

Managed Duration Investment Grade Municipal Fund Portfolio Manager Commentary

NYSE: MZF

Q3 2011

The third quarter of 2011 brought a negative shift in market sentiment and consumer confidence. In August political battles ensued surrounding a needed increase in the United States' debt ceiling with the dual mandate of reducing future budget deficits. An agreement was reached that did not meet the expectations of Standard and Poor's which downgraded the credit rating of the United States to AA+. A dramatic downward revision to the first quarter's GDP growth to 0.4 percent, coupled with below trend second quarter GDP growth of 1.3 percent, led the Federal Reserve (the "Fed") to indicate that monetary policy will remain accommodative through mid-2013. Employment data disappointed the markets with anemic payroll growth and a stubbornly high unemployment rate. The Fed cited significant downside risks to growth at its September meeting which prompted the launch of "Operation Twist," a program where the Fed sells treasury securities with maturities inside of three years and uses the proceeds to buy longer dated treasuries. The long-term solvency of certain European sovereign nations also came back into question and continues to weigh on the financial markets.

State tax revenues continue to register positive growth and posted their seventh consecutive quarterly increase. Local government revenues continue to falter as municipalities find fewer options to generate revenues; since their main source of income is property tax, which is correlated to the downturn plaguing the real estate markets. Much of the "low hanging fruit" expense reductions have been picked and municipalities are now being forced to make cuts to education and school district funding. The federal budget deficit and Congressional focus on expenditure reductions could negatively impact municipal revenues and is a cause for unease amongst investors. State general funds commonly generate approximately 30 percent of their revenues from federal grants and transfers. Local governments typically receive about 40 percent of their revenues from federal and state sources. The downgrade of United States' credit rating had a ripple effect in the municipal bond market and certain issuers were downgraded or placed on credit watch because of their reliance on federal aid, federal backing, or, in some cases, federal employment. President Obama's "Jobs Plan," which contains a provision that could potentially limit the benefit of the tax exemption on municipal bond interest to 28 percent, is also creating angst for market participants. This change would make the interest on municipal bonds slightly less valuable

to tax payers in higher tax brackets, who happen to be large buyers of tax-exempt debt. This plan is also being discussed and debated by the deficit reduction "super committee."

Recessionary concerns, coupled with continued accommodative monetary policy, fueled the fixed income markets in the third quarter and pushed long maturity treasury yields and tax-exempt yields to near term lows. "Sticker shock" is a term often used to describe investors' reactions to the high price and low yields offered by municipal bonds; from a historic perspective, however, municipal yields currently look attractive relative to US Treasury bond yields. Primary market supply experienced a modest pick-up in the third quarter but remains well behind levels from the prior year. Supply for the year registered a paltry \$193 billion, which represents a reduction of over 35 percent versus the year prior. The austerity mindsets of many governors will likely limit municipal bond issuance not only in the current year but in the coming year as well. Liquidity has been sporadic as investors digest record low yields and mutual fund cash flows have generally been positive. Default activity continues to run below analyst estimates and has generally been limited to revenue bond issuers with low or non-investment grade ratings.

The Barclay's Municipal Bond Index¹ had a return of 3.81 percent in the third quarter. The municipal yield curve (from 1-30 years) flattened during the period from 412 basis points to 330 basis points. The yield on 30-year AAA general obligations² ("GOs") decreased by 80 basis points during the period, while 10-year yields decreased by 53 basis points. Tax-exempt bonds underperformed Treasury bonds, which pushed the ratio of 30-year tax-exempt yields to 30-year Treasury yields from 99.3 percent at the start of the third quarter up to 122.4 percent at quarter-end.

Investors maintained their appetite for risk during the quarter as credit spreads modestly tightened with healthcare and education paper exhibiting top returns. Return data shows that investors favored securities with long maturities as scarce supply and elevated ratios made long bonds attractive. According to Barclays Capital, high-yield, tax-exempt spreads slightly widened during the quarter as the Barclay's municipal non-investment grade index underperformed the investment grade index by 56 basis points.

¹ **The Barclay's Municipal Bond Index** is a rules-based, market-value-weighted index engineered for the long-term tax-exempt bond market. To be included in the index, bonds must be rated investment-grade (Baa3/BBB- or higher) by at least two of the following ratings agencies: Moody's, S&P, Fitch. The index is unmanaged and it is not possible to invest directly in an index.

² **General Obligation Bond ("GO")** - A municipal bond backed by the credit and "taxing power" of the issuers' jurisdiction rather than the revenue from a specific project.

For illustrative purposes only. Performance data quoted represents past performance, which is no guarantee of future results, and current performance may be lower or higher than the figures shown.

The forecasts and opinions are those of Cutwater Asset Management as of September 30, 2011 and are subject to change at any time due to changes in market or economic conditions. The comments should not be construed as a recommendation of individual holdings or market sectors, but as an illustration of broader themes. Such forward-looking statements are subject to significant business, economic and competitive uncertainties and actual results could be materially different. There are no guarantees associated with any forecast.

There can be no assurance that any closed-end fund will achieve its investment objective(s). The value of any closed-end fund will fluctuate with the value of the underlying securities. Historically, closed-end funds often trade at a discount to their net asset value.

Municipal Bonds Risk: There are also specific risks associated with investing in municipal bonds, including but not limited to interest rate and credit risk. Interest rate risk is the risk that prices of Municipal Bonds generally increase when interest rates decline and decrease when interest rates increase. Prices of longer term securities generally change more in response to interest rate changes than prices of shorter term securities. Credit risk is the risk that the issuer will be unable to pay the interest or principal when due. The degree of credit risk depends on both the financial condition of the issuer and the terms of the obligation. The secondary

market for municipal bonds is less liquid than many other securities markets, which may adversely affect the Fund's ability to sell its bonds at prices approximating those at which the Fund currently values them. The ability of municipal issuers to make timely payments of interest and principal may be diminished during general economic downturns. In addition, laws enacted in the future by Congress or state legislatures or referenda could extend the time for payment of principal and/or interest. In the event of bankruptcy of an issuer, the Fund could experience delays in collecting principal and interest

Additional Leverage Risk: Certain risks are associated with the leveraging of common stock. Both the net asset value and the market value of shares of common stock may be subject to higher volatility and a decline in value. The AMPS market continues to remain illiquid as auctions for nearly all AMPS continue to fail. A failed auction is not a default, nor does it require the redemption of a fund's auction-rate preferred shares. Provisions in the Fund's offering documents provide a mechanism to set a maximum rate in the event of a failed auction, and, thus, investors will continue to be entitled to receive payment for holding these AMPS.

Investors should consider the investment objectives and policies, risk considerations, charges and expenses of any investment before they invest. For this and more information, please contact a securities representative or Guggenheim Funds Distributors, Inc., 2455 Corporate West Drive, Lisle, Illinois 60532, 800-345-7999.