

ECONOMIC & BOND MARKET QUARTERLY UPDATE

THIRD QUARTER 2007

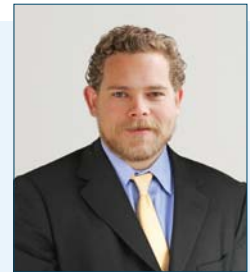
THE EVOLVING RISK / REWARD LANDSCAPE

Investor psychology is one of the most significant and unpredictable variables in the financial markets. It has become a field of study among academics and is now considered almost as important as fundamental security analysis by many successful investors. And while there is much we don't yet understand about investor psychology, there are certain aspects of human nature we must always carefully consider when making investment decisions.

When market volatility reflects confusion and uncertainty, disoriented investors invariably look at history to provide a frame of reference. It is basic human nature to seek out patterns of behavior. As the recent liquidity crisis has unfolded, it has drawn inevitable comparisons to the last major liquidity crisis back in 1998. Not surprisingly, a number of investors borrowed pages from the '98 playbook, when an emergency Fed rate cut marked a turning point and eventually led to a renormalization of credit markets. So when the Fed announced a 50 basis point rate cut at their most recent meeting, the herd responded in a typical Pavlovian manner by

buying risk assets wherever they could be found.

It can be very comforting to pursue a strategy that has proven itself once already, especially when one is in the company of many other professionals who seem to agree. But we would urge caution here. There are a number of similarities between the credit crises of '98 and '07, but there is one significant difference that we find very sobering: today's events are much less isolated than they were in 1998. Then, as now, we experienced a major "leverage unwind" triggered by large losses in one sector of the credit markets, but in 1998 those losses were neither caused nor accompanied by major fundamental deterioration in the domestic economy. Payrolls were



Derrick Wulf, CFA
Sector Portfolio Manager

continued on page 2

CREDIT CRUNCH BITES DOWN ON MARKETS Fixed Income Sector Review

Corporates

Corporates turned in their worst excess return performance in five years, underperforming duration-matched Treasuries by 244 basis points as spreads widened by 48 basis points during the quarter. Despite this, the sector still had a positive total return of 1.82%, as the bond market rally more than offset the spread widening.

Weakness in the corporate market during the early summer accelerated into the third quarter as troubles in subprime mortgages, collateralized debt obligations (CDOs), and housing markets led to increased concerns about a consumer-driven economic slowdown. By late July those concerns had evolved into a full-blown credit crunch. As fear gripped the market, brokers and hedge funds bought credit protection in the credit default swap (CDS) market, driving credit spreads wider.

Spreads came under further pressure from heavy new issue supply when declining liquidity in the commercial paper markets prompted companies to term out financing. From late July until the FOMC voted to cut the fed funds rate in mid-September, spreads on the Lehman Brothers Credit Index widened by 59 basis points. The Fed's actions finally helped

continued on page 5

INSIDE THIS ISSUE

Economic Update.....	3
Dwight News.....	9
Assets by Product Strategy.....	10

Evolving Risk/Reward Landscape, continued from front cover

Recent volatility in the bond markets has left a lot of investors feeling a bit battered.

▶ growing at an average monthly rate of more than 250,000 in 1998; unemployment was falling; GDP grew at 4.7% in the third quarter and accelerated to 6.2% in the fourth quarter.

So let us not so blithely dismiss the weaker payroll numbers that have trickled in during these last few months. The primary explanation of economic resilience in the face of weakening housing markets and high gas and food prices throughout the first half of this year was strong job and wage growth. Since that time, food and gas prices have remained stubbornly high; the housing market has only gotten worse; now the labor market is softening too. These conditions have a number of skilled economists forecasting a recession, and one 50 basis point cut in the fed funds rate won't quickly change that. The weaker dollar probably won't rescue the economy either. It will help exports, but it won't have much of an immediate impact on domestic demand.

There is also more bad news likely to come out of the credit markets. Most of the eventual loan delinquencies and foreclosures in recently originated subprime mortgage securitizations have yet to translate into realized capital losses. Amid a huge overhang of unsold homes and a softening economy, it is hard to expect any real improvement in collateral performance over the next few months. Many of the poorly performing deals will face downgrades and principal writedowns at the lower end of the capital structure, which may lead to another round or two of forced liquidations.

We view the recent improvement in investor sentiment with a healthy dose of skepticism, and we certainly don't expect spreads to tighten a whole lot further anytime soon. But despite all the reasons for caution, we do feel that there are still some bonds worth buying right now.

Recent volatility in the bond markets has left a lot of investors feeling a bit battered. It has been said

that time heals all wounds, and while there is definitely some truth to this saying, there is also something to be said for the healing powers of money. If you combine the two, you can readily bounce back from a pretty sound beating. That is to say, the accrual of spread income can cushion investors against a fair amount of mark-to-market volatility over longer time horizons. And with spreads where they are right now, that cushion is actually a pretty cozy place for investors to lay their weary heads.

Spreads on high-quality assets such as AAA-rated commercial mortgage-backed securities (CMBS) and asset-backed securities (ABS), for example, offer investors significant yield concessions over comparable Treasuries. On bonds with very limited credit risk, that incremental yield can help offset the impact of further spread volatility over longer time horizons. To help quantify the value of this cushion, we ran a few simple breakevens on various asset classes using the Lehman Brothers Aggregate Index data from the close of business on September 28 (the last trading day of the third quarter). The average option-adjusted spread (OAS) on the CMBS component of the index at the time was 119 basis points over Treasuries. That amount of spread would produce incremental income of almost 10 basis points per month. With a duration of just over five years, the CMBS Index could sustain about 2 basis points of widening per month and still outperform comparable Treasuries. If your time horizon is one year, your breakeven spread widening is more than 23 basis points. That's a pretty large margin for error. The ABS component of the Lehman Brothers Aggregate Index, meanwhile, had an average OAS of 144 basis points and a duration of just over three years. More spread and less duration translate into

continued on page 11

ECONOMIC UPDATE

In September, the Fed surprised market participants with a 50 basis point cut in the target funds rate, from 5.25% to 4.75%, marking the first change in the official policy rate in more than a year and the first reduction since 2003. Investors generally expected a rate cut, but few expected such bold action because just prior to the FOMC meeting, Fed officials were still talking tough on inflation and showing little sympathy for struggling credit market participants. Despite inflation and moral hazard risks, we were pleased with the size of the cut because we felt it was necessary to jump-start the credit markets and ward off an impending credit crunch that would threaten the economic expansion.

FOMC members' opinions evolved significantly during the six weeks between the August 7 meeting and the September 18 meeting. In that period, it became obvious that financial market turmoil, if allowed to continue, would restrain economic growth. The Fed initially pulled a number of policy levers to restore liquidity without loosening monetary policy. Importantly, the Fed pledged to act as lender of last resort, and it lowered the discount rate to back up that claim. Credit turmoil eased in reaction to these and other actions, but not enough to prevent a downgrad-

ing of the Fed's economic forecast. As a result, the FOMC voted to ease monetary policy at its September 18 meeting in hopes of mitigating some of the fallout on the economy.

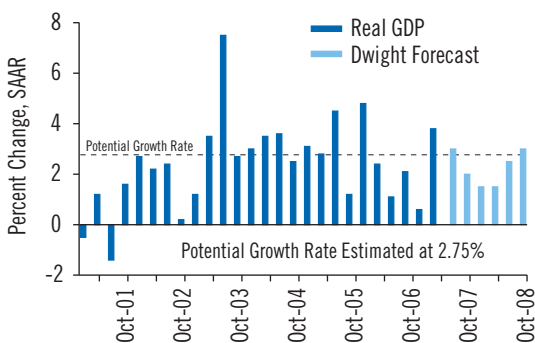
Is it "one and done" for the Fed? We doubt it. While capital is now flowing to most regions of the credit markets and the level of angst has appreciably subsided, market participants are noticeably more risk averse. In the go-go days of yesteryear, it was unchallenging to securitize and sell a loan backed by deadbeat collateral. We feel that those days are gone. While this change is positive for the long-term health of the financial markets, it will exacerbate the housing market downturn because borrowers, even responsible ones, are now finding it more difficult and more expensive to get a loan. We expect weakness in the housing sector, coupled with slower employment growth, to lead to slower consumption growth, and we have marked down our GDP and federal funds rate forecasts accordingly. Economic growth should be decidedly subpar over the next few quarters, and this sluggishness should encourage another 50 to 75 basis points in policy easing by next spring.

Real GDP growth should slow by more than a percentage point over the next two quarters, compared to an expected 3% pace in the third quarter (see Figure 1, left). In this environment, the unemployment rate will start to increase; consumption will slow; capital spending will be restrained; finally, residential construction will decline further. The danger is that a feedback loop will form, whereby slow activity perpetuates itself and the economy grinds to a halt. Or worse, the economy could back up. We feel that there is a 30% chance of this danger coming to pass. The odds would be higher but for lean inventories, no capital overhang, strong export growth, and the potential for easier monetary policy. In the past,



Jane Caron, CFA
Chief Economic Strategist

Figure 1: Real GDP: Actual Versus Forecast
Downside Risks Are Significant



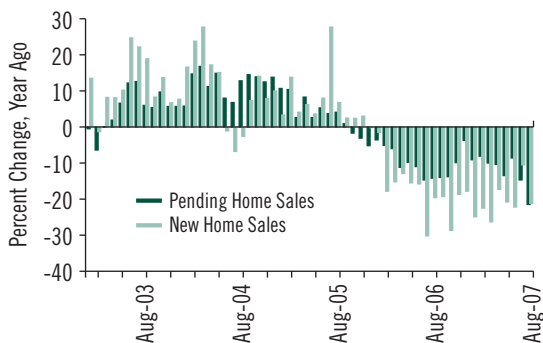
Source: Global Insight and DAMCO

continued on page 4

Economic Update, continued from page 3

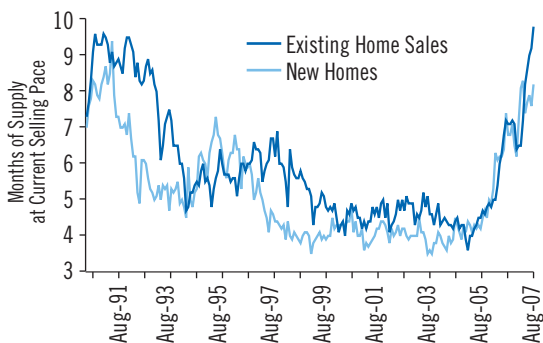
- ▶ downturns have often caused sharp cutbacks in production, employment, and capital spending because corporate managers found themselves with bloated inventories and unused capacity. Corporations are leaner and meaner today, which augurs for a slowdown rather than a recession.

Figure 2: Home Sales: New and Pending
No Sign of a Turnaround in Home Sales



Source: Global Insight

Figure 3: Housing Market: Inventory-to-Sales Ratio
Rising Inventories Portend Lower Prices



Source: Global Insight

the trough is another 10 percentage points lower from here (see Figure 4, right).

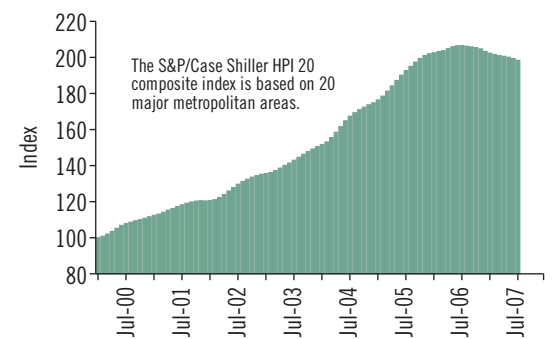
The housing market recession has not yet seriously disrupted consumption because income growth has

Our main worry is the housing market; it is in the deepest downturn seen since the 1990-1991 recession. As of August, new home sales were down 21% from their year-ago level, while pending home sales, a proxy for existing home sales, were also down 21% (see Figure 2, left). Meanwhile, inventories of homes for sale are at 17-year highs (see Figure 3, below left). Not surprisingly, these conditions are depressing construction. August housing starts were down 27% from their year-ago level and down 46% from their 2006 peak level. Home prices are following suit, but with a lag. The Case-Shiller home price index shows a 4% decline from the peak 2006 level, and some experts believe that

acted as an offset. In August, inflation-adjusted disposable income was up 4.4% on an annual basis, providing consumers the wherewithal to maintain their consumption patterns. This tailwind is starting to fade, though, as income growth slows in line with slower employment growth. Moreover, the monthly savings rate remains very low, and consumers may choose to save more, now that their homes are no longer acting as piggy banks.

Recent employment reports whipsawed markets with unexpected weakness in August, followed by unexpected strength in September. Most of the confusion was due to statistical problems in the government sector, so we did not adjust our forecast for employment growth in reaction to either report. The underlying story is that payroll growth is slowing, a trend that is evident in the private payroll data. On average, private payrolls grew 74,000 per month in

Figure 4: Housing Market: Case-Shiller Home Price Index
Despite Recent Declines, Index is Still Nearly Twice the 2000 Level



Source: Global Insight

the third quarter, down from the second-quarter average of 114,000 and the 2006 average of 169,000. We expect this trend to continue, leading to a moderation in income growth and an increase in the un-

continued on page 9

Fixed Income Sector Review, continued from front cover

- ▶ restore some confidence to the credit markets, and spreads tightened by 11 basis points from their mid-month highs.

Among the major sectors, financials were the hardest hit in the third quarter. With ongoing financing needs and reduced access to commercial paper, brokers and finance companies were forced to come to market at the worst time. Finance companies involved in the mortgage origination business were particularly hard hit as access to the capital markets via securitization disappeared. Countrywide Financial, the nation's largest stand-alone mortgage originator, saw its spreads widen by more than 1000 basis points as the market speculated about an imminent default. Hybrid securities were also hard hit due to their unique sensitivity towards changes in financial market liquidity and volatility. Homebuilder securities also continued to significantly underperform as the housing recession deepened. On the other hand, higher beta credits, those not involved in mortgage origination or home construction, performed surprisingly well as the credit crunch substantially reduced the likelihood of leveraged buyouts (LBOs) and other leveraged event risk.

We had positioned our corporate bond holdings to avoid credits most exposed to event risk: home construction and subprime mortgage origination. As such, and given the high-beta tilt of our holdings, our portfolios were positioned to perform well. Our holdings in hybrid securities, however, experienced greater price volatility than we had anticipated. We remain cautious on the outlook for corporates and currently plan to maintain our underweight to the sector. Although valuations are much more appealing at current spread levels, we are growing increasingly concerned about potential economic deterioration and its impact on credit fundamentals.

Mortgage-Backed Securities

The mortgage-backed securities (MBS) sector returned 2.64% during the third quarter of 2007, 20 basis points lower than the overall Lehman Brothers Aggregate Index. On a duration-adjusted basis, MBS returned 91 basis points lower than U.S. Treasuries. While MBS was not spared from the recent market turbulence, the sector did manage a better relative return than more credit-sensitive assets.

The return of volatility and shrinking risk appetites impacted MBS performance both directly and indirectly in the third quarter. As large banks and brokers continued to shrink balance sheets, and as access to financing became more constrained, the market was faced with a glut of secondary supply from forced sellers. Concurrently, general risk aversion drove more investors away from spread assets to the safety of U.S. Treasuries. This forced all spread assets, including MBS, to trade at wider levels.

In the MBS sector, spread widening was exacerbated by the fact that net new agency mortgage supply continued at a record pace. With lending markets becoming constricted, the conforming agency market became one of the few viable outlets for new loan production. We expect this dynamic to remain in place for some time, acting as a potential headwind to the sector.

After beginning the third quarter with a neutral position in MBS relative to our benchmarks, we moved to a modest overweight in August. Though the prospect of heavy forward supply is a concern, we feel that the degree of widening experienced by MBS relative to Treasuries more than compensates for that risk. Further, agency MBS are largely insulated from the credit concerns that have

The return of volatility and shrinking risk appetites impacted MBS performance both directly and indirectly in the third quarter.

continued on page 6

Fixed Income Sector Review, continued from page 5

► dominated investor sentiment recently. While the current environment makes it difficult to predict the near-term performance of any asset class, we feel that over a longer horizon, MBS should be able to recover most or all of the recent underperformance.

Commercial Mortgage-Backed Securities

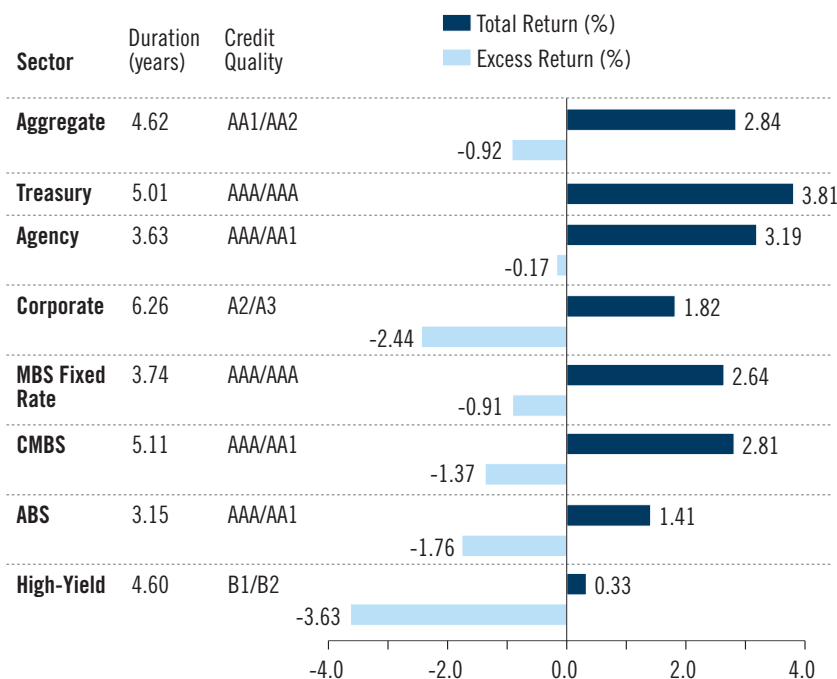
Commercial mortgage-backed securities (CMBS) ended a tumultuous third quarter with a total return of 2.81%, as measured by the Lehman Brothers Aggregate Index. While the performance was roughly in line with that of the overall index on a total-return basis, excess returns were sharply negative, as broad-market credit and liquidity

concerns brought about significant spread widening. The average option-adjusted spread in the CMBS component of the index widened 37 basis points in the third quarter, which led to 137 basis points of underperformance relative to Treasuries on a duration-adjusted basis. Lower-rated classes experienced the most significant spread widening, reflecting an increased aversion to risk among investors.

While much of the underperformance was attributable to general market unease, there was some concern about the fundamental outlook as well. While loan delinquencies and foreclosures remain low, aggressively underwritten loans may not fare as well in a weakening economy. Slowing job growth would likely lead to a decline in demand for office space, especially in many suburban markets. Retail and hotel properties, which tend to exhibit the greatest cyclicity, would also see performance suffer in an economic downturn, while the decline in the residential housing market over the past year has already begun to put pressure on rents, as real estate investors and speculators have replaced their “For Sale” signs with “For Rent” signs.

We share the market’s concerns about aggressive loan underwriting, and we have been anticipating a deterioration in loan performance for some time now. As a result, we have concentrated our holdings in the highest-quality components of the CMBS market, namely “super-senior” classes (AAA-rated classes with an additional cushion of credit support) and high-quality seasoned deals that benefit from more conservative loan underwriting and a few years of property appreciation. Despite our concerns, however, we feel that the prospects for attractive risk-adjusted returns among these high-quality securities remain very compelling, and we expect to maintain our overweight to the sector into the fourth quarter.

Figure 5: Third Quarter 2007 Sector Statistics*



*Source: Lehman Brothers Global Family of Indices. Excess returns represent returns over duration-matched Treasuries. Credit quality represents market-weighted average credit quality for the indicated sector expressed in Moody’s nomenclature.

continued on page 7

Fixed Income Sector Review, continued from page 6

▶ **Asset-Backed Securities**

The third quarter of 2007 was a tough three months for those managing any sector other than Treasuries, but this period was even more brutal for those of us managing asset-backed securities (ABS). What started out as a subprime problem in February turned into a full-blown liquidity crisis as banks adjusted value at risk models, pulled back credit lines, and tightened their balance sheets. The resulting price volatility sent spreads dramatically wider on even the safest AAA-rated bonds, with asset-backed securities taking the most amount of pain.

The Lehman Brothers ABS Index posted its worst quarterly excess return performance on record, underperforming duration-matched Treasuries by 176 basis points, with a total return of 1.41%. Home equities led the index lower with a total return of -0.68%, representing 401 basis points of negative excess return. Spreads were pushed wider even on nonresidential safe haven sectors, such as credit cards and autos, despite the fact that both sectors are backed predominately by prime consumer credit and offer plenty of credit enhancement to investors. Transparency and liquidity started to reappear in September, however, and as a result the Lehman Brothers ABS Index beat all other spread sectors except for CMBS, returning 47 basis points of excess return for the month.

While short-term technicals drove spreads wider in July and August, we firmly believe that this situation has created a great buying opportunity at the top of the capital structure in both residential and nonresidential ABS. While the rating agencies may have missed the boat when initially rating subordinate home equity bonds, we expect that investors positioned in AAA-rated securities will continue to be very well protected by subordination and other structural features.

We expect to maintain our overweight to the

highest-quality home equity and equipment lease-backed paper, as we believe that pricing will stabilize and that such collateral will outperform in the long run. We also intend to take advantage of the recent spread widening in consumer ABS by continuing to decrease our underweight to credit cards, autos, and rate reduction bonds.

High-Yield

The high-yield market provided a paltry 0.33% total return for the quarter, an abysmal negative 363 basis points of excess return. July 2007 was the market's worst month since July 2002, as the market fell 3.14%. Concerns about the fallout from the subprime debacle and the subsequent seizing of the collateralized loan obligations (CLO) market resulted in a

continued on page 8

Dwight Sector Specialists

The Sector Update was written by the following sector specialists:



Michael Cazayoux
Corporates



Josh Kruk, CPA, CFA
Mortgage-Backed Securities



Derrick Wulf, CFA
Commercial Mortgage-Backed Securities



Peter Milne
Asset-Backed Securities



Edward Meigs, CFA
High-Yield



Keith McCarthy
Municipal Bonds

Fixed Income Sector Review, continued from page 7

► significant (and long overdue) repricing of risk. The market stabilized in August, returning over 1%; then it rallied in September with its best month since 2003, returning over 2%. The worst-performing sectors for the quarter were finance, transportation, and consumer cyclicals, with finance down almost 3% for the quarter. Utilities, energy, and capital goods were the top performers.

The new issue market was closed for most of the third quarter. Total issuance for July and August combined was a little over \$4 billion, down from over \$22 billion in June alone. September saw \$6 billion in new deals as the market adjusted to the new structures being offered by the dealers. Earlier this year, under very different market conditions, dealers had committed to provide some \$350 billion of financing for leveraged transactions. With the repricing of the market, this financing was at below-market rates, and consequently the dealers were left with most of the paper on, or potentially on, their balance sheets. Several deals that were completed or partially completed before the summer saw significant price declines throughout June and July. Underwriters had committed to the bank portion of the financing with very lenient covenant structures that the market refused to absorb. This massive technical overhang weighed on the market throughout the quarter, although recent deal flow is reducing this pressure. Some deals have been restructured or canceled, as private equity players recognize they have paid too much, (Sallie Mae, Axciom, Harman International), but others have been able to come to market using an incremental approach. Instead of bringing the entire deal, they bring a portion at a discount, hoping to bring each subsequent piece at a slightly higher price until the financing is complete. In a rising market, this technique is effective; in a softer market it may prove problematic.

While the market has weakened over the last quarter, we believe it remains overvalued. The supply overhang has begun to be absorbed, but we believe this technical pressure may result in a repricing of the market if deeper discounts are necessary to clear the backlog. The potential for slower economic growth has increased, and with this problem comes the risk of increased defaults. Other risks include increased Treasury and equity volatility, along with the continuing decline in residential real estate values. Although market liquidity is currently adequate, any decline could have sharply negative implications for market returns, as we saw in July and early August. We continue to believe that certain issues offer value, but we feel that the broader market is likely to experience more spread widening in 2007. Therefore, we intend to maintain our bias toward high-quality credits, and we will remain highly selective with new purchases.

Municipal Bonds

The total return for the Lehman Brothers Municipal Bond Index was 1.82% in the third quarter, compared with a return of 0.15% for the first half of the year. Year-to-date, the total return of the Lehman Brothers Municipal Bond Index was 1.97%, compared with a return of 4.86% for the Lehman Brothers Treasury Index. During the past twelve months the Municipals Index underperformed the Treasury Index by 253 basis points. The performance relative to Treasuries was driven primarily by the lower yield of the municipal bond market and was exacerbated by flight-to-quality buying in the U.S. Treasury market. Technicals also weighed on the municipal debt markets, as new issue volume for the quarter totaled approximately \$87.9 billion, putting year-to-date supply at \$322.6 billion, 20.9% higher than 2006.

continued on page 10

The potential for slower economic growth has increased and with it, the risk of increased defaults.

Adam White Joins Dwight as Quantitative Analyst

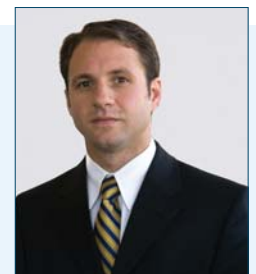
Adam White joined Dwight's Quantitative Analysis Team in July. Adam is responsible for quantitative analysis for Dwight's insurance clients. Prior to joining Dwight, he served as a Senior Investment Actuarial Analyst at Old Mutual Financial Network and as an Actuarial Analyst for PennCorp Financial Group. Adam earned a Bachelor of Arts degree from the University of Texas, Austin.



Adam A. White
Quantitative Analyst

Jason Wyman, Ph.D., Joins Dwight as Quantitative Analyst

Jason Wyman joined Dwight's Quantitative Analysis Team in September. Jason is responsible for quantitative analysis for Dwight's fixed income clients. Jason's Ph.D. research focused on condensed matter physics, fluids, and biophysics. He led an interdisciplinary research team and analyzed time-series data measurements of a chaotic fluid system. Jason is also the first inventor of U.S. patent for a process of microencapsulating particles in polymer coats. Jason earned a Bachelor of Arts degree from Middlebury College and a Ph.D. in Physics (12/07) from the University of Chicago. He is also a certified avalanche guide, National Outdoor Leadership School Alumni, and Middlebury Mountain Club Winter Guide.



Jason L. Wyman, Ph.D.
Quantitative Analyst

Additional Announcements

- Wendy Krygier joined Dwight's Client Portfolio Management Team in June.
- Scott Mildrum joined Dwight's Quantitative Analysis Team in July.
- Joseph Larkin joined Dwight's Credit Research Team in August.

Economic Update, continued from page 4

► employment rate to 5% over the next couple of quarters.

With the housing market acting as a serious headwind and the labor market offering a diminishing tailwind, we look for real consumption to slow by 1.5% or more, from an expected growth rate of 3.5% in the third quarter. The danger is that corporate management will overreact to this slowdown by seriously curtailing investment spending and new hiring. Robust export growth should help offset some of the concern about slower domestic demand, but clearly it is domestic, not foreign, demand that drives our economy.

We expect the Federal Reserve to loosen monetary policy another couple of notches as the economy slows and core consumer inflation remains inside the Fed's comfort zone. A rate cut at the October 31 FOMC meeting is possible, but not likely in our view.

It is possible because housing market data have been hideous; it is not likely because the credit crunch has been forestalled, and the Fed will want to collect more data before making another move. Indeed, the next move could be in 2008 rather than 2007. We expect that by the spring of 2008, the funds rate will be 4% or 4.25%.

I further predict that I will have finished reading Alan Greenspan's book *The Age of Turbulence: Adventures in a New World* by the time the funds rate reaches 4.5%. Also, I will have made it through Ben Bernanke's *Essays on the Great Depression* by the time the funds rate gets to 4.25%. Fortunately, Bernanke is indeed an expert on the causes of past recessions. With him at the helm, we stand a good chance of avoiding one in 2008. ■

*Written by Jane Caron, CFA
Chief Economic Strategist*

Fixed Income Sector Review, continued from page 8

▶ The decline in the housing sector and events in the subprime market spilled over into the municipal market, where overleveraged investment pools, hedge funds, and arbitrage accounts desperately tried to reduce exposure, which led to a dramatic underperformance in municipal bonds. Municipals began the quarter with a flatter curve, but because of the dramatic decline, we saw the curve steepen from 78 basis points at the end of June to 103 basis points at the end of September. Municipal bond yields exceeded 90% of U.S. Treasury yields in the 10-year part of the curve, and they reached approximately 100% in the 30-year part of the curve. This opportunity in municipals is a rare occurrence because, in addition to their tax exemption, municipals are considered a high-quality, low-risk sector, second only to U.S. government securities in safety. The illiquidity and relative cheapness of municipal bonds witnessed in the third quarter offered an attractive entry point for investors. The liquidity crunch that had persisted for most of the quarter recovered somewhat toward the end of September, as we saw real money buyers, as well as nontraditional buyers, step back in to support the municipal market and take advantage of this relative cheapness.

We look for municipal issuance to continue at a record pace, likely topping \$400 billion, and quite possibly topping 2005's record issuance of \$408 billion. And while recent disruptions have presented investors with attractive buying opportunities, a deterioration of the economic outlook could very likely lead to continued steepening in the municipal curve, possibly by 25 to 50 basis points. ■

Written by Dwight Sector Specialists

**Dwight Asset Management Company
Total Assets as of 9/30/07:
\$68.0 Billion**

Assets by Product Strategy (\$ Billions)

Stable Value	43.1 ¹
Fixed Income	27.3 ²
Insurance	19.8 ³

1. Includes assets also included in the fixed income total managed for stable value clients.
2. Includes assets also included in the stable value and insurance totals.
3. Includes assets also included in the fixed income total.
Please Note: Stable value separate account and commingled fund data is as of 8/31/07.

This Quarterly Update is prepared for general informational purposes only, without respect to the investment objectives, financial profile, or risk tolerance of any specific person or entity who may receive this report. Investors should seek financial advice regarding the appropriateness of investing in any investment strategy or security discussed or recommended in this update and should understand that statements regarding future performance may not be realized. Investors should note that income, if any, from any investment strategy or security may fluctuate and that underlying principal values may rise or fall. Past performance is not necessarily a guide to future performance.

For more information:**Fixed Income & Stable Value**

Greg Prisk
Executive Vice President
802.383.4104
gprisk@dwight.com

David Richardson, CFA
Managing Director
802.383.4024
drichardson@dwight.com

Insurance

Donald Hill
Senior Vice President
802.383.4062
dhill@dwight.com

John Loud
Vice President
802.383.4047
jloud@dwight.com

Consultant Relations

Lisa Trubiano, CFA
Senior Vice President
802.383.4066
ltrubiano@dwight.com

Anicia Mendez
Vice President
802.383.4067
amendez@dwight.com

100 Bank Street
Suite 800
Burlington, VT 05401
802.383.4000

One SW Columbia
Suite 1720
Portland, OR 97258
800.929.4427

www.dwight.com

The Evolving Risk/Reward Landscape, continued from page 2

- ▶ even larger breakevens, in this case nearly 46 basis points over the course of a year. To put that in perspective, in all of 2006 the OAS of the ABS Index stayed in a range of less than 15 basis points.

These breakevens do not address the risk of downgrades or defaults, but they are helpful in measuring the value of a nice spread cushion over various time horizons. Given the risks outlined above, it is imperative that investors tread carefully and be very selective with their purchases right now. It certainly isn't prudent to declare all spread product cheap and to start buying indiscriminately, but with some thorough analysis and a sound investment process, investors should feel comfortable putting some money to work at these levels. ■

*Written by Derrick Wulf, CFA
Sector Portfolio Manager*

This information reflects the viewpoint of Dwight Asset Management Company as of Third Quarter 2007 and is subject to change. This article was prepared for general informational purposes only, without respect to the investment objectives, financial profile, or risk tolerance of any specific person or entity who may receive it. Investors should seek financial advice regarding the appropriateness of investing in any investment strategy or security discussed or recommended in this article and should understand that statements regarding future performance may not be realized. Investors should note that income, if any, from any investment strategy or security may fluctuate and that underlying principal values may rise or fall. Past performance is not necessarily a guide to future performance.