VANDERBILT AVENUE ASSET MANAGEMENT

1st Quarter 2009

Volatility, uncertainty and historic economic and financial precedents describe the first-quarter of 2009. Fourth-quarter real GDP was revised down to -6.3% (annualized) versus an original estimate of -3.8%. Every major economic component declined except for government spending. The downward revision was primarily due to a contraction in inventories. Consumer spending (approximately two-thirds of overall GDP) was down 3.5%. Exports, retail sales and housing experienced significant declines. Exports and business investment declined approximately 23% during the quarter. Exports and business investment are forecast to be even weaker in the first-quarter. The decline in exports reflects the global nature of the recession. For example, Japan's exports dropped 49% in the 12 months ended February and real GDP contracted at a 12% (annualized) pace in the fourth-quarter of 2008 with predictions that the first-quarter could be worse. Japan has the second largest economy in the world and their exports are a major component of their economy. Consumer emphasis upon saving rather than spending is a trend that promises to remain in place longer-term with implications for a gradual, slow growing recovery. The labor market remains very weak with March unemployment at 8.5% and forecast to reach 9%-10% by year end. This is the highest unemployment level since 1983. The economy has shed at least 650,000 jobs for each of the last four months and 5.1 million jobs since the recession began December, 2007. Economic growth will be impeded until financial markets and institutions can resume more normal functioning.

The Obama Administration proposed several major programs during the quarter, in addition to previous proposals, to combat the economic and financial challenges. The administration proposed a $788 billion stimulus package of spending and tax reductions to be implemented over the next couple of years. In addition, a $3.6 trillion budget for the fiscal year starting October 1st has a deficit of $1.75 trillion-equivalent to 12.3% of GDP. This is the largest percentage deficit since 1942 and includes initiatives for health care, energy and education. The annual deficit is forecast to shrink to $533 billion by 2013; however, this forecast appears to be based on optimistic assumptions. The stimulus program is the first leg of an economic package aimed also at unclogging the credit markets, lifting housing and tightening regulation of the financial sector. The administration has also introduced a public/private investment program to spur the purchase of real estate related securities and loans in an attempt to remove toxic assets from bank balance sheets. The government will provide low cost margin financing that could result in up to $2 trillion of purchases. The administration has also introduced a $275 billion program to aid homeowners in either refinancing or modifying their mortgage. If the current programs are not enough, authorities have made clear more actions will be taken until they are satisfied the economic and financial risks have been adequately addressed.

The Federal Reserve remained very active during the quarter. The Fed reaffirmed their aggressive easing at the March 18th FOMC meeting. They unanimously voted to maintain the fed funds rate at the 0%-.25% level. In addition, their quantitative easing was expanded. They outlined a program whereby they will purchase $300 billion in long-term US Treasury issues, $1.25 trillion of mortgage-backed securities and $200 billion of US Agency debt. Since last September, the Fed's balance sheet has gone from $900 billion to $1.8 trillion. The announced actions are likely to expand that amount to at least $4 trillion by year end-equivalent to almost 30% of GDP. The Fed said "in these circumstances the Fed will employ all available tools to promote economic recovery and to preserve price stability." The Fed recently marked down their economic forecast, with a slow recovery not expected until next year amid rising joblessness. The Fed's forecast is that the economy will continue to experience steep contractions thru the first-half 2009, unemployment will approach 9%-10% by year end and the deleveraging process by both borrowers and lenders will continue for some time. They think the unemployment rate will rise more steeply into the early part of 2010. Policy reflation eventually should succeed. At that point, the markets will start to turn their attention to the long-run implications of the unprecedented monetary and fiscal stimulus. Future potential risks of these policies include inflationary pressures and US dollar weakness. Fed policymakers are very sensitive of the future need to unwind their money printing before it leads to an inflation problem.

During the first quarter, interest rates rose across the US Treasury yield curve. Greater rate increases occurred as maturities lengthened. For example, the two-year note rose four basis points, the ten-year increased 45 basis points and the 30-year rose 85 basis points. As a result the yield curve became more positively sloped versus the beginning of the quarter:

	31-Dec	31-Mar	Change
3-monthTreasury Bills	0.08	0.20	0.12
6-month Treasury Bills	0.26	0.42	0.16
2-year Treasury Note	0.76	0.80	0.04
5-year Treasury Note	1.55	1.66	0.11
10-year Treasury Note	2.21	2.66	0.45
30-year Treasury Note	2.68	3.53	0.85
10-year vs. 2-year	1.45	1.86	0.41

Mortgage-backed securities (MBS) provided excess returns versus their US Treasury benchmark of positive 172 basis points for the quarter. Since the Federal Reserve's announcement on November 2008 to purchase $500 billion of MBS, purchases year-to-date are $300 billion. The program was implemented in the first week of January and has since then been expanded to $1.25 trillion. These purchases have helped to lower thirty-year mortgage rates to approximately 4.86% as the Federal Reserve continues to support the mortgage market. The duration of the MBS index peaked in February to 2.57 and has since dropped to 1.53 in March. This drop has not triggered the typical convexity concerns associated with sharply lower interest rates due to slow prepayment speeds linked to the housing slowdown. The portfolio remains overweight in high-quality, very liquid mortgages that should benefit going forward.

As the government continues with its initiatives to support the fixed income market, the Treasury announced the Public-Private Investment Program ("PPIP") on March 23rd. The two programs, one for "legacy loans" and another for "legacy securities," seek to provide relief for the financial sector by providing for the creation of investment funds capitalized by private and taxpayer funds to purchase distressed assets. The total for the program is expected to reach $2 trillion. The Treasury anticipates a taxpayer capital contribution of $75 to $100 billion, funded by the Troubled Asset Relief Program ("TARP"). As part of the legacy securities public-private investment program, the scope of the TALF program has been broadened to include legacy residential mortgage securities and commercial mortgage backed securities. We view the creation of public-private investment partnerships and the expansion of TALF as positive developments for the securitized sector.

Credit markets entered 2009 on a slight upward trend after having experienced a dismal 2008. The corporate rally that started during December carried over into January as spreads tightened 60 basis points to begin the year. The Barclay's Credit Index OAS began the year at 493 basis points after having been as wide as 545 basis points at the beginning of December. Investor optimism seemed to stem from the prospects of a new administration in Washington and expectations regarding a plan to solve the financial crisis. This optimism carried through Inauguration Day and only met resistance following the release of Treasury Secretary Geithner's plan, which in lacking specifics, unsettled markets. Additionally, equity markets came under selling pressure as concerns regarding bank nationalization, asset quality and mark-to-market accounting became front page news. This together with continued heavy new issuance of corporate bonds pressured spreads during February and March. The fact that the market was able to absorb such heavy issuance was positive, but the impact of having to offer significant new issue spread premiums pushed secondary market spreads wider. The Credit OAS finished the quarter at 483 basis points; 60 basis points off the lows of February 13th. Year-to-date total and excess returns for the Credit Index were -1.78% and -15 basis points, respectively. Total returns were negatively impacted by rising US Treasury yields during the quarter.

We remain constructive on corporate issues looking forward given the significant spread pickup against Treasuries and the level of protection this provides versus both widening spreads and defaults. For example, at 483 basis points, spreads would have to widen over 80 basis points before corporate bonds would underperform similar duration Treasuries over the next 12 months. Further, the implied probability of default is approaching 40%; a level not likely to be seen. We continue to like defensive sectors (utilities and pharmaceuticals) versus those most sensitive to the economy (cyclical and manufacturing) and believe there is merit in owning issuers likely to benefit from implicit and/or explicit government support. This would include FDIC-backed corporate bonds.