



NEWGATE

CAPITAL MANAGEMENT LLC

WINTER 2010

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## MUNICIPAL *Income* PORTFOLIO

### INVESTMENT OBJECTIVE

The portfolio invests in federally tax-exempt securities offering high current yields.

### INVESTMENT PROCESS

Newgate uses a three-step discipline to identify and invest in tax-exempt closed-end funds. The first is the use of top-down Asset Allocation which determines investment commitment and cash reserves. Secondly a Strategic Fund Evaluation that identifies the best performing funds and the third is acquiring the best values. Newgate's investment strategy is implemented through the shares of closed-end funds (CEFs) that invest in tax-exempt securities. Unlike mutual funds, CEFs typically sell at discounts from their net asset value. The ability to invest in municipal bonds at substantial discounts to market value can dramatically improve returns without increasing overall risk. Buying CEFs at discounts to their net asset value can result in higher current yields.

### THE FIRM

Newgate Capital Management LLC is a privately held global investment advisor located in Greenwich, Connecticut. The firm provides investment management services to private, corporate and public funds, educational and charitable institutions, healthcare organizations, insurance companies and private clients. Newgate's primary mission is to provide superior risk-adjusted performance for their clients. Founded in 1982 on the philosophy of top-down, value oriented investing, Newgate has grown to become one of the world's leading investment houses.

### INVESTMENT REVIEW

Closed-end municipal bond funds were down slightly during the fourth quarter, hardly surprising given the outsized returns during the first nine months of the year. The Newgate Municipal Income Portfolio lost 1.0% during the quarter and gained 37.7% for the year. This compares to a loss of 1.4% and a gain of 18.5%, respectively, for the Lipper General Municipal Funds Index over the same periods.

**MARKET REVIEW.** Simply removing the fear that we were falling into a 1930s (or worse) depression accounted for a significant portion of the year's recovery. The major source of tension in the financial markets is the uncertainty regarding what will happen if monetary stimulus is withdrawn too early (renewed recession) or too late (hyperinflation). For now, we appear to be within that window of economic recovery, while job creation in the developed world remains anemic.

The recovery was caused not only by renewed liquidity in the fixed income markets as a whole, but also by restoration of confidence in the closed-end fund market. The widespread acceptance of exchange traded funds

(ETFs) shows investor appetite for commingled vehicles to access certain segments of the market. ETFs also provide an effective conduit to those segments where liquidity had vanished. ETFs are not only benefiting from the healing of the fixed income market, they are contributing to it. Traditional closed-end funds are also receiving greater investor interest, with the launch of two new fixed income funds in November and the reorganization of many funds to widen their appeal and increase liquidity. Fund companies also have had success unwinding auction rate preferred securities, the traditional sources of leverage for closed-end funds, and by finding additional sources of financing.

Even as taxable credit instruments become more attractive to investors, there has been increased worry about the credit quality in municipal bonds. Bond insurance, which had boosted credit ratings, is now recognized as inadequate protection against systemic defaults across multiple bond issuers. At Newgate, we believe that mass defaults of general obligation bonds (that is, bonds backed by entities with broad taxing authorities) as opposed to revenue bonds (bonds backed by fees from specific, identified activities) are unlikely. Although absolute levels of state debt are high, often at record levels, state deficits relative to current revenues are only at average levels. California has been the focus of much speculation as its credit rating has been downgraded. However, California law requires that holders of general obligation bonds must be paid before all other state expenses (not obligations, but actual expenses), with the exception of schools. So, other than schools, all other state services would have to be eliminated before the state could default on its bonds.

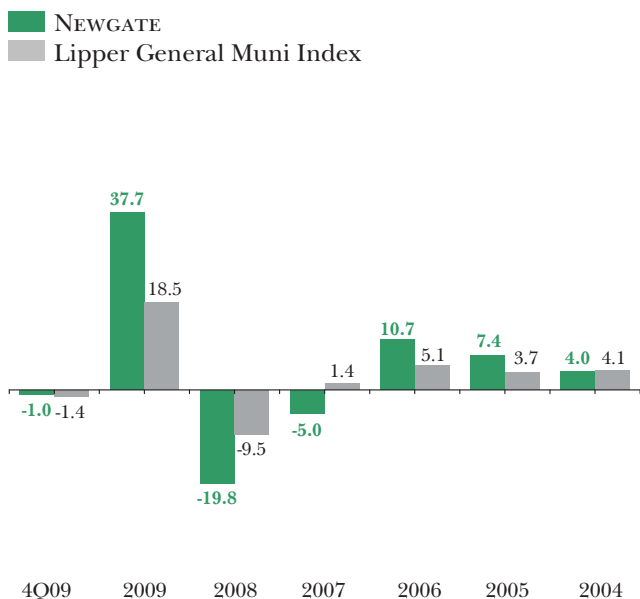
**PORTFOLIO ACTIVITY.** We deployed cash that had built up early in the quarter. ETFs have been an important part of our strategy, as these funds do not have leverage and do not run the risk of wide discounts. As the municipal market recovered, unlevered funds did not fully participate in the rally, and we were able to purchase funds like the Nuveen Municipal Value Fund (NUV). Even as the Treasury yield curve is very steep, the municipal yield curve is flat by historical standards, reducing the value of leverage. We still find value in state specific funds such as the Blackrock Muniyield California Insured Fund (MCA) yielding 5.8% and trading at a 12% discount. The fund invests primarily in tax-backed and utility-issued bonds, essential services with low default risk.

**OUTLOOK.** Municipal bonds are a logical next step for investors seeking a real yield in the era of low interest rates and fears of inflation. We believe that among general obligation bonds, credit risk, while real, is more likely to be felt in price volatility rather than defaults. Tax rates at the state and federal level are almost certain to rise, making municipal investments more attractive. The Portfolio is currently yielding 5.6%, a 160 basis point premium over traditional municipal bond investments. This represents a significant value added approach to an already attractive asset class. ♦

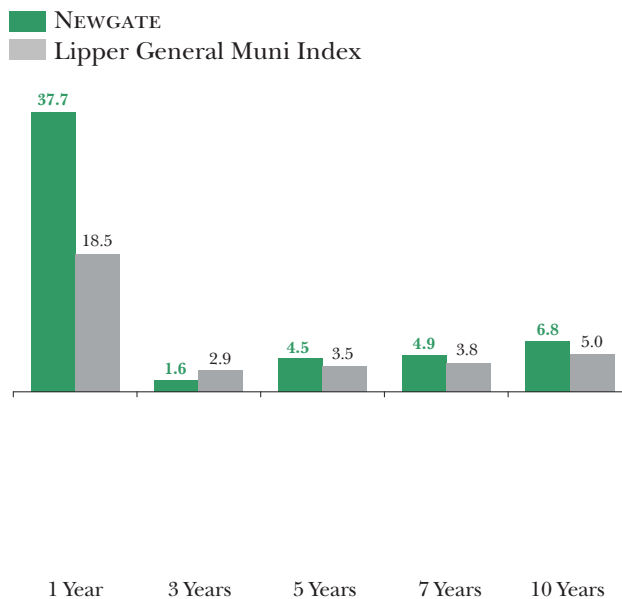


# MUNICIPAL *Income* PORTFOLIO

## PERFORMANCE



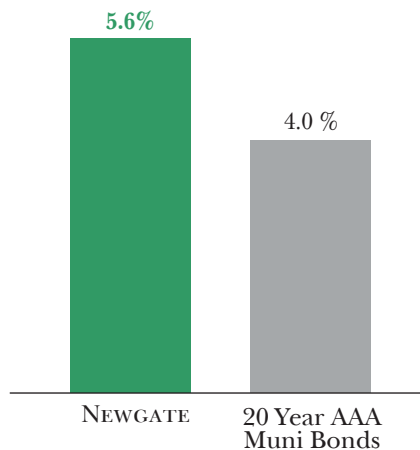
## ANNUALIZED RETURNS



## PORTFOLIO DATA

|          |            |
|----------|------------|
| Yield    | 5.6%       |
| Quality  | AA         |
| Maturity | 16.7 Years |
| Duration | 8.2 Years  |
| Cash     | 4.0%       |

## YIELD COMPARISON



M I N D I N G T H E F U T U R E T O D A Y <sup>SM</sup>

Past performance is no guarantee of future results. Performance may vary across accounts. Returns are calculated using a time-weighted market value assuming reinvestment of dividends. Performance is reported net of management fees, commissions, and other direct expenses, but before custody charges, withholding taxes, and other indirect expenses. Performance shown is compared to the Lipper General Municipal Income Index, a broad-based securities index that is unmanaged and not subject to fees and expenses. Investments cannot be made directly in a broad-based securities index. Any securities, sectors and markets listed are included for illustrative purposes at the time of publication and may not be held by accounts currently managed by Newgate. The securities identified do not represent all of the securities held in client accounts. It should not be assumed that any investments identified were or will be profitable. © 2010

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