
PORTFOLIO COMMENTARY

FROM THE ALDER FINANCIAL MANAGEMENT TEAM

ISSUED APRIL, 2009

If you remember, our last portfolio commentary focused a great deal on the range of investment opportunities that we could use in light of our expectation of unstable equity markets for the foreseeable future. Our current portfolio commentary is intended to give you an update on how we are proceeding.

Normally when cash yields are low, one moves into other higher-yielding and therefore riskier alternatives. However, this market has been different. Because of the prevalent amount of fear in the market, investors have been willing to accept lower return potential in exchange for safety. This is precisely why investors have been willing to buy Government bonds (T-notes and T-bills) at such historically low rates. We think this option is poor at best and have chosen a different path for our clients. The interest rates on Government bonds and bank CDs are inadequate to produce the cash flow our clients need. Indeed, this year will most likely shape up as the year of increased reliance on fixed income to produce cash flow. While the stock market returns or lack thereof will be discussed ad nauseam on the nightly news, it is the fixed income markets that will produce the needed returns to right our economic ship.

Given our proposal of the desire to improve cash flow, the current situation of our economy requires us to be flexible and decisive on our strategies. Our main goal is to capitalize on opportunities as they become available in many different kinds of instruments. To give you a better idea of our trading tactics, I will illustrate some recent strategies we put into place.

Mispriced Mortgage Securities

This economic crisis basically started as a real estate crisis. As you may recall, a lot of assertions have been made by the media lately about the number of delinquent loans and foreclosures in this country. However, the vast majority of home owners continue to make their loan payments as usual. Some time ago, we began to notice that the prices of all mortgage securities that were not guaranteed by the government began to fall dramatically. We viewed this event as an opportunity to buy the mortgages at a price we felt was far cheaper than their intrinsic values. Therefore, we began an intensive review of various securities to look for those we felt were mispriced and offered us a great risk/return tradeoff. Here is an example of one of the bonds we felt met our parameters.

RAST 2006-A8 1A1

This is a security that contains a pool of various mortgages. The RAST stands for Residential Asset Securitization Trust. This is an example of a bond that felt the full force of the credit crisis. It was originally an AAA credit bond but it started to have small issues creep up due to the aforementioned delinquencies and foreclosures. The rating agencies began to lower the rating to reflect those issues. This situation happened to a majority of other similar mortgages at the same time. That issue together with the banking crisis sent investors away from mortgage assets like this RAST. We, however, saw a different side to the story. We believed this bond would be a great one to own at the right price because only a small portion of the mortgages would foreclose. Because

the market was so distorted , we were able to buy at a price low enough to more than make up for the loan issues. We purchased this bond for 44 cents on the dollar. It pays a stated 6% coupon for every dollar purchased. At our price the yield to our clients is more than 12%. That is only one part of the story. We still have to account for the expected higher level of loan defaults within the bond. Even with a worst case scenario, our analysis indicates that our clients will earn an expected 10-11% over the life of the bond. Another benefit is that the security has a life of at least ten years. Therefore we expect our clients will receive a long-term monthly stream of great cash flow. As time has passed, the market has begun to agree with us because the current price has increased into the mid 50's.

Short-Term Strategies

An interesting thing to remember about investing is that every once in a while there will appear an opportunity to take advantage of investor fear. During this crisis, that situation appeared time and time again when investor fear caused them to stop buying various bonds. This was the case of my next example. The higher level of potential defaults on residential mortgages caused investors to stop wanting to own anything that even resembled a mortgage. That included bonds that were backed by automobile loans. Normally, auto-loan bonds are relatively tame, short-term alternatives to money market funds. However, for a brief time this spring, the prices dropped enough for the yields to become very compelling.

TAROT 2007-A A3

TAROT stands for Triad Auto Receivables Owner Trust. That is a mouthful, but it simply refers to the collateral on the bonds, which is sub-prime auto loans. The issue to be aware of on bonds such as this is the amount of loans that will potentially default. Our analysis and the bond's low price led us to believe that this was a rare combination of great yield, relative safety, and short-term maturity. We expect the bond will yield our clients over 8% during the next year. We did extensive testing of multiple scenarios to determine our conclusion. Currently, yields on these types of bonds is in the 5% range. Clearly, our purchase timing could not have been any better.

In summary

This quarter's commentary was designed to give you a little glimpse of our thought process during this financial crisis. We are continually looking for ways to make lemonade during these troubling times. And one way for us to do this is with cash flow strategies that take advantage of apparent mispriced securities.