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Stamper Capital & Investments, Inc.

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MORNINGSTAR

Our Favorite Muni Short Funds

by Eric Jacobson | 02-01-01

Analyst Picks: Muni Short Category

| | YTD Return (%) | 3-Year Return (%) | 5-Year Return (%) | 3-Year Risk Score* |
|---|---------------------------------|------------------------------------|------------------------------------|-----------------------------------|
| Vanguard Ltd-Term Tax-Ex VMLTX | 1.84 | 4.57 | 4.74 | 0.29 |
| Evergreen High Income Municipal Bd A VMPAX | 1.19 | 3.71 | 5.13 | 0.65 |
| Strong Short-Term Municipal Bond Inv STSMX | 1.47 | 4.00 | 4.94 | 0.28 |
| T. Rowe Price Tax-Free Short-Interm PRFSX | 2.06 | 4.61 | 4.74 | 0.36 |
| USAA Tax-Exempt Short-Term USSTX | 1.63 | 4.44 | 4.85 | 0.18 |
| Muni Short Average | 1.46 | 3.82 | 4.22 | 0.40 |

*Risk scores through 03-31-01. Returns through 04-20-01.

Maybe you're looking for a bond fund that can deliver exciting total returns. Or perhaps you're seeking one with a first-rate yield. If so, you won't find anything of that sort here. (Rather, you should check out the pick of the go-go high-yield bond category.) What you will find in the short-term municipal-bond fund category are funds that provide more income than the typical tax-free money-market offering without going overboard on credit risk.

These funds generally carry durations (a measure of interest-rate sensitivity) of less than 4.5 years; investing in short-term bonds lessens the funds' sensitivity to shifts in interest rates. What's more, they invest across varied states and sectors, which dampens volatility as well.

More importantly, the income generated from muni-short funds is exempt from federal taxes. That increases their appeal, especially for investors in higher tax brackets. However, as with all bond funds, it's important to look for an offering with low expenses. This group traditionally has a narrow range of returns, and a fund with a low expense ratio has a built-in advantage versus its competitors.

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Vanguard Ltd-Term Tax-Ex VMLTX

This fund shows how important low expenses are. Its expense ratio is 64 basis points below the group norm, which gives it a big edge, year in and year out. As a result, the fund's long-term returns rank in its group's top half. This is particularly impressive considering that this quality-conscious fund pays less attention than most of its peers to low-quality credits, which have outperformed in recent years. And it has consistently provided a generous stream of income to boot.

Evergreen High Income Municipal Bd VMPAX

This fund was formerly known as Davis Tax-Free High Income, but longtime manager Clark Stamper, who signed a new deal with Evergreen in 2000, remains at the helm. That's good news, because Stamper has a knack for finding underpriced gems. And though the fund stumbled a bit in 1999, it has generated some of the best long-term returns in the muni-short group, as well as a handsome payout.

Strong Short-Term Municipal Bond In STSMX

New manager Lyle Fitterer, who took over in March of 2000, hasn't made any changes to this fund's successful approach. He will continue to load up on BBB-rated bonds and nonrateds, which have supplied generous income while boosting returns, thanks to a prolonged rally in lower-rated credits. Meanwhile, he will also keep duration in a tight two- to three-year range, which has kept volatility moderate. Investors should be careful, though. The fund will likely lag its peers if there is a flight to quality. However, it remains a good choice for those who don't mind taking on additional credit risk to capture more income.

T. Rowe Price Tax-Free Short-Interm PRFSX

True to its family's legacy, this offering favors a cautious, measured approach. Manager Charles Hill doesn't make big interest-rate bets, and the fund is only allowed to invest 5% of assets in nonrated and below-investment-grade bonds. Meanwhile, Hill has demonstrated a talent for ferreting out higher-yielding winners, and the fund has gotten a boost from its low expense ratio, which is well below the group norm. As a result, the fund's risk/reward profile is impressive, and it has consistently delivered a better-than-average income payout.

USAA Tax-Exempt Short-Term USSTX

Manager Clifford Gladson has found a great formula for success. He is keen on low- to mid-rated credits, which have rallied strongly in recent years, so the fund's long-term returns are strong. At the same time, he keeps duration short and fairly steady, which moderates volatility. And low expenses sweeten the deal. So far, investors have been rewarded with a nice income stream and good returns, but they should be aware that the fund is subject to trouble among lower-rated credits.

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Returns - Figures quoted are total returns calculated for the share class and time periods shown. Performance includes the reinvestment of income dividends and capital gains distributions. Performance does not reflect the deduction of taxes that a shareholder would pay on a fund distribution or the redemption of fund shares. Please go to Morningstar's and/or Lipper's websites for more information.

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