

Memo

To: MDE Clients

From: Mitchell D. Eichen J.D., LL.M

Date: April 11, 2003

Re: WHB/Wolverine Enhanced Yield Convertible Strategy

With our roots in strategic financial planning, MDE has always believed in creating and following a disciplined and well reasoned long term plan. We have never relied on any futile attempt to predict unpredictable short-term events. Over the past 15 plus years, most of our clients have accumulated substantial amounts of wealth by sticking to this discipline and avoiding overreaction to near term events. However, there is no denying that our disciplined philosophy of following a long term, well thought out strategic plan did not avoid the rolling series of events that created the unpredictable, and at times irrational, stock market debacle of the past three years.

But we have not sat by for the last three years merely wringing our hands and blindly hoping for a return to the good old days of the late 1990s. We literally meet with scores of managers each year looking for unique insights and approaches to, what may very well be, a choppy market environment for some time to come. Of late, this process has produced our high dividend strategy, our foray into hedge fund of funds as well as some opportunistic and more flexible managers. We are always disappointed with the pace of progress, but we have always believed that it is better to be right than fast. If we are to be criticized, we would rather be criticized for being too thorough, than not thorough enough. In addition to finding promising new investments, our other goal is to avoid those investment disasters that will always befall the investor or advisor looking for the “hot dot” in any market environment.

As we like to say about our search process, we have to kiss a lot of frogs until we find a prince. Well we think we have found a new prince—or at least a knight—for this investment environment which prizes certain characteristics that may not have been important in the past. After a six-month due diligence process, we recently added WHB/Wolverine Asset Management’s Yield-Enhanced Convertible Strategy to our MDE Wealth Management investment platform.

WHB/Wolverine Asset Management is a registered investment advisor that specializes in constructing portfolios of convertible bonds, convertible preferred stocks, and so-called structured securities, utilizing a blend of growth and value research ideas. While we have reviewed many much larger convertible bond managers over the past 18 months, we did not think their strategies provided a sufficient diversification effect to pure equity holdings. In contrast, Wolverine provides a unique yield enhancement overlay, which consequently provides additional downside protection, by engaging in covered call writing. Since this is a very labor-intensive process, requiring specialized expertise, we have not yet found another firm that employs this approach.

Wolverine’s minimum investment account is generally \$1,000,000 and their regular fee for their services is 1% of assets under management. However, MDE always negotiates institutional terms with those managers with whom we place money based upon the size of our relationship. For MDE clients Wolverine’s minimum account size is \$250,000 and their fee is .5%—an excellent fee

structure for a complex and active strategy. Therefore, clients can begin placing money in this strategy at lower account balances and add to these accounts over time as they gain increased comfort levels.

We have attached a more detailed explanation of Wolverine's strategy. We will proactively contact those clients for whom we feel this strategy is appropriate. In the interim, if you have any questions, or wish to receive more detailed information about the strategy or the firm, please contact your MDE Financial Counselor.

As always, we thank you for your loyalty and support. We will continue to work hard each and every day to find creative solutions that make strategic sense, not only for today's investment environment, but for the future as well.

Best personal regards.

A handwritten signature in black ink, appearing to be 'L. Miller', written in a cursive style.

WHB/WOLVERINE ENHANCED YIELD CONVERTIBLE STRATEGY

Convertible Securities—A Brief Overview

In general, a convertible bond or convertible preferred stock is an interest or dividend paying security, respectively, that grants its holder the option to exchange that security for a predetermined number of common shares in the underlying company at a specified price. Therefore, investors in convertibles receive enhanced safety of principal, in terms of a prior claim to assets over equity security holders, and relative income stability at a known rate. Furthermore, due to the conversion feature, if the common stock of the issuer rises in price, the convertible will likely also rise to reflect this increased value. Alternatively, if the underlying common stock declines in value, the convertible can often be expected to decline, albeit by an amount less than the common stock. The convertible should decline only to the extent that it would yield a satisfactory return relative to a bond or preferred stock of comparable price and quality. So, investors in convertibles can generally expect to receive:

- a yield higher than that of an issuer's stock (on average, an incremental 250 to 750 basis points annually), but less than that of the issuer's bond;
- upside potential greater than that of an issuer's bond, especially if the price of the issuer's stock has risen to a level within or above the conversion price, but less than the common stock;
- downside protection greater than that of an issuer's stock, since in an extreme market sell-off, the value of a convertible should stabilize near its intrinsic fixed-income value, as determined by the prevailing interest/dividend rates of similarly rated corporate debt or preferred stock.

In short, convertible securities provide investors with exposure to the stock market, without attempting to engage in market timing. In addition, investors would be rewarded with a higher yield than either cash or stocks, while mitigating against both any rise in market interest rates or a decline in the underlying stock.

Effect of Par Value on Convertible Securities

The stated par value of common stock has absolutely no relation to the prevailing market value. It is nothing more than a legal requirement set at the time of incorporation. There is no redemption value to common stock stated par.

In the case of convertible preferred stock, par value would only be of import at the preferred stock's maturity date if the value of the underlying common, multiplied by the conversion ratio, were less than the stated par. However, in such a case, the forces of arbitrage in the open market would result in the preferred stock's value matching its par on the maturity date. In other words, the premium would effectively be reduced to near zero by the maturity date when the preferred stock is redeemed for par. Of course the financial health of the corporate issuer would have to be sound even though the underlying common stock was trading at a low level. Since convertible preferred stocks almost always have maturity dates that far exceed those of convertible bonds, this rarely becomes relevant for issues purchased with long dated maturities. By way of example, many convertible preferred stocks, like most of their straight preferred stock brethren, are issued with a 30-year maturity date. On the flip side, when the underlying common's market price is substantially above its market price at the time the convertible preferred was issued, then the forces of arbitrage will serve to

compact and eventually eliminate any “*premium*” that existed in the convertible preferred stock’s market price, but definitely not reducing it to par. But here again, the extremely long maturity period rarely affects the market price of the convertible preferred stock, thus making it a very viable investment instrument.

In contrast, the effect of par value on convertible bonds presents a different situation. The average maturity of convertible bonds is typically five to seven years from date of issue, as differentiated from the aforementioned extended maturities of convertible preferred stocks. Understandably, this time factor provides the investor with the assurance that, like a straight corporate bond, on maturity date, redemption of the issue will be 100% of par (or \$1,000 face value per bond). Assuming the corporation to be fiscally sound, the market activity in the convertible bond becomes significantly influenced by the diminishing time period to maturity date, all things being equal. However, should the underlying common stock be trading at a price above straight conversion value, that stock valuation would keep the bond above par value. In this situation, the bond would actually be converted to common stock, or sold on the open market prior to maturity, to preserve the existing investment (intrinsic) value of the bond.

So-called “*busted*” convertible bonds are those instruments that reflect only their value as straight fixed-income investment, based upon the prevailing interest rates for comparable credit quality. This results due to a significant drop in value of the underlying common stock. In this case, the financial health of the issuing company becomes the prime determinant of value. If that corporation is financially sound, then the decision to hold that busted convertible bond to maturity at 100% of par (i.e., \$1000) would be determined by the remaining timeframe, and the yield to maturity calculation.

The Effect of Current Yield on Convertibles

Any investor who purchases a convertible bond can expect to receive a dollar return from one or more of the following sources:

- coupon interest payments (the “*cash-on-cash*” return)
- capital gain (or loss) when the bond matures, is called or is sold
- income from reinvested coupon interest payments (“*interest-on-interest*” return)

The yield measures that are commonly referenced to evaluate the potential return from investing in a convertible bond are current yield, yield-to-maturity, yield-to-call and, if applicable, yield-to-put. These yields are expressed as a percent return rather than a dollar return.

The most important of these measures -- the current yield -- relates the annual coupon interest to the current market price; it only considers the coupon and no other source of return that will affect an investor's return. In other words, no consideration is given to the capital gain affect that the investor may realize when the bond matures. Likewise, no recognition is given to the theoretical capital loss that the investor would realize when a bond selling at a premium matures in the unlikely event that the investor does not either convert or sell the bond before maturity. In addition, interest-on-interest from reinvesting coupon payments is ignored completely.

Wolverine’s Value Added Approach

Wolverine’s Yield-Enhanced Convertible Portfolios are typically constructed with a minimum of 80% “total return” oriented convertible bonds, with *conversion premiums* ranging from 10% to 40%, i.e. convertible prices some 10%-40% above the current stock price. The remainder of the portfolio is

typically constructed with convertible preferred stocks and various structured securities (i.e., mandatory convertibles, exchangeables, reverse exchangeables, etc.). Wolverine currently calculates the average rating for these convertibles to be BB+/BBB- while the yield on the pure debt instruments is investment grade, i.e. BBB or above.

This means that Wolverine typically does not invest in high premium or “busted converts” where the price of the stock into which the convertible instrument may be exchanged has fallen far below the market conversion price of the convertible. These convertibles tend to behave more like high yield bonds, where the investor’s primary concern is credit risk, and equity sensitivity is low. Nor does Wolverine typically invest in low premium or “equity-like converts” where the price of the underlying stock has risen sharply since the initial issuance date of the convertible, thus causing the value of the convertible to become very closely tied to the value of such shares. These convertibles tend to behave more like a common stock, where the investor’s primary concern is equity price volatility.

Wolverine believes that such “balanced converts” offer investors the best risk-return tradeoff, since these convertibles enjoy some of the appreciation potential of the common stock, while retaining the relative downside stability of a corporate bond. Of course, Wolverine also applies rigorous analysis to the selection of convertibles within this universe, both from the standpoint of credit quality and equity fundamentals. Above all else, Wolverine must ultimately feel convinced that there is some capital gain potential for each convertible security selected. Taking into account conversion terms and call provisions, Wolverine then initiates laddered convertible positions with a holding period horizon of at least 12 to 24 months.

Wolverine’s Yield Enhancement Strategy

To further enhance the portfolio’s yield, and provide further downside protection, Wolverine also writes “covered calls” giving third parties the right to purchase the underlying equities at a specified price within a specified period. These call options typically target out-of-the-money strike prices at or above underlying conversion prices. In effect, the premiums received for writing these covered calls serve to *monetize* the expected future return from stock price appreciation--upfront. But Wolverine never engages in options speculation, nor does it participate in naked positions. It only writes options against stocks that may be acquired in accordance with the terms of an associated convertible instrument. Therefore, the greatest risk associated with covered call writing on a convertible is that an investors’ profit potential may be limited, in some circumstances, so they may not fully participate in a short-term upward surge in the price of the underlying stock. Realistically, however, an underlying stock would have to rise in value at an annualized rate of at least 25% to 30%, before the stock would outperform a yield-enhanced convertible position.

Summary

By overlaying their convertible securities portfolio with this covered call writing program, Wolverine attempts to provide increased income and risk management, leading to improved portfolio returns. Because the cash proceeds representing the option premium are received immediately, this yield-enhancing technique enables the total position to achieve a more risk adverse posture. In other words, the immediate cash proceeds received from selling covered calls will act as partial compensation for a decline in the value of the associated convertible instrument.

Under current market conditions, the annual interest and dividend yield of an average portfolio is approximately 5%-6%. Unfortunately, this income is taxable at ordinary rates. But this is part of the price to be paid for increased security stability. In a neutral or moderately bullish market,

the expected contribution that could be attributed to option premium income is approximately an additional 4% to 5%. This option premium is all taxable as short-term capital gain. For those individuals with recognized tax loss carry-forwards, this element of return effectively becomes tax-free. Therefore, *standstill* (cash-on-cash) returns should average about 9%-10% (i.e. the interest /dividend income plus the option premium) assuming no change in convertible price. In addition the investor retains some of the potential price appreciation potential should equity markets experience a significant move upward. Conversely, the combination of the standstill return, and the fact that the convertible security is less volatile than the underlying stock, provides substantial downside protection. We view this combination of risk/return drivers to be optimum in under “choppy” or low growth market conditions, i.e. those conditions we have experienced in the recent past and those conditions which may persist for some time into the future.

Recommendations

Since we believe that any attempt to time wholesale shifts between stocks and bonds is pure folly, we are actively searching for hybrid strategies, that combine the characteristics of both to “soften the lines of distinction” between fixed income and equity investments. Therefore, we recommend a minimum 5%-10% allocation to this enhanced yield convertible strategy.

We view this commitment to a yield-enhanced convertible portfolio, not as a replacement for traditional stock and bond asset allocations, but as an important complement. Because convertible securities valued at or near par generally retain their hybrid characteristics, a modest allocation to such investments minimizes the need to dynamically rebalance the portfolio in anticipation of future market conditions. As a hybrid investment approach, yield-enhanced convertibles also offer the following benefits:

1. reduce the risk of equity ownership in a period of market volatility, nervousness, or uncertainty;
2. impart a high-yielding, fixed-income quality to equity positions intended to be held for the long-term;
3. offer an opportunity to convert a fixed-income instrument into shares of common stock as a safeguard against a rise in market interest rates; and
4. offer investors with large capital loss carry forwards a more predictable mean of utilizing such losses to enhance their future, after-tax returns since premiums from call overwriting is characterized as short term capital gain.