

U.S. DEBT DOWNGRADE

AUGUST, 2011

On August 5, 2011 Standard & Poor's Corporation dropped the credit rating of long-term obligations of the United States to AA+ from AAA.

In a press release, S&P explained that a major factor in its decision was its disappointment with the effectiveness, stability, and predictability of American policymaking and political institutions and shared its opinion that the fiscal consolidation plan that Congress and the Administration recently agreed to falls short of what is necessary to stabilize the government's medium-term debt dynamics. The S&P press release is available at <http://www.standardandpoors.com/ratings/ratings-actions/en/us>.

S&P's outlook on the long-term rating continues to be negative and it is possible they could lower the long-term rating to 'AA' within the next two years if there is less reduction in spending than agreed to, higher interest rates, or new fiscal pressures during the period result in a higher general government debt trajectory.

On Monday August 1, Jim Huntzinger, Chief Investment Officer for BOK Financial Corporation, in a review titled "Debt Ceiling and Budget Cutting...The Bill Coming Due" said:

"Standard & Poor's has said the credit rating of the U.S. will be cut unless the size of deficit reduction reached \$4 trillion over the next ten years, (the deal on the table is \$2.4 trillion), and there was only one vote to address both the debt ceiling and debt reduction, (there are two stages to the agreement). I expect that S&P will be downgrading U.S. debt ratings to AA. I don't believe that will necessarily destabilize markets, but it is yet another hit to confidence for America. I am hopeful that despite the bickering of the last month, we are indeed addressing our long term debt problem; \$14 trillion of public debt outstanding, projected to jump to \$25 trillion over the next decade."

So, while not completely unanticipated, the downgrade certainly is another hit to confidence, at a time when market psychology is fragile.

IMPACT ON MONEY MARKET

S&P's downgrade of long-term U.S. debt should not have a significant impact on money market funds generally, and Caval Hill money market funds specifically.

The Caval Hill money market funds' ability to purchase or hold U.S. government securities is not impacted by the recent downgrade of those securities. Furthermore, although S&P downgraded the *longer term* debt of the U.S., it affirmed its A-1+ rating on the nation's *short term* obligations, the highest rating available for short-term debt. Notably, the other two major credit-ratings agencies, Moody's Investor Service and Fitch Ratings, did *not* downgrade U.S. sovereign debt, and both recently affirmed their Aaa/AAA ratings on the government's long-term U.S. debt.

It is also important to note that as of August 10, 2011, the Caval Hill Treasury Fund and Caval Hill Cash Management Fund are both rated Aaa by Moody's and AAAM by S&P¹, and that also as of that date the Caval Hill Tax-Free Money Market Fund is rated Aaa by Moody's². S&P has said as long as the nation's short-term rating remains A-1+, a downgrade on long-term U.S. debt would not have an impact on S&P's money market fund ratings. Money market funds are also subject to stringent liquidity and maturity rules and we remain confident in the ability of the Caval Hill money market funds to maintain their excellent credit ratings.

The Caval Hill money market funds continue to be managed with high standards of quality and liquidity.

¹ The Funds are rated by Standard & Poor's and Moody's. The rating is historical and is based upon the Funds credit quality, market exposure and management. It signifies that the Funds' safety is excellent and that it has superior capacity to maintain a \$1.00 net asset value per share.

² The Fund is rated by Moody's Investor Services, Inc. The rating is historical and is based upon the Fund's credit quality, market exposure, and management. It signifies that the Fund's safety is excellent and that it has superior capacity to maintain \$1.00 net asset value per share.

As we monitor the events in Washington, D.C., and the concerns of the major credit-ratings agencies, we remain focused on the goal of maintaining the stability, credit quality and liquidity of our money market funds.

IMPACT ON BOND MARKET

The rating downgrade of U.S. debt is the first since S&P assigned the AAA rating 70 years ago, so there is no historical benchmark to review. Downgrades in credit ratings in general are usually accompanied by some rate hikes. We would expect small, if any, increases in rates on Treasury securities. Short-dated securities and maturities out to 10 years probably won't see much movement. Longer maturities to 30 years might see a 0.25 percentage point increase over time.

But the bond market doesn't operate within a vacuum. The U.S. economy is in a soft patch. Slow economic conditions are good news for bond prices. In addition, the equity market recently has been losing ground. A weak equity market also can help raise prices on U.S. bonds and lower rates. So, holding everything else constant, rates on U.S. Treasury securities may increase slightly. But given current market conditions, it's unlikely this downgrade will significantly affect bond prices. S&P also downgraded debt issued by various government agencies, including the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corp. (Freddie Mac), and 10 of the nation's 12 Federal Home Loan Banks (two already had been downgraded). Certain municipal bonds also may face ratings downgrades. The Federal Reserve released a statement on August 5th that the risk weightings for U.S. Treasury securities held on bank balance sheets would not change. There was some fear that a downgrade could force some holders to sell if their investment mandate is to hold only AAA securities. Again, while there may be some investors in that position, we don't anticipate a massive shift out of U.S. securities.

IMPACT ON EQUITY MARKET

It's logical to assume the market most affected by the debt downgrade would be the bond market. But it's likely the stock market will face the brunt of the fallout. The downgrade comes at a time of equity market weakness, which will cause additional worry. Since the short-term direction has been downward for stocks, this announcement will reinforce the current momentum. Recent economic releases have been weaker than expected, and economists are downgrading GDP forecasts for the second half of 2011 and 2012. It's clear the odds of

another recession have gone up recently, but the data have not fallen to recessionary levels. For example, U.S. vehicle sales increased in July to 12.2 million, (seasonally adjusted annual rate), chain store sales rose 4.6% year over year, and mortgage applications were up 5% during the first week of August. The employment data were mixed, as July payrolls grew by 117,000 and the unemployment rate dropped 0.1 percentage point to 9.1%. Nevertheless, the employment situation in the U.S. remains poor. While the unemployment rate has improved from its worst point of the recession, the nation still has lost 7 million jobs from the peak employment rate in early 2008. Europe continues to face more serious economic issues. Trying to find a way to manage Europe with a single currency /monetary policy and individual fiscal policies in each country is proving difficult.

Finally, the downgrade of U.S. debt to AA+ may raise angst more than interest rates. In a big picture sense, a slight downgrade in our credit rating is less important than the growth rate and momentum of the U.S. economy. The central challenge remains the same for the U.S. and much of the world: how to foster growth while simultaneously cutting government spending.

DISCLOSURES

The Advisor

Caval Hill Investment Management, Inc. is an SEC registered investment adviser and a wholly-owned subsidiary of BOKF, NA, a wholly-owned subsidiary of BOK Financial Corporation, a financial holding company ("BOKF"). SEC registration does not imply a certain level of skill or training. BOKF, NA serves as the custodian for the Caval Hill Funds. BOKF holdings also include BOSC, Inc., the distributor for the Caval Hill Funds (the Funds). Caval Hill Investment Management, Inc., provides investment advice, administration and other services for the Funds and receives a fee for providing such services as fully described in the prospectus. BOKF, NA offers investment management and administrative services nationally and administers more than \$30 billion in assets for numerous clients, including foundations and endowments, and high net worth individuals.

An investor should consider the funds' investment objectives, risks, and charges and expenses carefully before investing or sending any money. This and other important information about the investment company can be found in the funds' prospectus or summary prospectus. To obtain a prospectus or summary prospectus online, please visit www.cavalhillfunds.com or call 1-800-762-7085. Please read the prospectus or summary prospectus carefully before investing.

The Funds are distributed by BOSC, Inc., an SEC registered investment adviser, a registered broker/dealer, member FINRA/SIPC. SEC registration does not imply a certain level of skill or training.

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Past performance does not guarantee future results. The investment return and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than the original cost. Although the money market funds seek to preserve the value of an investment at \$1.00 per share, it is possible to lose money by investing in the Funds. Mutual funds, including money market mutual funds, and other investments are not insured by the FDIC, are not deposits or other obligations of, and are not guaranteed by, any bank or any bank affiliate. Investments are subject to risks, including possible loss of principal amount invested.