1st Quarter 2009 Market Outlook/Strategy

Pugh Capital's outlook is for a prolonged recession that is deeper than current market expectations. The consumer will experience another year of stress as housing prices and equity markets continue to fall and unemployment rises. The result will be less spending and more saving. However, the stress is not limited to consumers. Deteriorating economic and market conditions are hurting government entities, corporations, and non-profits, resulting in budget cuts and layoffs.

The recovery will be anemic and the U.S. will experience below trend growth for multiple years. Government debt servicing will take a bigger chunk from national income, reducing funds available for capital investments, thus negatively impacting innovation and productivity. More regulations and risk oversight, while needed, will reduce future growth rates. We also expect tighter underwriting standards and less credit availability for the private sector to limit growth prospects.

Core and nominal inflation continue to decline. The global economic slowdown is creating tremendous excess capacity and reinforces our expectations for lower inflation. A weak economy, declining inflation and the treasury repurchase program all align to be positive for longer duration securities. The portfolio is positioned to benefit from yield curve flattening. Pugh Capital will maintain a neutral to slightly long duration position relative to the Index. Interest rates are at low levels, but given the weak economy there is limited risk of significant rate increases.

While our economic outlook is pessimistic, we have a positive view of certain sectors of the investment grade market. Government policies currently provide significant support for agency debt, mortgages, and treasuries by purchasing these securities. These markets are well supported and are trading at rich levels. The commercial mortgage backed securities (CMBS) market, which was greatly distressed due to weak fundamentals and poor technicals, is the latest benefactor of government support. We believe CMBS is the most attractive sector of the market. Investment grade corporate bonds also look attractive.

Pugh Capital's primary strategy for the second quarter will be to increase exposure to the corporate and CMBS sectors. Valuations are attractive and Government support is curtailing some of the downside risks. Deteriorating economic conditions and a tight credit environment still favor a high quality emphasis within the portfolio. The new issue market for corporate bonds continues to offer attractive price concessions and is a key part of our strategy for adding high quality, liquid corporate bonds to the portfolio. The CMBS sector provides equity-like returns, and with government support, this sector is poised to perform well.