VANDERBILT AVENUE ASSET MANAGEMENT

2nd Quarter 2009

Revised first-quarter GDP was -5.5% on an annualized basis (vs. -6.3% for fourth-quarter 2008). These two quarters represent the greatest six-month decline in GDP since 1958. The first-quarter's falloff was led by declines in business investment and inventory liquidation. The global nature of the recession was reflected by GDP declines of 14.4% in Germany and 14.2% in Japan-two countries dependent upon export growth. The labor market continued to show weakness with the June unemployment rate up to 9.5%-a 26-year high. The losses for June lifted net jobs shed since the beginning of the recession to 6.5 million-equal to the net gain over the previous nine years. This is the only recession since the Great Depression to wipe out all the jobs growth from the previous business cycle. The unemployment rate is expected to top out at above 10%. The consumer (70% of GDP) is going to remain spending constrained given the hit to net worth from the housing and stock markets as well as the continued weak labor market. Inflation is not today's story-the more immediate concern is deflation. The primary reason for this is substantial excess capacity (in the US as well as globally) in both the labor market and factory utilization (at 65%). One of the future uncertainties regarding longer-term inflationary implications is the unwinding of the aggressive monetary and fiscal programs. Estimates for second-quarter GDP are for a decline of approximately 1.3%. We expect the recession to end in mid-2009 but the recovery will be weak. The consumer will continue to deleverage and increase the savings rate, business fixed investment will remain weak reflecting a sub-par economic environment and exports will not be a sector of strength due to the global nature of the recession. Government spending at the federal level is the only sector exhibiting growth and this is somewhat diminished by cutbacks at both the state and local levels. Credit headwinds will continue with both borrowers and lenders reluctant to expand credit. The very accommodative Federal Reserve policy has not yet resulted in significant increased lending. We forecast a further 10%-15% decline in housing prices as the cycle of more homes for sale, lower prices, more negative equity and further defaults and losses continue. Expansive fiscal policy will result in $2 trillion in deficits for both 2009 and 2010. These deficits are an unprecedented 14% of GDP and do not include any further deficit spending for a universal health plan. The economic and financial environment will continue to have a high degree of uncertainty.

As expected, the Federal Reserve maintained the fed funds level in a 0%-0.25% range at their second-quarter meetings of April 29th and June 24th. The Fed said they would continue to purchase US Government securities but would not enlarge the program. They said they would keep interest rates low for an extended period and will use all available tools to promote a recovery. Their outlook is for the economy to remain weak and inflation subdued for some time. The challenge the Fed has is to promote economic recovery and normal functioning of the credit markets through an aggressive easing policy while at the same time conveying to the markets they are diligent about not letting inflation get out of control longer-term. In Congressional testimony, Bernanke said the pace of economic contraction is slowing but due to the plight of consumers and business investment "recovery will only gradually gain momentum and that economic slack will diminish slowly." He said that businesses are likely to be cautious about hiring and the unemployment rate is likely to rise even after economic growth resumes. It could take some months or even years to get the jobless rate back to the longer-run trend. There has been some improvement in the credit markets as indicated by lower interest rate levels and narrower quality spreads; however, by no means are the markets normalized with free flowing credit availability. The Fed will have to first make sure the economy is over the threat of deflation and then balance their long-term exit strategies vis-à-vis potential inflation.

During the second quarter, interest rates rose across the US Treasury yield curve (with the exception of US Treasury bills). Greater rate increases occurred as maturities lengthened. As a result, the yield curve became more positively sloped versus the beginning of the quarter:

	31-Mar	30-Jun	Change
3-monthTreasury Bills	0.20	0.18	-0.02
6-month Treasury Bills	0.42	0.34	-0.08
2-year Treasury Note	0.80	1.11	0.31
5-year Treasury Note	1.66	2.56	0.90
10-year Treasury Note	2.66	3.53	0.87
30-year Treasury Note	3.53	4.33	0.80
10-year vs. 2-year	1.86	2.42	0.56

Mortgage-backed securities (MBS) provided excess returns versus their US Treasury benchmark of positive 123 basis points for the second-quarter. The MBS portion of your portfolio is slightly overweight. This overweight benefited the portfolio during the quarter. The Federal Reserve's $1.25 trillion program implemented at the beginning of the year to purchase MBS continues to run smoothly, purchases year-to-date are $598 billion. These purchases have helped to lower thirty-year mortgage rates to approximately 5.2%. We remain positive on the MBS sector given the yield pick up against US Treasuries and the continuing support of the Federal Reserve. The portfolio remains overweight in high-quality, very liquid mortgages that should benefit going forward.

The consumer asset-backed securities sector (ABS) continues to improve given the creation of the Federal Reserve's Term Asset Backed Securities Loan Facility ("TALF"). In the second-quarter, spreads for AAA have tightened by 200 basis points. TALF is the $200 billion program aimed at supporting the issuance of ABS collateralized by student loans, auto loans, credit cards and loans guaranteed by the Small Business Administration. In the month of June, eight consumer ABS deals priced for a total of $11.5 billion. All were well received by the market.

The Treasury's Public-Private Investment Program ("PPIP") announced on March 23rd has been revamped to focus only on "legacy securities," the "legacy loans" portion of the program has been postponed indefinitely. The size of the US Treasury capital contribution has been decreased to $30 billion. The "legacy securities" 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.

The corporate sector had very strong relative performance in the second-quarter. The Barclays Credit Index OAS began the 2nd quarter at a 483 basis points yield spread and rallied to 275 basis points by the end of the quarter. Excess return for corporate issues in this three month period was a positive 1178 basis points. US dollar denominated debt issued in the 2nd quarter was a large $775 billion. New issuance performed well across all sectors due to strong investor demand as investors encompassed greater risk. Most new issues were oversubscribed due to attractive yield spreads.

We maintained an overweight allocation to the corporate sector and this benefitted your portfolio. Strategic additional investments to this sector were made keeping fundamental value and attractive spreads as the primary focus. The government's commitment to sustain liquidity in the credit market, buttress home owners in the form of new programs and provide stringent stress tests of the banking sector encouraged investors. Going forward, we will continue to look for attractive new issuance and be aware of any market dislocations that may be occurring from macroeconomic factors. We remain constructive on the corporate sector, participating in new issuance and secondary trading of defensive sectors (for example food conglomerates), while also finding opportunistic areas of investment in TLGP issuance from financial companies.