ASSET PRESERVATION ADVISORS

MARKET COMMENTARY

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Uncertainty surrounding the strength of the overall global economy has caused extreme market volatility in recent weeks. Fears stemming from the slowing U.S. economy and the escalating debt crisis in Europe were further exacerbated last week when the U.S. Government was stripped of its top-notch AAA credit rating by Standard & Poor's. We expect near-term volatility will persist as financial markets react to ongoing economic developments and heightened risk aversion amongst investors.

Overview

- A dramatic increase in market volatility following concerns over the strength of the global economy sparked a sharp flight to quality rally in the U.S. fixed income markets.
- Despite the recent downgrade of U.S. sovereign debt, Treasuries continue to be the "safe haven" of choice during times of economic uncertainty, as no alternative currently exists that can match the depth and liquidity of the U.S. Treasury market.
- A high level of uncertainty remains surrounding the short- and long-term impact on the municipal market following the U.S. downgrade and the enactment of the Budget Control Act of 2011.
- APA believes several positive technical and fundamental factors that have supported the municipal market in 2011 will likely continue through the end of the year.
- Recent volatility may give rise to attractive buying opportunities in the municipal market.

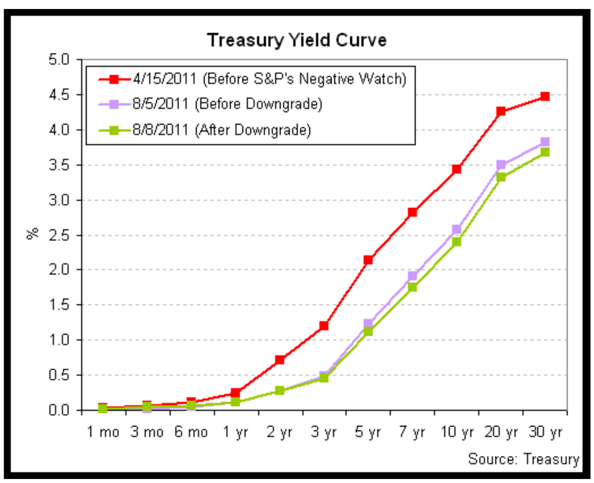
The U.S. Downgrade and Its Impact on the Muni Market

Though the U.S. Federal Government successfully avoided defaulting on its debt by passing a last-minute debt ceiling extension and deficit reduction plan earlier this month, the deficit-cutting measures taken were deemed inadequate by S&P. The rating agency announced late Friday afternoon its decision to strip the United States of its top-tier AAA credit rating, stating that "the downgrade reflects [S&P's] view that the effectiveness, stability, and predictability of American policymaking and political institutions have weakened at a time of ongoing fiscal and economic challenges to a degree more than [S&P]

envisioned". The rating agency further expressed its discontent with recent highly publicized quarrels among political leaders stating: "the prolonged controversy over raising the statutory debt ceiling and the related fiscal policy debate indicate that further near-term progress containing the growth in public spending, especially on entitlements, or on reaching an agreement on raising revenues is less likely than [S&P] previously assumed and will remain a contentious and fitful process".

APA does not believe the recent downgrade represents a fundamental increase in U.S. sovereign debt risk. Investor confidence in long-term U.S. government debt has proven steady in recent days, indicating that the U.S. Treasury market remains a global safe haven during times of economic uncertainty. Moreover, S&P's downgrade has been anticipated for many months, and several economists believe the U.S. downgrade may have already been priced into the market prior to the announcement. We feel that current market volatility is mainly a result of increasing uncertainty over global economic growth and the escalating debt crisis in Europe.

The following graph shows the downward shift of the yield curve since April 15, 2011, the day before S&P put the U.S. rating on negative watch. Despite S&P's ongoing criticism of the U.S. debt reduction plan, demand for U.S. Treasuries has increased recent months, sending yields to record lows following last week's downgrade. The decline in yields, especially on longer maturities, reflects a lack of investor concern over U.S. sovereign debt's risk profile. It further confirms the likelihood that the downgrade had already been priced into the market prior to last week's announcement, as yields had already declined considerably over the past few months.



There is still a high level of uncertainty surrounding the various short- and long-term impacts on the municipal market following S&P's unprecedented downgrade of U.S. sovereign debt and the recent enactment of the Budget Control Act of 2011. S&P has already lowered the AAA ratings of approximately 11,500 municipal securities tied directly to the federal government, according to data compiled by Bloomberg. They include debt backed by federal mortgage guarantors Fannie Mae and Freddie Mac and pre-refunded and advance refunded bonds, which are paid from escrow accounts typically funded with U.S. Treasury securities. S&P has clearly stated that state and local government ratings are not directly linked to the U.S. sovereign rating and can therefore maintain or achieve ratings above that of the sovereign. An independent review of state and local governments will be necessary to determine each government's individual exposure to U.S. sovereign risk. Municipal credits with a greater reliance on federal funding and a lower degree of financial flexibility are among the most vulnerable to a negative rating action.

Moody's Investors Service recently examined the level of sovereign debt risk exposure of fifteen top-rated states based on the following criteria:

1. Employment volatility due to U.S. factors;
2. Federal employment as a percentage of total state employment;
3. Federal procurement contracts as a percentage of state gross domestic
4. Medicaid as a percentage of total state expenditures;
5. Puttable variable rate debt as a percentage of available resources; and
6. As a mitigant to those risks, available operating fund balance as a percentage of operating revenue.

Based on these risk factors, Moody's believes the following five states have an above average exposure to U.S. sovereign debt risk: Maryland, New Mexico, South Carolina, Tennessee, and Virginia. APA is conducting an internal review of our current allocation to the general obligation debt of these states and will act accordingly to mitigate any apparent sovereign debt risk. We agree that state and local governments must be evaluated on a case-by-case basis and therefore do not anticipate widespread rating actions among municipal issuers not linked to U.S. Federal debt.

Current Market Conditions Bode Well for Tax-Exempt Munis

Increased market volatility and risk aversion in recent weeks has sparked a flight to quality rally in U.S. fixed income markets. Municipal yields across the curve have plummeted in conjunction with a sharp rally in U.S. Treasuries. Treasury yields hit record lows on Tuesday after the Federal Reserve announced it intended to keep its key policy rate near zero until mid-2013 in an effort to revive economic growth. The 2-year Treasury yield tumbled to a record breaking 0.157% while the benchmark 10-year note's yield hit 2.033%, breaking the previous low of 2.034% made on December 18, 2008 after the Lehman Brothers collapse.

AAA Municipal Yield Curve

	1 yr	2 yr	3 yr	5 yr	8 yr	10 yr	12 yr	15 yr	20 yr	30 yr
7/1/11	0.23	0.42	0.69	1.28	2.34	2.76	3.11	3.52	3.94	4.36
7/15/11	0.20	0.40	0.65	1.19	2.25	2.66	3.01	3.37	3.83	4.32
7/29/11	0.20	0.40	0.63	1.16	2.23	2.67	3.05	3.40	3.86	4.35
8/8/11	0.20	0.35	0.49	1.00	2.00	2.38	2.73	3.08	3.53	3.92
Change	-3	-7	-20	-28	-34	-38	-38	-44	-41	-44

Source: MMD

Lack of supply in 2011 continues to be the primary driving force behind the positive performance of tax-exempt municipals, and we expect this trend to continue over the remainder of the year. July issuance declined 16.8% year-over-year to $24.3 billion and volume for the first seven months of the year declined 49.5% to $141.7 billion versus the same period last year.

Fundamentals on the state level continue to improve, with state tax receipt growth accelerating from an average of 3% in the first three quarters of 2010 to an average of 9% in 4Q10 and 1Q11. Furthermore, negative headlines concerning municipal credit risk have subsided as the rate of municipal defaults continues to trend downward. Through July 2011, 35 issuers have defaulted on $946 million in municipal bonds year-to-date, according to the Distressed Debt Securities newsletter. This marks a significant decline from last year, when 92 issuers defaulted on a total of $3.98 billion in municipal debt. Municipal issuers have a very limited default experience with only 54 defaults over the period 1970-2009, according to a study on Moody’s-rated municipal issuers. The majority of municipal defaults occur in the speculative, non-rated sectors such as land-secured bonds, housing, long-term care and corporate-backed issues. In addition to having a significantly lower default rate and exhibiting lower volatility, municipal bonds have outperformed their corporate counterparts year-to-date. The Merrill Lynch Municipal Index has returned 6.12% through July 2011, compared with 4.46% for Treasuries and 6.03% for corporates.

Exhibit 3: 10-Year Average Cumulative Default Rates for Municipal and Corporate Bonds, 1970 - 2009

RATING	MUNICIPAL	CORPORATE
Aaa	0.00%	0.50%
Aa	0.03%	0.54%
A	0.03%	2.05%
Baa	0.16%	4.85%
Ba	2.80%	19.96%
B	12.40%	44.38%
Caa	11.60%	71.38%
All Investment Grade	0.06%	2.50%
All Speculative Grade	4.55%	34.01%
All Rated	0.09%	11.06%

Source: Moody's Investors Services, February 2010

Note: For any rating category, the percentage shown is the cumulative total of the bonds defaulting over 10 years. The Municipal column includes general obligations and non-general obligations. The general obligation default percentage is almost zero in all rating categories. Moody's database of corporate defaults covers over 3,600 long-term bond defaults by issuers. The figures do not include bonds that were not rated at the time of issuance. Rating agencies such as Moody's, rate securities from Aaa (highest quality) to C (lowest quality) with Baa and above being called investment grade securities. Ba and below are considered below investment grade (speculative) securities.

APA's Strategy

At APA, our main strategic direction may be summarized as follows:

1. For new portfolios, given the steep municipal yield curve, we continue to implement a barbell strategy by targeting the following yield curve segments:

   50% of total holdings allocated to 1-3 years in maturity.
   50% of total holdings allocated to 8-12 years in maturity.
   In addition, we do not see a long-term threat from significantly higher inflation. We feel that the current moderate uptick in inflation is mostly driven by the cyclical and transitional nature of commodities. Moreover, we do not project further inflationary pressure in the near-term, as prolonged high unemployment rates and a depressed housing market continue to suppress labor costs. Our overall duration target remains within the 4.00 to 4.50 year range.

2. We recommend investors allocate a portion of their portfolios to out-of-state bonds, even in high-tax states, in order to increase geographical diversification and help mitigate concentration risk. Currently, investors can take advantage of the steep municipal yield curve to make up the tax on out-of-state bonds by extending maturity just a year or two on out-of-state issues.

3. We believe that we are well positioned to capture additional yield by investing in market sectors where credit spreads remain wider than historical averages. Examples include water & sewer bonds, highly rated hospital bonds, public power authorities and public school district debt in states that offer an intercept program which should bolster diversification and price stability in our portfolios.

Disclosures:

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