



3RD QUARTER 2004

I've been a science fiction fan my entire life. For those of you who partake in the fantasy fiction, you are aware there is a constantly reoccurring theme of a parallel universe.

Well, the bond market reminds me of a "sci fi" parallel universe; oil prices rise: bond yields fall, U.S. trade deficit rises: bond yields fall. Flummoxed, that's how we feel.

The inability to find stocks that provide safety and total return continues to drive capital into the bond market.

But don't, for a minute, get the impression it's smooth sailing. Quarter after quarter we have few comments directed to our municipal bond clients because of the safety and security munis historically provide.

Something very disconcerting happened in municipal bond land. The elected officials of San Diego, over the years, have allowed their public pension fund to remain grotesquely underfunded, all the while promising bigger, fatter benefits to their workers, many of whom are already retired. San Diego's finances are in disarray, they still have not faced up to their mounting fiscal problems and the rating agencies have downgraded numerous issues and suspended the city's bond ratings.

As you look through your portfolios and see the name "San Diego", your bonds are either sewer bonds, water bonds, certificates of participation or school bonds, **BUT** all are insured. "If" San Diego can not reconcile its checkbook and pension promises and "if" it files for bankruptcy, your bonds won't skip a beat; their value and income will not suffer.

Continuing our parallel universe story is

Fannie Mae. Combine equal parts of aggressive accounting with equal parts of corporate greed from those at the top of Fannie's food pyramid, and violá...problems are surfacing. We had purchased some callable Fannie Mae bonds as a money market replacement but as the bad news headlines continue to leach out, the bonds were sold. There's no need to be subjected to the headline news when you are not getting paid for the risk.

Is there anything to rejoice about? Absolutely. Corporate America is on the mend. One-half trillion dollars sits on corporate balance sheets, leverage has decreased and cash flow is increasing. The captains of industry seem unlikely to do risky acquisitions or wild-eyed deals soon. In fact, they are hesitant to hire new employees, or expand via capital expenditures. Certainly this feels like a parallel universe from the "bubble days" of the late 1990's.

Bond yields have fallen as the Federal Reserve has raised short term interest rates. It's that old parallel universe again. As the Asian central banks and foreign investors created additional buying demand, Treasury and corporate prices rose, as yields declined.

Usually in a parallel universe plot, someone realizes he can blast off and leave the universe for earth. I believe economic relationships will get back in sync but it seems the plot will linger a while longer before it concludes. In the meantime, rest easily as the interest rate environment remains benign.

Wishing you a Happy Halloween, Happy Thanksgiving and before you blink, Happy Holidays!

Marilyn Cohen