C.W. HENDERSON & ASSOCIATES, INC.

***Investment Managers Specializing
in Tax-Exempt Municipal Securities***

March 30, 2015

Focus on the Fed

The Federal Reserve's policy guidance after the mid-March FOMC meeting indicated that "patience" regarding the likely timing of an increase the Fed Funds rate from near zero (where it has been maintained since December 2008) is no longer necessary. Subsequent commentary by Chairwoman Yellen suggested that a move is probable this year, but contingent on the Fed's assessment of U.S. economic strength and inflation. Too little of either could stay their hand. Despite recent signs of slackness, our working assumption is that moderate growth will prevail in the coming months prompting one, or possibly two, modest increases in the targeted Fed Funds rate during the second half of this year. Additional rate hikes next year will again be dependent on the Fed's appraisal of the economic landscape at that time. Once the process of moving rates higher begins, we anticipate that the impact of each adjustment will be critically analyzed before a subsequent move is made. A "normalized" Fed Funds rate (some level above the prevailing inflation rate) seems unlikely for a year or more.

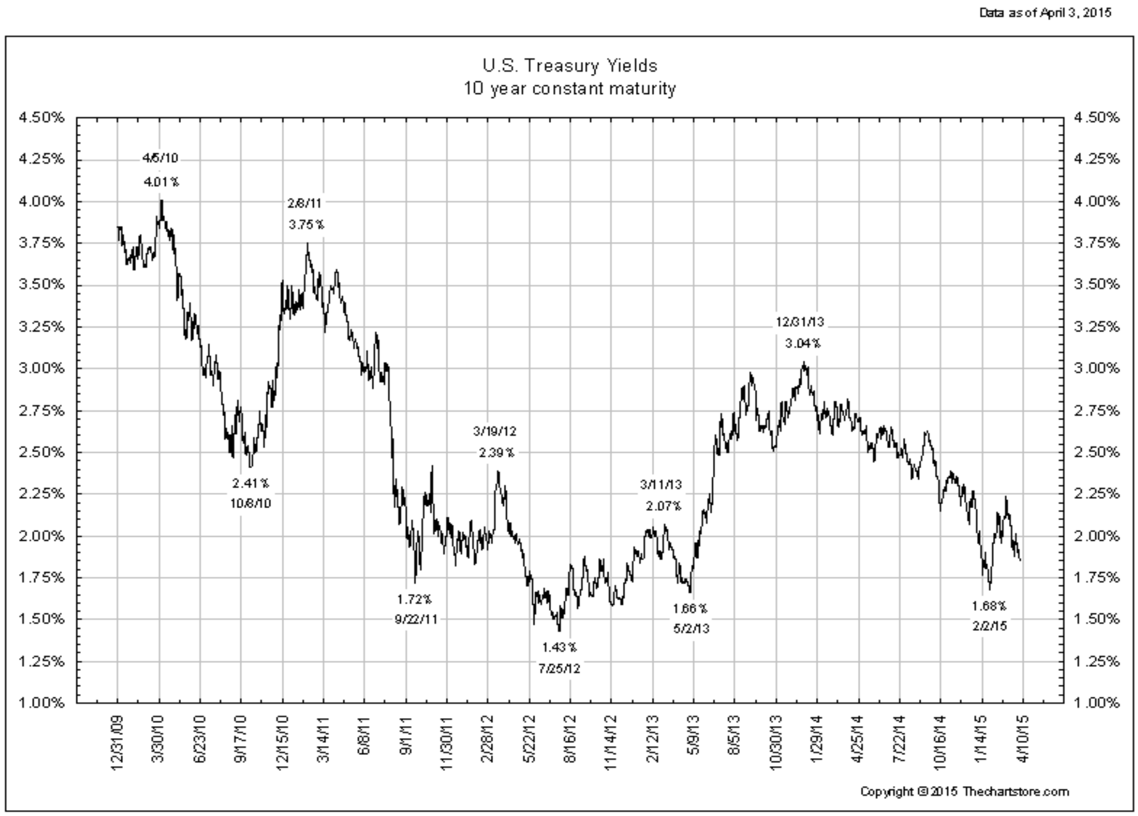
The measured tightening process we anticipate contrasts with the approach the Fed has typically taken in the past. There have been three periods of monetary tightening over the past twenty plus years, each with significant increases in the Fed Funds rate over relatively short time periods.

Tightening Period		
First Rate Increase	Last Rate Increase	Fed Funds Change
February 4, 1994	February 1, 1995	300 BP; 3.00% to 6.00%
June 30, 1999	May 16, 2000	175 BP; 4.75% to 6.50%
June 30, 2004	June 29, 2006	425 BP; 1.00% to 5.25%

One of the Fed's current goals is a 2% annual inflation rate. The year-over-year increase in the core inflation rate (excluding food and energy) was 1.7% through February. Current forecasts do not indicate much, if any, increase from this level. In fact, price pressures could subside somewhat in the coming months in response to limited U.S. wage growth and global sluggishness. A targeted Fed Funds rate above 1.5% to 2.0% seems unlikely in the foreseeable future.

Will Fed tightening push longer rates higher? Perhaps modestly, but we doubt there will be a dramatic impact. A backdrop of modest economic growth and limited inflation combined with the safe harbor appeal of the U.S. markets in an unsettled world argues for limited rate pressure. In addition, minimal returns offered in Europe and Japan (ten year German and Japanese government bonds are yielding, respectively, 0.20% and 0.37%) and the strength of the dollar continue to attract foreign investors. This added demand is acting to further restrain U.S. interest rate pressures.

Despite this benign rate outlook, caution is warranted in the low prevailing yield environment. As depicted in the attached chart illustrating the ten year Treasury yield since the end of 2009, courtesy of The Chart Store, rate surges cannot be dismissed. An inflation surprise or stronger than expected growth could precipitate a rate jump. Portfolio durations remain targeted at slightly over three years, down from a neutral position of about four years. We remain focused on principal protection.



Heavy First Quarter New Issuance

Spurred by a rush of refunding issues, municipal new issue supply surged to $102.6 billion in the first quarter, a 58.8% increase over last year’s opening quarter. First quarter issuance has historically averaged about 22% of annual volume. If 2015 followed this historic norm, annual volume would total close to $465 billion. We doubt that this year’s supply will reach that level. If short rates rise as we expect, the appeal of advance refundings will diminish. Also, new money deals declined 4% last quarter compared to 2014 reflecting the continued hesitancy of municipal officials to initiate new capital projects. We expect that new money financings will remain somewhat limited as municipalities focus on day-to-day operational issues. Our current estimate is that new issuance will total about $385 billion this year, a 15% increase from last year and in line with average volume over the past ten years.

Municipal Market Activity

Despite the surge in issuance last quarter, tax-exempt yields remained in a relatively narrow range throughout the period. The table below shows beginning and ending prime municipal yields along the curve as well as the highs and lows reached during the period.

Prime Municipal Yields

	12/31/14	1/30/15	3/05/15	3/31/15
1 Year	0.17%	0.15%	0.21%	0.23%
5 Years	1.31	0.95	1.35	1.29
10 Years	2.05	1.74	2.12	1.99
15 Years	2.36	2.13	2.54	2.44
20 Years	2.60	2.34	2.76	2.66
30 Years	2.88	2.49	2.92	2.80

Market stability in the face of significant volume and relatively low yields reflects continued demand for tax-exempt income. The municipal market's safe harbor appeal further enhances the attractiveness of these investments. We expect demand to remain relatively strong over the course of the year.

Increased Market Volatility?

We have mentioned in recent newsletters that volatility could become more pronounced. Dodd Frank legislation mandated that major financial institutions increase reserves and reduce risk profiles. One result has been reduced capital allocations to trading desks. This creates thinner secondary markets, especially for lower quality and less actively traded bonds. An individual trade executed in a thin market can have an inordinate price impact. While volatility can cause market disruptions, C.W. Henderson seeks to take advantage of opportunities during these periods. Close attention to market dynamics and assessment of relative value can result in attractively priced securities being added to client portfolios while bonds trading at inordinately high prices are swapped into securities providing better value.

Trading Efficiency

The existence of thousands of municipal securities with varying coupons, maturities, calls and other structural features provide an array of potential bond purchases for investors seeking tax-exempt income to select from. Credit quality variations, issue size and the frequency that an issuer comes to market influence the trading characteristics of individual bonds. State income taxation represents an additional factor influencing relative valuations.

Discerning value in this complex environment requires focused attention and trading acumen. C.W. Henderson's security selection process focuses on four primary factors: credit quality (review and approval by the credit group); good liquidity characteristics; security structures that match one of the strategies employed in the construction of client portfolios; and attractive relative value. Utilizing this framework, securities are purchased and sold on a daily basis with the objectives of aligning portfolios with the Firm's strategic outlook, attaining best execution and enhancing portfolio values. Examples of meaningful trades are shown below.

High Coupon Bonds with Short Calls

- October 25, 2013 purchase of Massachusetts Water Pollution Trust (Aaa/AAA) 5.25% bonds due 8/01/2015 at 0.20% yield to 2/01/2014 par call. Bonds not called at first call date but approximately four months later on 5/26/2014. Holding period return of 2.98%.

Bonds Refunded After Purchase

- May 28, 2014 purchase of Missouri Highway revenue bonds due 5/01/2022 at 0.48% yield to the 2016 call. Bonds prerefunded after purchase and sold shortly thereafter at 0.28% to call/prerefund date. Double digit annualized return.

Purchase of Underpriced Security

- May 14, 2014 purchase of Fort Wayne, IN School Building Corp. 5% bonds due 7/15/2027 at 3.07% yield to 2024 par call. Bonds sold 6/10/14 at 2.93% yield to call. Price gain of 1.23 points in 27 days. Ten year prime municipal yield had risen by two basis points during this period while the ten year Treasury yield was unchanged.

Sales of Securities Not Meeting Credit Criteria

- Detroit Water 5.25% bonds due 7/01/2025 inherited with a new account in the spring of 2013. Bonds sold 5/22/2013 at 3.75% yield, dollar price of 110.38. Bonds traded near par a few weeks later.

- Numerous sales of Puerto Rico securities. Holdings of Puerto Rico bonds in new accounts that are funded with securities have always been sold as soon as practical to do so. Many Puerto Rico bonds liquidated over the past few years are now trading thirty to forty points lower after suffering serious rating downgrades.

Tax Loss Harvesting

- Tax efficiency is a central component of the Firm’s trading activity. Turnover is relatively high when rates are rising and capital losses can be harvested. Rate increases in 2008 and 2013 provide recent examples. Captured short-term capital losses totaled $8.3 million and $12.1 million, respectively, in 2008 and 2012 in the accounts comprising our Traditional Composite. These losses, represented 49 and 62 basis point pre-tax benefits in the respective years and provided offsets to capital gains realized in other components of clients’ portfolios.

Credit Focus

The sharp decline in oil prices has raised credit quality concerns in petroleum production areas with Alaska and North Dakota on the radar screen. Outstanding debt from these states is limited and C.W. Henderson has minimal exposure except for state sponsored securities. Draught conditions in the west and southwest are also being monitored with exposure to impacted areas being reviewed.

Firm News

In the coming months Tom Mallman will shed some of his day-to-day responsibilities at C.W. Henderson and assume an advisory role. He will remain involved in the Firm’s operations and development and assist with marketing, strategy implementation, and various projects on an as needed basis. His professional industry affiliations will be maintained.

Craig W. Henderson　　　　　　　　　　Thomas L. Mallman, CFA