.

The yield curve continued to steepen during the quarter, driven by a yield decline in shorter maturities. The treasury curve is now completely positively sloped, which is the typical scenario as investors are compensated more for the risk of investing in longer-term securities. The yield of the 10-year U.S. Treasury note, which is commonly used as benchmark for mortgage interest rates and other key lending rates, decreased from 4.02 percent on December 31, 2007 to 3.41 percent on March 31, a decline of 61 basis points over the quarter. The yields on two, five, and thirty-year Treasury notes also decreased by 146, 100, and 16 basis points, respectively, over the same period.

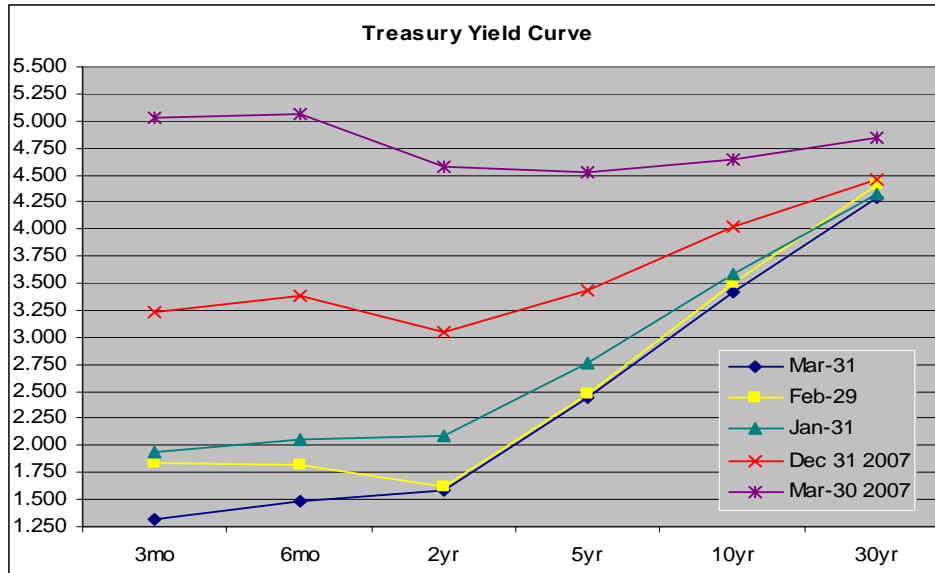
The yield spreads between corporate bonds and treasuries of comparable maturity widened during the quarter (further discussed in the Portfolio / Sector Update section.)

As the following Treasury yield table shows, treasury of all maturities fell throughout the quarter, as well as on a year/year basis.

	Mar-31	Feb-29	Jan-31	Dec 31 2007	Change in Basis Points: 12/31/2007 to 03/31/2008	Mar-30 2007	Change in Basis Points: 03/30/2007 to 03/31/2008
3mo	1.316	1.838	1.941	3.237	-192.1	5.028	-371.2
6mo	1.481	1.815	2.054	3.389	-190.8	5.063	-358.2
2yr	1.582	1.616	2.093	3.047	-146.5	4.574	-299.2
5yr	2.437	2.469	2.76	3.440	-100.3	4.532	-209.5
10yr	3.410	3.509	3.593	4.023	-61.3	4.644	-123.4
30yr	4.292	4.402	4.322	4.452	-16.0	4.843	-55.1

Source: Bloomberg





Source: Bloomberg

FEDERAL RESERVE

The Fed's actions clearly show that chairman Bernanke is no longer comfortable with the direction of the economy, citing downside risk to growth. Furthermore, the Fed intends to provide easier access to liquidity in order to curb a looming credit/financial crisis, and has introduced new measures to enable this.

Last quarter we introduced the Fed's new Term Auction Facility (TAF), which is an alternative way to make term cash funds available to banks during periods of strained market conditions. Since its introduction in December 2007, TAF has auctioned off \$260 billion in eight auctions, providing much needed liquidity to banks. The Fed will continue this program "for as long as necessary." In addition, in March the Fed introduced two new programs intended to foster the general functioning of financial markets or to stem liquidity shortfalls: the Term Securities Lending Facility (TSLF) and the Primary Dealer Credit Facility (PDCF).

TSLF is a weekly loan facility that promotes liquidity thus fostering the functionality of financial markets more generally. The program offers loans to primary dealers over a one-month term against other program-eligible general collateral. In short, primary dealers have the opportunity to "exchange" less liquid securities for more liquid ones, thereby reducing the dealers need to rapidly sell mortgage collateral and the risk that these "fire sales" will further impair mortgage collateral values. The first TSLF was held on March 27, in which \$75 billion in securities were swapped. This program will also continue "for as long as necessary."

PDCF is an overnight loan facility that allows the Federal Reserve Bank of New York to provide overnight funding to primary dealers in exchange for a specified range of collateral. The program will provide a significant useful supplement to funding, providing convenience and flexibility. The program was used in the tri-party "bail out" of Bear Sterns through JP Morgan and the New York Fed.

The newly created programs show that the Fed is proactively trying to stem any liquidity crisis. The actions have been widely praised by market participants and observers alike.

BENCHMARKS

	Q1-08 Total Return	Mar-08	Feb-08	Jan-08
Lehman Brothers Aggregate Bond Index	2.17	0.34	0.14	1.68
Lehman Brothers Intermediate Index	3.00	-0.01	0.87	2.13

PORTFOLIO / SECTOR UPDATES

ICM's clients' assets are invested in different asset classes in quality and investment-grade bonds. This diversification spreads any adverse effects among asset classes, thereby reducing the overall risk within client portfolios.

TREASURIES / GOVERNMENT AGENCIES

A broad-ranged "flight to quality" caused by panic-selling in corporate, mortgage, and equity markets pushed demand and, subsequently, prices higher for treasuries and agency bonds during the quarter. Yields, on the other hand, decreased to the lowest in nearly five years (bond prices and yields move in opposite directions.) On a total return basis, higher market values positively contributed to performance.

Other positive news included regulatory changes affecting Fannie Mae and Freddie Mac, when a major capital threshold was lowered to 20 percent from 30 percent, enabling the companies to buy as much as \$200 billion in securities backed by home loans and help prop up the housing market. The lower threshold results in a reduction in the capital they need to guard against losses on their combined \$5 trillion of mortgage investments.

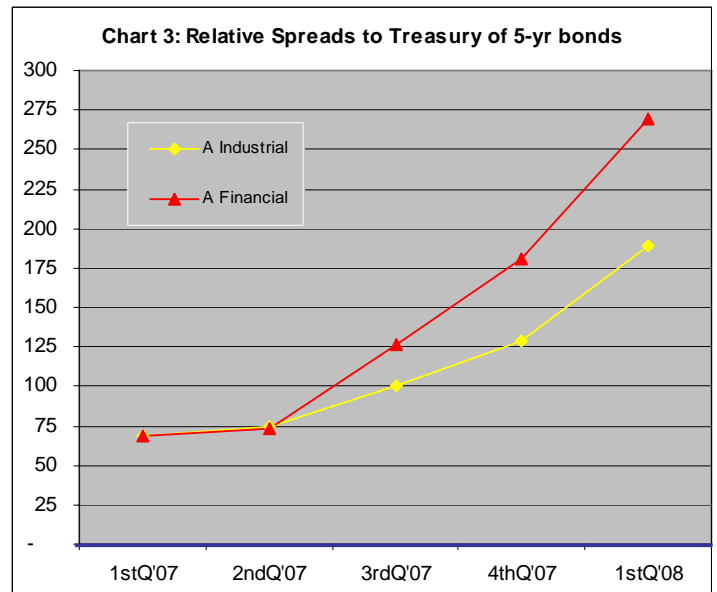
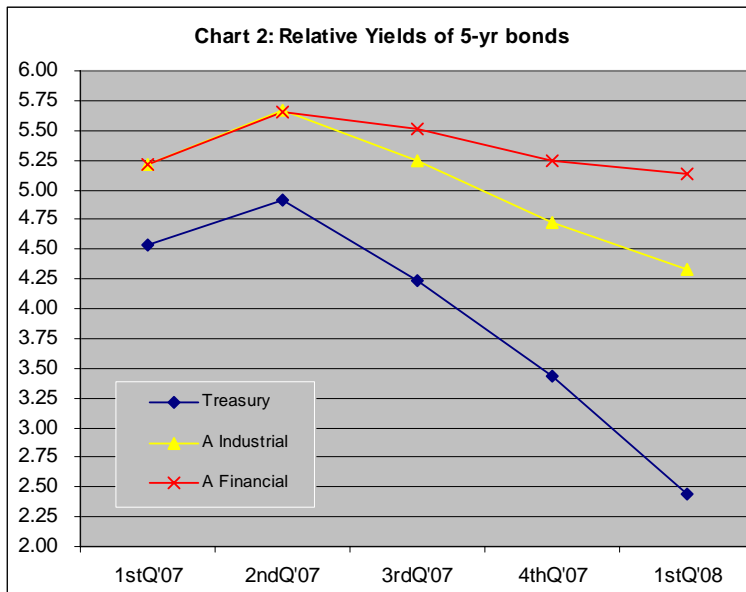
CORPORATE BONDS

Investment-grade corporate bond prices experienced a crazy quarter. Corporate spreads to treasuries increased across all sectors as the "Flight to quality" scenario dominated the second half of the quarter. Scared investors took their money and invested in treasuries, which caused increased pressure on prices and a virtually non-existing sell (bid) side. This helps to explain the underperformance in selected portfolios. Let's take a closer look:

Non-financials such as industrial and utility names weathered the storm rather well during the quarter. This is where the focus of fixed income managers has been in recent weeks. At ICM, we shifted our focus to non-financials as early as fall of 2007, with the majority of investments in this sector. Most non-financials experienced price appreciation, which in turn contributed positively to total return performance.

Financial names on the other hand were hit hard by the surging credit/financial crisis, particularly broker-dealers. Financial bond spreads widened the most during the quarter as illustrated in Chart 3 below. Some names saw spreads spike as illiquidity, write-downs, and earnings forecast spooked both fixed income and equity markets. This triggered panic-selling in certain names, forcing prices and market values down, which in then lowered total return performance.





Source: Bloomberg

LOOKING AHEAD

The pessimistic outlook on the U.S. economy, the credit/financial markets turmoil, and the housing crisis will continue to dominate the weeks and months ahead. This scenario is likely to cause the Fed to lower short term interest rates further, though the pace and extent of further easing is an open question. The market consensus reveals at least a quarter point reduction of the benchmark rate by the end of the second quarter of 2008 to 2.00 percent. Much will depend on the upcoming earnings reports of companies in the financial sector beginning in mid-April. The yield curves are expected to continue to steepen, but at a slowing pace.

With expectation of slower yield curve steepening, we will gradually begin to strategically position bonds in the intermediate sector, (5 to 10 year maturities), of the curve, taking advantage of higher yields. This will help safeguard portfolios of a likely flattening of the curve in the latter part of 2008.

As we move through the year, we expect the presidential election will also have an impact on markets and expectations. Markets will undoubtedly feel an impact as the presidential candidates reveal their visions and plans for the economy, taxation, fiscal policy, retirement, and healthcare. All in all, we are looking at uncertain but compelling opportunities given the current special conditions that exist.

TREASURIES / GOVERNMENT AGENCIES

We expect short term treasuries and agencies to rally, but at a more moderate pace, as seen during the first quarter, as both fixed income and equity investors will likely shift their focus away from the panicky "flight to quality" mentality to a "looking for the light at the end of the tunnel" approach. We also expect a slow shift towards other asset classes as investors work through the markets and start to absorb volatility and valuations. With world inflation in resources/commodities persisting, it seems unlikely that longer term treasury rates will decline.

CORPORATE BONDS

Corporate bonds had a rough time since the credit/financial crisis began last July. We believe the “flight to quality” attitude will persist for a bit longer, but not to the same extent seen in the past quarter. With the economy on the brink of a recession, increasing unemployment and slowing consumer spending, along with poor liquidity in the secondary market, high-rated investment-grade bonds will likely rally. We see opportunities to invest in corporate bonds at relatively cheap levels, particularly as spread widening is expected to gradually level off in the second half of 2008. We will focus on industrial offerings with sound balance sheets, global market focus, and attractive yields. In addition, financial companies, although currently shunned by many investors, offer attractive yields, especially true for solid banks and insurance companies. We will be carefully evaluating potential candidates based on their balance sheets, earnings, outlooks and forecasts, as well as credit ratings before making any new investments. Individual portfolios will be assessed to examine how potential investments would fit with current allocations and investment policy. Again, we believe that there is compelling opportunity in many sectors, particularly for long-term investors willing to take on slightly more risk.

In conclusion, we continue to maintain our disciplined approach of investing appropriately for each client. Each portfolio is assessed on a case by case basis to ensure that portfolio fundamentals and composition match the current market environment. Sufficient diversification has been and continues to be one of our risk management principals. ICM applies fixed income investment strategies that are specifically designed to handle a dynamic interest rate environment.

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.

