

For the third quarter of 2010, Barclays Capital municipal indices showed returns ranging from 0.31% for short-term municipal securities to 4.49% for the longest maturities. The “flight to quality” bias within the municipal market that took place in the second quarter reversed in the third quarter as investors sought higher yields in an environment where yields were near historically low levels. The five-year pre-refunded sector returned 2.15% for the quarter, compared to 2.70% for the five-year revenue sector. Non-traditional issuers, such as hospital and industrial development revenue bonds, had strong returns of 3.86% and 4.57%, respectively. Our investment philosophy is to buy high quality, traditional issuers and over time make trades designed to maximize the after-tax income.

### Noteworthy News

- While state and local government units are struggling with lower revenues, unlike the federal government they must balance their budgets. While this does not make the budget process any less difficult, it does impose fiscal responsibility. News reports have been actively highlighting those government units that have been experiencing difficulty in balancing their budgets.
- Given the continued economic pressure, even high quality traditional issuers will need to make painful expense reductions in order to balance their budgets.
- While there is still concern over rising interest rates, recent sentiment is moving towards an extended low rate environment.
- The municipal yield curve remained at relatively steep levels as of September 30, 2010. The two-year to ten-year spread stood at 193 basis points (1.93 percentage points) at the end of the quarter, 36 basis points flatter than last quarter-end.
- The five-year municipal to treasury ratio ended the quarter where it began, at 96%, versus a ten-year average of 85%. This illustrates the attractiveness of municipal bonds relative to Treasuries.
- With the federal deficit at a record level and climbing, the municipal market is attracting buyers who are fearful of an increase in income tax rates.

### Past performance does not guarantee future results.

Reflects aggregate information for the accounts included in the Municipal Fixed Income (Short & Short-Intermediate) composite. The composite is not an actual account, and the information provided may vary from one account to another. Portfolio holdings, and therefore characteristics, are subject to change. The Barclays Capital Municipal Bond Index is a market-value-weighted index comprised of investment-grade, tax-exempt, fixed-rate bonds with long-term maturities. The Barclays Capital U.S. Aggregate Bond Index (formerly Lehman Brothers) is designed to measure the U.S. investment grade, fixed-rate bond market, which includes publicly issued, fixed-rate, nonconvertible, dollar-denominated, taxable U.S. government, corporate, mortgage pass-through and asset-backed securities rated investment grade or higher. Index performance information was furnished by sources deemed reliable and is believed to be accurate, however, no warranty or representation is made as to the accuracy thereof and the information is subject to correction. You cannot invest directly in an index, securities in the Composite may not match those in the index and performance of the Composite will differ. Although reinvestment of dividend and interest payments is assumed, no expenses are netted against an index's returns.

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