



NEWGATE

CAPITAL MANAGEMENT LLC

SUMMER 2009

VOLUME 19, NUMBER 3

## 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

Newgate's Municipal Income Portfolio had a strong quarter, rallying 9.4% and now up 23.8% year to date, compared to 4.2% and 9.8%, respectively, for the Lipper General Municipal Income Index.

**MARKET REVIEW.** Credit markets have continued to heal, with most sectors recovering to their pre-Lehman collapse metrics. The massive liquidity pumped into the global credit system by most central banks has resulted in low LIBOR and other short term rates. The current steepness of the yield curve clearly reflects some measure of confidence that rates will be rising in the near future. Pessimists, however, point to fears of inflation and a possible collapse in the US dollar as reason for the rise in longer rates.

Municipal bonds have rallied sharply this year, as the Federal Reserve succeeded in pushing down Treasury rates. Munis started the quarter with extreme valuations, with the entire AA municipal curve yielding higher returns than Treasuries at every point along the curve. Even though that relationship started to normalize by quarter's end, municipal

yields are still at historically high levels relative to Treasuries, and well above Treasuries at the long end of the curve.

Concerns about credit quality of municipal bonds have lessened somewhat, similar to corporate bonds. While credit risk remains, the excess yield on municipals continues to reward investors. The largest potential source of stress is California, which is having difficulty meeting its budget obligations. The State of California's bond rating has been cut several times. The recession is bringing to light structural problems in municipal finance not only in California but in New York, New Jersey and a number of other states. We also believe that when faced with the truly unacceptable reality of defaulting on their debt obligations, governments in those states will be forced to make the difficult, necessary choices. We view significant defaults of municipal bonds issued by taxing authorities as possible, but extremely unlikely.

**PORTFOLIO PERFORMANCE.** Municipal bond prices rose across most issuers and maturities. Even California bonds rose despite credit concerns. Discounts on closed-end funds narrowed during the quarter, adding to performance. In addition, many closed-end funds increased their dividends during the quarter. The very low cost of leverage, often under 1%, and the steep yield curve meant increased earnings, and therefore dividends, for many funds. Since most funds generally try to avoid dividend cuts, this quarter's dividend increases are likely to remain in place for the foreseeable future.

**PORTFOLIO ACTIVITY.** Duration was reduced in the quarter, primarily through an increase in cash. While we feel that true inflation is most likely several years away, the longer end of the yield curve will be vulnerable to profit taking in the short term. We maintained allocations to several state-specific municipal bond funds, including the Blackrock Muniyield California Insured Fund (MCA). After raising its dividend during the quarter, the fund now yields 6.5% and trades at a 14.5% discount. We believe this represents an attractive price for a portfolio of very high quality insured bonds. We also have a substantial position in the Nuveen Dividend Advantage Municipal Fund 3 (NZF) with a 7% yield. More importantly, more than 25% of the bonds held by the fund are backed by the US government, and it has a lower duration (7.7 years) than most funds, allowing us to reduce interest rate risk while maintaining yield.

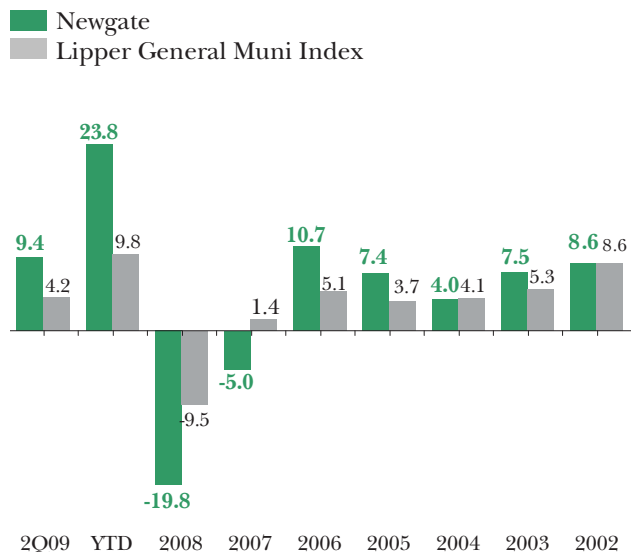
**OUTLOOK.** The municipal sector still has ample opportunities as the credit markets attempt to return to a more normal state. If we were in a normal environment, municipals would seem exceptionally attractive. They still are, and will be, as investor confidence returns. Closed-end funds are still priced at attractive levels, but have come in from their extremes. That and future inflation have led us to raise some cash temporarily. We anticipate opportunities to deploy this cash in the near term as credit issues get resolved and investor confidence increases further. The Portfolio's 5.8% yield still represents value compared to the 4.2% yield on both AA municipals and 15 year Treasury bonds. ♦



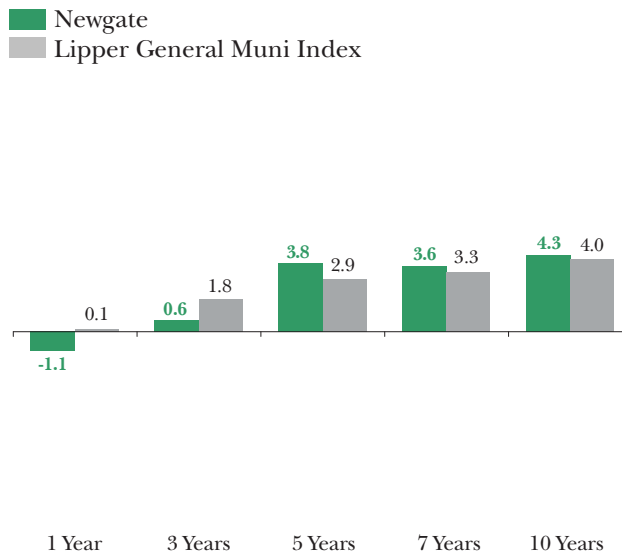
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**MUNICIPAL *Income* PORTFOLIO**

**PERFORMANCE**



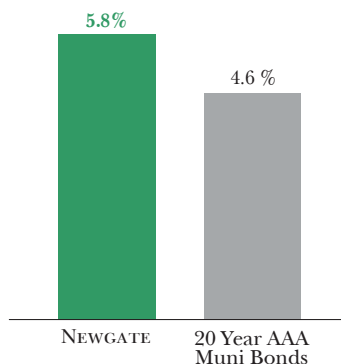
**ANNUALIZED RETURNS**



**PORTFOLIO DATA**

Yield	5.8%
Quality	AA
Maturity	14.5 Years
Duration	10.4 Years
Cash	18.5%

**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. © 2009

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