VANDERBILT AVENUE ASSET MANAGEMENT

Second Quarter 2008

First quarter 2008 real GDP grew slightly more than previously estimated; however, concerns are rising about potential threats to growth in coming months. First quarter GDP rose 1.0% versus the initial estimate of 0.9%. Fourth quarter 2007 was 0.6%. Stronger consumer spending and export growth paced the rise while inflation was also revised upward. Inflation (personal consumption expenditures excluding food and fuel), the Fed's preferred method of viewing inflation, was up 2.3%. The Fed's acceptable band for inflation is 1%-2%. There is concern of the impact upon growth as the stimulus from the government rebate checks fades. Consumer confidence has plunged to its lowest level since 1992 as the labor market exhibits weakness; the decline in home prices accelerates; and soaring prices for food, energy and other commodities continues. The consensus outlook is for sub-par growth for the rest of the year but no recession. Economic clouds that give no sign of abating anytime soon include housing, continued credit market turmoil and an economy facing a prolonged period of deleveraging by both borrowers and lenders. In addition, the last thing the economy needs in the face of these problems was a persistent rise in energy costs which will lessen consumer spending (70% of GDP) and add to inflation pressures. On April 30th, the Federal Reserve lowered the fed funds rate an additional 25 basis points from 2.25% to 2.00%. This was the seventh time in the past eight months since last September the Fed has lowered rates in reaction to the credit market turmoil and the weakening economy. At their June 25th meeting, the Federal Reserve left the fed funds rate unchanged at 2%. This ended the streak of rate cuts from the 5.25% level since last summer. For the first time in months the Fed made inflation more of a concern than economic weakness. On the other hand, the motivation to keep the fed funds rate unchanged is their acknowledgement of housing weakness, soft business spending and a weak labor market. The Fed expects inflation to moderate later this year and next year. They are hoping that the slowing economy and soft labor market, plus the possible end to the dollar's decline, will help relieve inflationary pressures. The Fed is attempting to "talk up" the dollar without having to support it with a higher fed funds rate at this time. The Fed is balancing weak growth vis-à-vis inflation pressures and have left themselves room to raise rates in inflation intensifies and lower rates if there is a sharper slowdown in economic growth. The Fed's interest rate reductions along with their expanded lending to the broker/dealer community has helped keep the economy out of a recession and, they are hopeful, should help to foster moderate growth over time.

Corporate Bond Market Review

The second quarter of 2008 was certainly better for credit markets than the first-quarter; however, there continue to be worrisome trends. The Lehman Credit Index generated 134 basis points (bps) of excess return; however, most of that outperformance came in April on the heels of a rally following the rescue of Bear Stearns. Returns for May were modest while June was down. The second-quarter total return for the Lehman Credit Index was -0.90% as tighter spreads (the Lehman Credit OAS tightened from 259 bps to 238 bps) were more than offset by rising interest rates. On a year-to-date basis, credit excess and total returns were -283 bps and -0.48%, respectively. The JP Morgan takeover of Bear Stearns was a significant market event with regard to the financial market turmoil that began during mid-2007. What began primarily as a sub-prime mortgage problem eventually impacted all segments of the global financial markets. As we began the second quarter, our main concern was the extent to which this crisis would impact the overall economy. While this topic was much debated during the quarter, it is clear that the impact is significant and the problems are likely to be with us for a while. While the Federal Reserve has taken unique and innovative steps to deal with this turmoil, the fact remains that banks are in a capital preservation/building mode and still unable and/or unwilling to lend. The net result is a shrinking US "balance sheet" and the ongoing disposition, redeployment and write-down of financial assets and real estate.

Corporate spreads are well off the tightest levels of late-May/early-June (210 bps) and we believe it's possible they could test the historical wide levels seen in mid-March (265 bps). While we had moved to an overweight in credit in late March, taking advantage of the extremely wide spread levels, we moved back to a neutral/ defensive position later in the quarter as spreads tightened and the macro-outlook began to worsen. We favor companies in defensive and non-cyclical sectors such as utilities, pharmaceuticals and energy. While we believe there will be an attractive opportunity within bank/finance, we feel that it is still early for this strategy given ongoing asset-quality trends and the potential for further write-downs. Additionally, we will look to avoid sectors most exposed to the consumer and the macro-economic cycle.

Mortgage-Backed Securities (MBS) Review

After recovering strongly in April from the decline in mid-March, the securitized market carried positive momentum through May and early June until the resumption of risk aversion at the end of the quarter. In mortgage-backed securities, historically high option adjusted spreads (OAS) and a constructive prepayment environment outweighed duration extension concerns to draw in demand from overseas investors, banks and the government sponsored entity (GSE's) Agencies. Despite volatility and bouts of illiquidity, the diversification of product within high- grade MBS seemed to offer a relative value opportunity. In April, higher interest rates and lower prices contributed to modest duration extension. This benefited five and ten-year cash flows inherent to 30-year MBS and 10/1 hybrid adjustable rate mortgages (ARM's). The relaxation of capital constraints on the GSE's (FNMA and FHLMC) provided further demand side support. In May, relative returns fell from the mid-month peak as convexity hedging pushed swap spreads wider. A combination of higher interest rates and slower prepayments caused MBS duration to extend thereby prompting the selling of discount coupons. In this environment hybrid ARM's and high-coupon pass-throughs benefited from average life extension and high current yields which cushioned performance. The significant bull steepening that began in mid-June coincided with a spike in volatility and wider swap spreads to weigh on spread sectors. Risk aversion was triggered by the downgrade of the largest monoline insurers. MBS investors responded by rotating into the less volatile agency 15-year and hybrid ARM space.

As the quarter ended, the fundamentals for Agency MBS were still viewed as strong due to the limited menu of securities that provide both liquidity and high risk-adjusted returns. Additionally, prepayments have shifted lower due to negative HPA, higher mortgage insurance premiums and tighter lending conditions. Consequently, partially due to the best convexity environment in 10 years, we increased our allocation to Agency MBS during the period. For the quarter, MBS compiled positive excess returns (versus similar duration US Treasury issues) of 51 basis points in the face of the index duration extending 0.9 years.

Asset-Backed Securities Review

As the quarter began, better financing improved economic carry and eased liquidation pressures to help high-grade asset-backed securities (ABS) post their first positive monthly excess return in six-months. However, below AAA the outlook didn't improve as high leverage, reduced net worth and worsening labor conditions ensured a constrained consumer. A generally positive tone prevailed into May but it was clear that home prices needed to fall further to equate to rents while burgeoning inventories would further depress prices. Thus, a fundamental case had not developed to form a market bottom with supply side pressures from foreclosures and forced sales expected to continue through the remainder of 2008.

Stunted liquidity in the non-Agency jumbo market continues to thwart recovery outside the auspices of government supported programs. The freezing out of non-Agency conduits will prevent the allocation of capital needed to balance risk/reward until pricing better reflects the uncertainty still inherent to the macroeconomic environment. The credit driven average life extension in ABS continues to weigh on valuations as does the increased sophistication needed to evaluate the prioritization of cash flows under distress/default scenarios. In response to this environment, we significantly reduced exposures to both residential and consumer based ABS during the quarter. For the second quarter, ABS posted positive excess returns versus their US Treasury benchmark of 78 basis points.