

Fixed Income Monthly REPORT

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Tax-Exempt Municipal Fixed Income

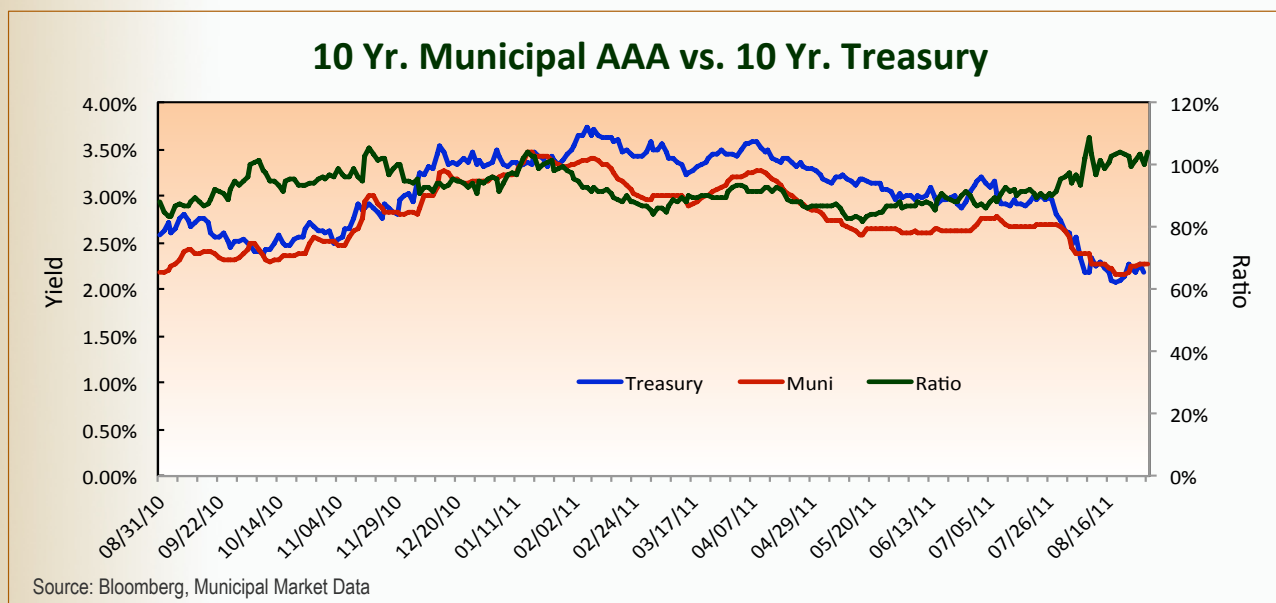
The tax exempt market had strong performance during August as the Barclays 1-10 year muni index returned 1.44%. The 1-10 year muni index returned 5.54% year to date, which has outperformed the Treasury intermediate index, which returned 5.48% and the Government/Credit intermediate index, which returned 5.04% year to date. However, the Treasury intermediate index outperformed in August as U.S. Treasuries rallied due to weaker than expected economic releases and a flight to safety from risky asset classes. As a result, 10 year AAA tax exempt munis yield 102% of the 10 year Treasury note yield compared to the 1 year average of 93% (see graph below). As you will see in the table below, representative AA muni yields are attractive to Treasury yields, particularly on a taxable equivalent yield basis. Although tax exempt municipal new issue supply picked up in June and July, August new issue supply was lighter and the year to date supply is down almost 22% year over year. It is expected that new issue supply will increase beginning in September, which may result in higher yields and wider spreads to AAA yields (see Visible Supply graph at the bottom of page 2).

According to the Rockefeller Institute, U.S. State tax revenue increased 11.4% in the 2nd quarter, the fastest pace in 6 years, as state governments recover from the longest recession since World War II. Given our interest rate outlook for gradually higher yields, we continue to be cautious and selective and are buying high quality bonds.

Barclays Indices	MTD Total Return	YTD Total Return
Muni 1-10 yr	1.44%	5.54%
Tsy Int.	1.77%	5.48%
Govt/Credit Int.	1.07%	5.04%

	AA Muni Yield	Treasury Yield	Taxable Equivalent Yield (35% Tax Rate)
2 Year	0.50	0.20	0.77
3 Year	0.58	0.32	0.89
5 Year	1.19	0.96	1.83
7 Year	1.92	1.56	2.95
10 Year	2.65	2.22	4.08

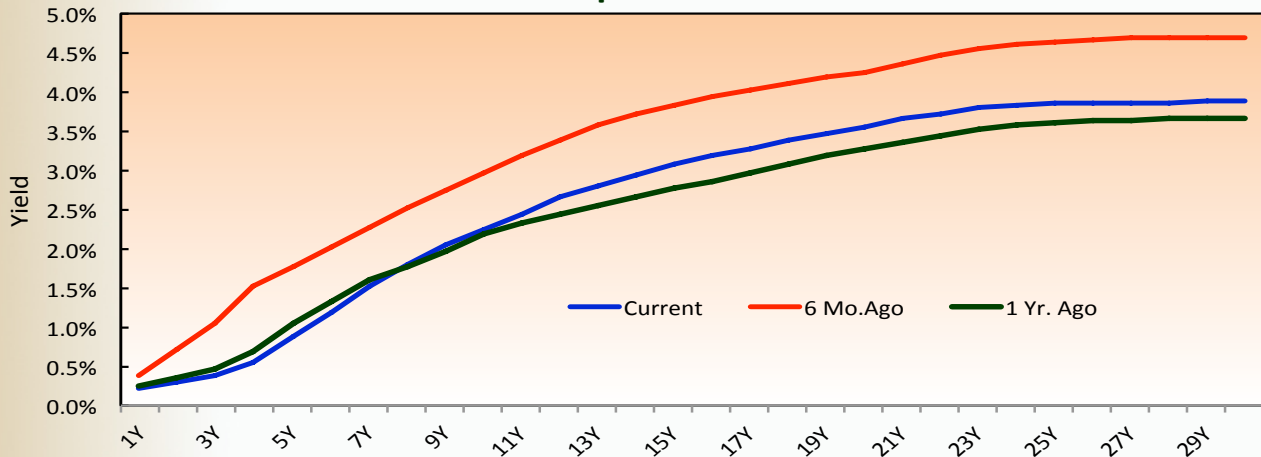
Source: Bloomberg, Municipal Market Data – As of August 31, 2011



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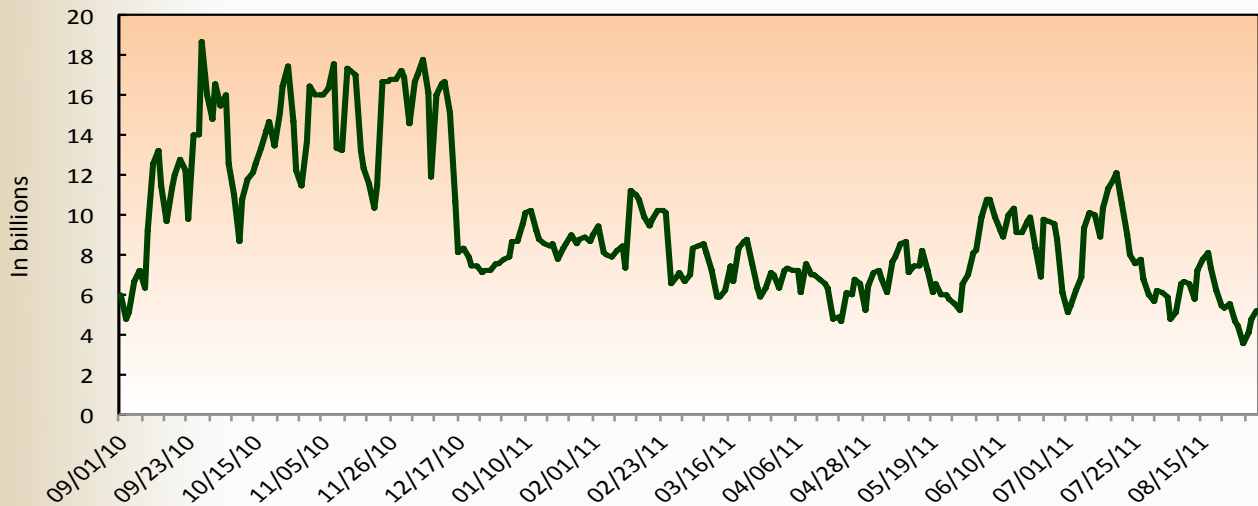
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Municipal AAA Curve



Source: Municipal Market Data

30-Day Visible Supply



Source: Bond Buyer

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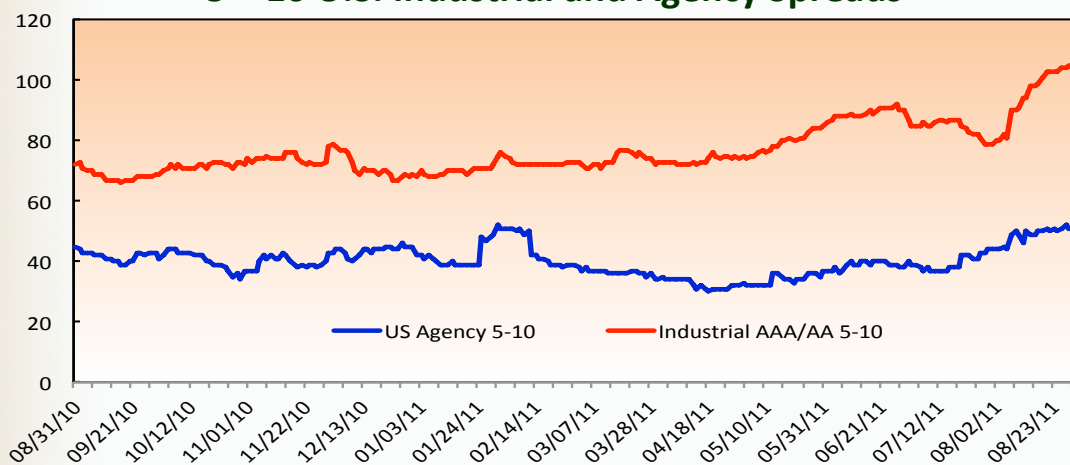
Taxable Fixed Income

The taxable bond market had strong performance in August as the Treasury market saw its largest gains since December of 2008. The Intermediate Govt/Credit index returned 1.07% for the month while the Intermediate Treasury index returned 1.77%. Year-to-date, performance remains robust with the Intermediate Govt/Credit index returning 5.04% and the Intermediate Treasury index returning 5.48%.

There was no lack of headlines in August as we saw Congress agree to raise the debt ceiling, S&P subsequently cut America's sovereign debt rating from AAA to AA+, and traders continued to worry over trouble in Europe's financial system and a faltering recovery here in U.S. The end result of this flood of negative news was unprecedented swings in the equity markets, with four straight days of over 400pt swings in the Dow, and a large flight to quality into U.S. Treasuries. Equally significant, while not as publicized, was the Fed's commitment to keep short term rates near zero until mid 2013. As you can see below, credit spreads have also begun to widen amidst this uncertainty, accompanied by the lowest corporate issuance since May of 2010. The end of the month, however, has seen improving economic numbers and the potential that the Fed may initiate yet another stimulus plan to aid the recovery. While the likelihood of a recession remains very low, consensus estimates point to the continuation of slow growth, albeit positive. With these events, we are now finding the best value in the 5-10 year maturity range as the yield curve is currently steep.

We believe that with short-term rates anchored near zero for the next several years, the long end of the curve is most susceptible to larger moves. We are concentrating purchases in the belly of curve and staying defensive by purchasing higher quality bonds.

5 – 10 U.S. Industrial and Agency Spreads



Source: Merrill Lynch

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