

FIXED INCOME COMMENTARY LETTER FOURTH QUARTER 2007

OVERVIEW

The fourth quarter of 2007 was driven by a continued strong rally in the treasury market, causing treasury yields to decrease, while credit spreads continued to widen. As expected by investors and traders alike, the Federal Open Market Committee (FOMC) lowered interest rates in consecutive meetings on October 31 and December 11, to 4.50 percent and 4.25 percent respectively. Persistent uncertainty about the health and direction of the U.S. economy and the unrelenting negative impact of the housing market coupled with the sub-prime loan situation, plague the capital markets. Re-pricing of risk, interest rate cuts, rate expectations, volatile economic data, and investors' demand for more conservative assets led to a buying spree or a typical flight to quality/flight to safety scenario, pushing treasury prices up and yields down.

U.S. ECONOMY

The final revised GDP (the output of goods and services in the United States) for the third quarter showed that the economy continued to expand, by 4.9 percent, although at a slower pace than in the prior quarter. Unfortunately, final GDP numbers for the full year are expected to be below the Fed's comfort level of 3 percent. Some analysts are calling for numbers around 2 percent annually.

The unemployment rate increased to 5 percent during the fourth quarter of 2007. Unemployment is expected to remain relatively steady for 2008, though a slight increase is possible. While the up-tick in unemployment is not large enough for the economy to slip into a recession, recessionary pressures are weighing in heavily. This will force the Fed to lower interest rates further. Because the consumer side of the ledger represents more than two thirds of GDP, job and wage growth are crucial factors in keeping the economy out of a recession. Consumer spending increased during the third quarter by a more than moderate 1.4 percent.

The Fed's current opinion is that readings on core inflation have improved modestly, but inflation risk remains due to higher energy and commodity prices. Economic growth is slowing due to intensified declines in the housing market and deterioration of financial market conditions. The Federal Open Market Committee agreed that there is an uncertain outlook for both economic growth and inflation, in its last meeting on December 11.

HOUSING

The housing market along with the sub-prime mortgage situation continues to put a drag on the economy as well as financial markets. Sales of existing homes continued to decline for the seventh straight month in October but slightly leveled off in November, still hovering at the lowest level in five years. Prices of existing homes continued to fall. Sales of new homes and construction starts declined as well.

The negative trend for the overall housing market is expected to continue through at least mid-2008 before a gradual leveling-off and likely recovery in 2009. Mortgage delinquencies and default rates accelerated during the fourth quarter of 2007. These delinquencies and foreclosures threaten to increase inventories further and put increased pressure on house prices throughout the country.

The flat housing market will further lower consumer spending, since spending in previous years was driven considerably by home equity appreciation and borrowing against that equity. Federal regulators continue to push for better oversight and tighter lending standards.

BENCHMARKS

The U.S. investment-grade fixed income market (treasuries, bonds, and mortgage-backed securities) as measured by the Lehman Brothers Aggregate Bond Index gained 2.98 percent during the quarter. The index increased by 0.90 percent in October, gained 1.80 percent in November, and ended the quarter up another 0.28 percent in December. Its return was 6.97 percent for 2007. This index benefited considerably from the flight to quality, as investors moved assets into treasuries as a safe haven in the latter half of the year.

The total return of the Lehman Brothers Intermediate Index (securities with intermediate maturities) rose by 0.73 percent in October, 1.9 percent in November, and another 0.26 percent by the end of December, ending the fourth quarter with a total return of 2.89 percent for the period. Its return was 7.39 percent for 2007.

The total return of the Lehman Brothers 5-year Municipal Index (securities with 4 to 6 year maturities) gained 1.89 percent during the quarter. The index increased by 0.38 percent in October, gained 1.07 percent in November, and added another 0.44 percent in December. Also benefiting from the flight to quality, the index's return for 2007 was 5.15 percent.

INTEREST RATES

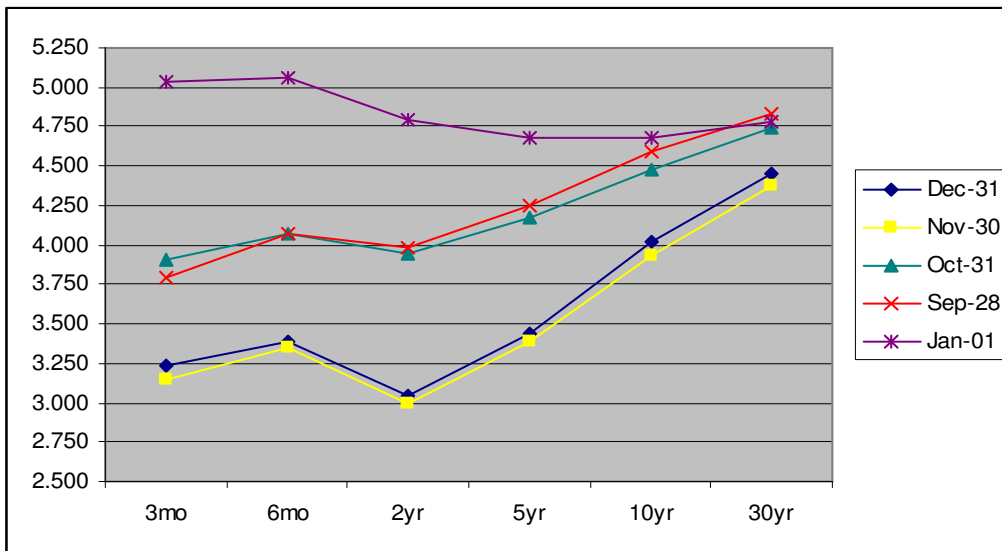
The FOMC lowered short-term interest rates by 25 basis points (0.25 percent) in consecutive meetings, from 4.75 percent in September, to 4.5 percent on October 31

and 4.25 percent on December 11. These moves indicated that Fed chairman Bernanke was no longer comfortable with the direction of the economy, further acknowledging the adverse effects of the sub-prime loan crisis and its impact on the housing market. It is increasingly apparent that the Fed has put the task of containing financial market stability ahead of inflation concerns.

As the following treasury yield table shows, treasuries in all maturities fell throughout the quarter, as well as over the year.

	Dec-31	Nov-30	Oct-31	Sep-28	Change in Basis Points: 9/28/2007 to 12/31/2007	Jan-01	Change in Basis Points: 01/01/2007 to 12/31/2007
3mo	3.237	3.144	3.911	3.796	-55.9	5.036	-179.9
6mo	3.389	3.348	4.066	4.075	-68.6	5.057	-166.8
2yr	3.047	2.995	3.945	3.984	-93.7	4.791	-174.4
5yr	3.440	3.382	4.169	4.243	-80.3	4.675	-123.5
10yr	4.023	3.938	4.471	4.587	-56.4	4.680	-65.7
30yr	4.452	4.379	4.746	4.836	-38.4	4.785	-33.3

Source: Bloomberg



Source: Bloomberg

The yield curve steepened during the quarter. The treasury curve is now positively sloped; this is more typical because it compensates investors 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 4.59 percent on September 28 to 4.02 percent on December 31, decreasing by 56 basis points over the quarter. The yields on two, five, and thirty-year treasury notes decreased by 94, 80, and 38 basis points, respectively, over the same period. The yield spreads between corporate bonds and treasuries of comparable maturity widened during the quarter as a result of the flight to safety.

Beginning in Dec 2007, the Fed instituted a new program called the Term Auction Facility (TAF). The intent of the TAF is to make term funds available to banks in a fashion that allows banks to become less reliant on high cost managed liabilities during this period of strained market conditions. This credit is an alternative to banks approaching the discount window, a phenomenon that entails a stigma of higher risk, and therefore, an implicit cost. Therefore, banks have been reluctant to go to the discount window, rendering the discount rate less effective as a tool for the Fed. To address this problem the Fed introduced TAF. Under the TAF, banks bid in auctions to buy term discount window credit, when it is less expensive than the cost of term funds in the inter-bank funding market. So far, it appears that the TAF is smoothing credit conditions modestly.

SECTOR UPDATES

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

Investment-grade corporate bond prices increased in value as we saw a treasury rally during the fourth quarter of 2007. Buying was triggered by strong demand, the looming credit and financial crisis, interest rate cuts and rate expectations, a flight to quality/flight to safety scenario, as a result of continued concerns about the sub-prime mortgage situation and housing.

With the economy slowing, along with mixed fundamentals and fading liquidity in the secondary market, investment-grade bonds will likely continue to rally. We expect investment-grade credit spreads to tighten slightly in the later part of the first half of 2008 as Fed actions and fallouts of sub-prime write-downs trigger through the capital markets. Spreads may continue to widen for distressed and lower grade credits.

The municipal bond market will see increasing supply in the weeks and months ahead. Therefore, municipal bond rates are no longer tracking treasury rates. Municipal credit markets are also suffering from the growing concerns regarding the quality of guarantees from bond insurers like MBIA and AMBAC. We expect a steepening of the curve in the months ahead as the bond market offerings increase and municipal issuers become more dependent on their own creditworthiness.

LOOKING AHEAD

The problem with the sub-prime market and its impact on the U.S. economy and the financial markets will continue to show its “grim” face in the weeks and months ahead, and is likely to cause the FOMC to lower interest rates further; the pace and extent of further easing is an open question. The market consensus expects considerably more reduction of the benchmark Fed rate by the end of the first quarter of 2008. Yield curves are expected to steepen further as a result.

At present, most bond portfolios are best positioned if they are kept predominantly in relatively short maturities, at the belly of their respective yield curves.

Sufficient diversification has been and continues to be one of our risk management principals, and ICM’s fixed income investment strategies are specifically designed to handle a dynamic interest rate environment. We continue to maintain our disciplined approach of investing appropriately for each client. Each portfolio is assessed to ensure the fundamentals match the current market environment. We will invest funds when we find compelling candidates that fit strategically in individual portfolios.

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.