Agincourt Capital Management, LLC

June 2000

INVESTMENT UPDATE

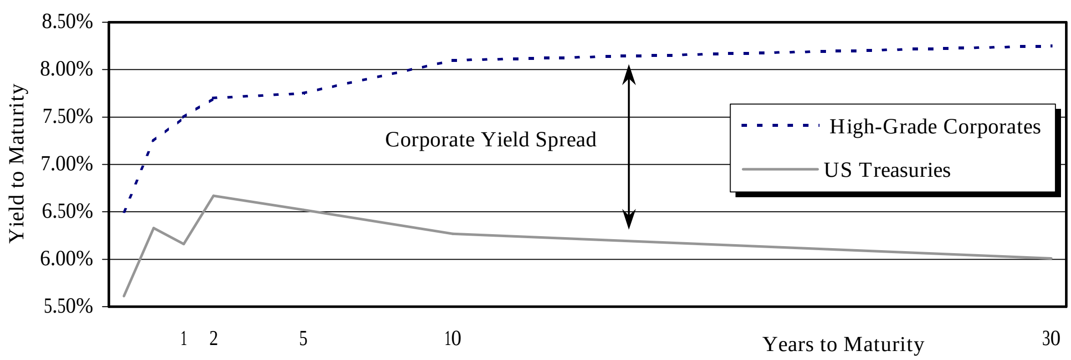
An overheating economy generally leads to higher inflation and an increase in the general level of interest rates. Typically, this would cause us to be most concerned with our client's interest rate risk, and we would tend to reduce the duration of our clients' portfolios, in order to protect against the negative price impact of rising rates.

In the first five months of 2000, however, the economy's explosive growth has had only a minor impact on inflation, but has had a major impact on the *corporate* bond market. This unusual turn of events has caught corporate bond investors off guard. Typically, a high-growth economy helps corporate bonds, as strong consumer demand for goods and services leads to better corporate cash flow, earnings and (most important to bondholders) ability to service debt. In this unusual year, however, *the indirect effects of an extremely strong economy have had a major negative impact on the performance of corporate bonds.*

These "indirect" effects are by definition a little obscure, and involve a little "onion peeling", so get ready. Let's start with Federal Reserve policy. In responding to above-target US economic growth, the Fed has raised short-term rates six times in the past year, most recently boosting the Fed Funds target to 6.5%. In pushing up short rates (and in combination with the Treasury's buyback of long-term Treasury Bonds) the Government bond yield curve has inverted, with short rates at higher levels than long rates. Long-maturity Treasuries have clearly benefited from this inversion, as their prices, inversely related to yields, have skyrocketed.

But while Treasuries have benefited, corporates have suffered from the inverted yield curve. Peeling the onion back one more layer, we begin to see that the performance of corporate bonds is highly dependent on the sentiment of those who trade and invest in them. Since the 1998 currency crisis, Wall Street firms have pulled back on their commitment to corporate bonds and have become increasingly reliant on hedging their inventory with "swaps" contracts. Without going too deeply into the arcane world of swaps (at that point, we'd be *inside* the onion!), swaps are used by investors who prefer to exchange their fixed-rate assets for floating-rate. When the yield curve inverts and short-term rates are higher than long rates, there is more demand for floating-rate debt. Thus the "swap spread" widens in order to entice interest rate swappers to give up their floating-rate debt in exchange for a series of fixed rate cash flows. When swap spreads widen, they lose their effectiveness as hedging vehicles and brokerage firms find it more difficult to prudently manage their corporate bond inventory. Brokers become less willing to buy additional corporates and mark down their existing inventory to clear the shelves. Corporate bond prices deteriorate and become de-linked from the Treasury market.

Treasury & Corporate Yield Curves 5/31/00



600 East Main Street Suite 2120 Richmond, VA 23219 Tel: 804.648.1111 Fax: 804.648.4475

To recap the onion-peeling:

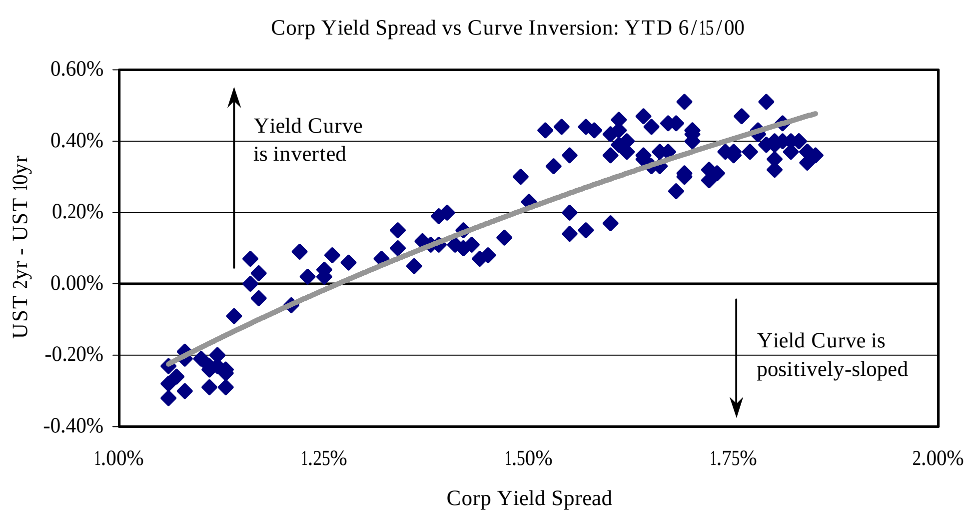
1) Economy grows at an excessive rate
2) Fed puts on the brakes, pushes up short rates
3) Curve inverts (Treasury buybacks play a part)
4) Nervous dealers and asset-swappers sell swaps
5) Demand for swaps dries up when curve inverts
6) Swaps fail to perform, corporate yield spreads widen

As we mentioned in our last quarterly update, this is not your typical credit-driven yield spread widening. *The recent poor performance of corporate bonds is primarily attributable to the inversion of the yield curve*. The scatter chart below shows the very strong relationship between an inverted yield curve (here, we use the yield differential between 2- and 10-year Treasuries) and the yield spread on a typical corporate bond. The yield curve inversion alone explains 92% of the widening of corporate bonds since year-end 1999. When short rates rise more than long rates, corporate bonds suffer.

After the worst relative performance for corporate bonds ever recorded by Lehman Brothers for the first five months of a year, corporates are now at their most attractive valuations in 15 years. We continue to be extremely positive about the fundamental value of corporates.

What appears to be changing now is that the technical factors are beginning to favor corporates as well. We expect to see a slow normalization of the yield curve (i.e., a re-steepening) in the months ahead now that it appears that the Fed's tight monetary policy is slowing the economy. We believe that the combination of a steeper yield curve and extremely attractive valuations will trigger a long-anticipated recovery in the corporate bond market, an event that will lead to significant outperformance in our client's portfolios.

Thank you for letting us share some of our thoughts on the bond market.



600 East Main Street Suite 2120 Richmond, VA 23219 Tel: 804.648.1111 Fax: 804.648.4475