Fixed Income Monthly
REPORT

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Tax-Exempt Municipal Fixed Income

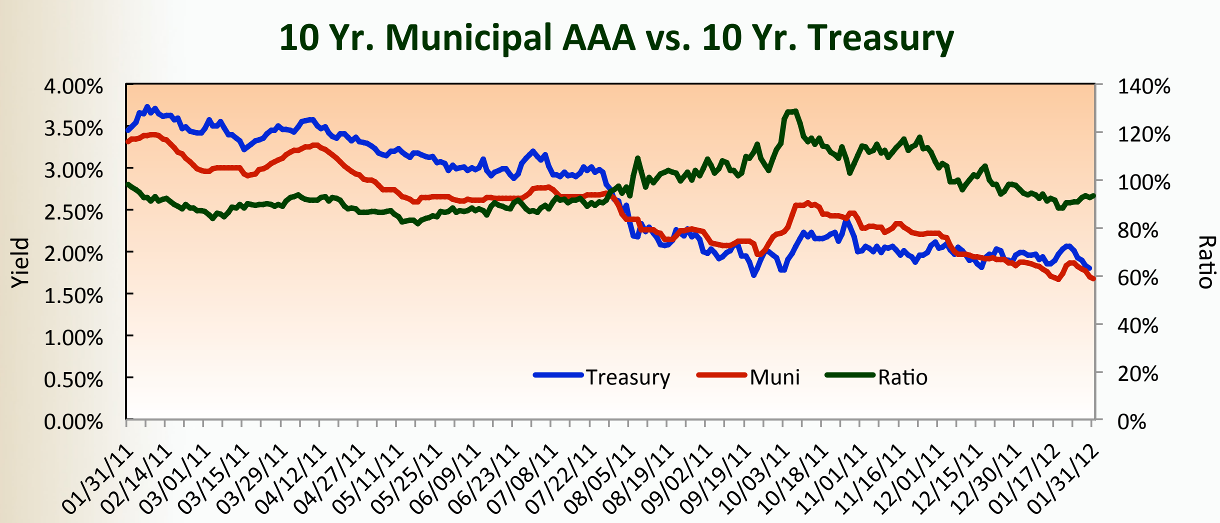
The tax exempt municipal market started 2012 with strong performance similar to the end of 2011. The 1-10 year muni index returned 1.06% for January 2012, which outperformed the Treasury intermediate index, which returned 0.51%, and the Government/Credit intermediate index, which returned 1.02%. Due to this outperformance, 10 year AAA tax exempt munis yield 93% of the 10 year Treasury note yield compared to the 1 year average of 97% (see graph below). However, 5 year AAA tax exempt munis remain attractive as these yield 100% of the 5 year Treasury notes compared to a 1 year average of 93%. As you will see in the table below, representative AA muni yields are attractive to Treasury yields, particularly on a taxable equivalent yield basis. Tax exempt new issue supply increased more than 17% over January 2011. Although new issue supply increased, municipals outperformed as redemptions from maturities, coupons, and calls flooded the market during January. However, many muni market strategists expect that new issue volume will increase in February and March as municipal issuers take advantage of the current low interest rates (see Visible Supply graph at the bottom of page 2).

Given our interest rate outlook, we are currently focusing new purchases inside of 5 years where there is better relative value, and to keep average maturities relatively short.

Barclays Indices	MTD Total Return	YTD Total Return
Muni 1-10 yr	1.06%	1.06%
Tsy Int.	0.51%	0.51%
Govt/Credit Int.	1.02%	1.02%

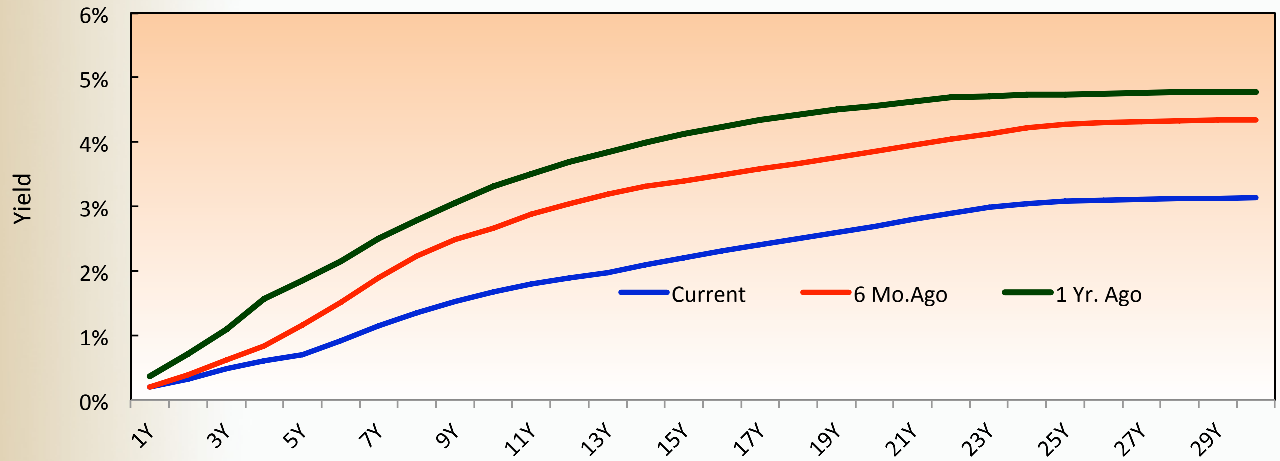
	AA Muni Yield	Treasury Yield	Taxable Equivalent Yield (35% Tax Rate)
2 Year	0.53	0.22	0.82
3 Year	0.69	0.29	1.06
5 Year	1.01	0.70	1.55
7 Year	1.55	1.24	2.38
10 Year	2.08	1.80	3.20

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



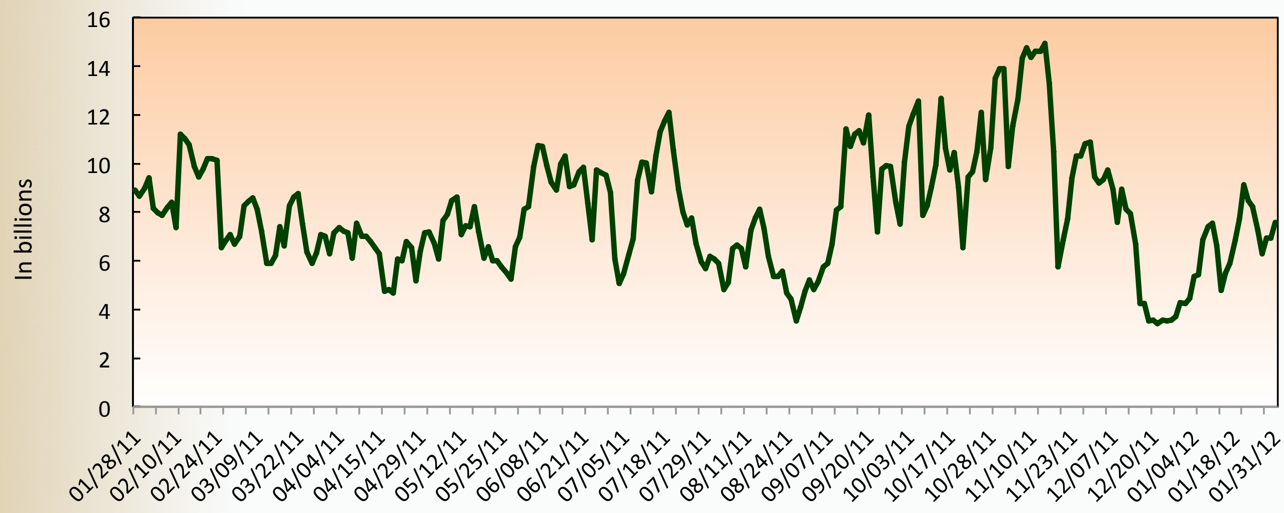
Source: Bloomberg, Municipal Market Data

Municipal AAA Curve



Source: Municipal Market Data

30-Day Visible Supply



Source: Bond Buyer

Taxable Fixed Income

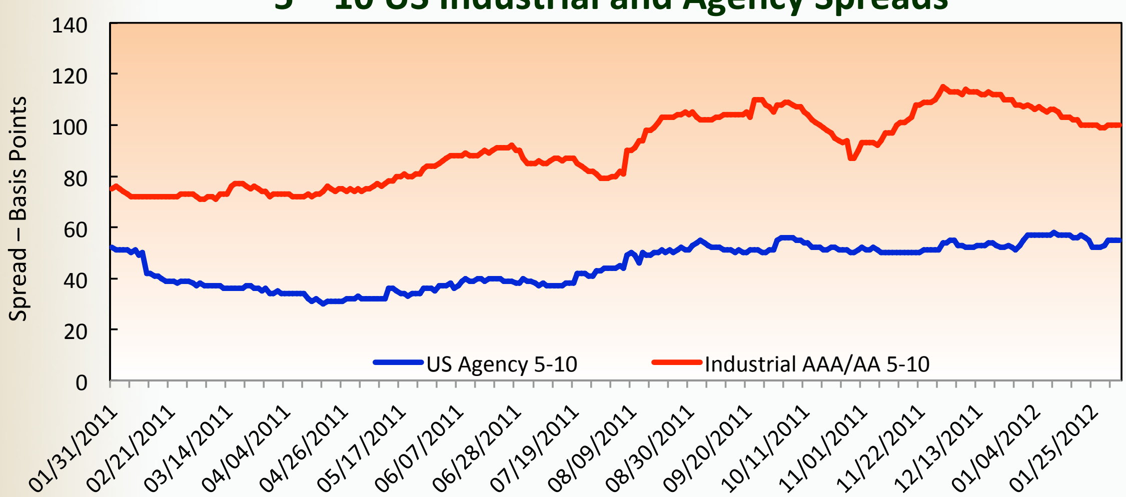
The taxable bond market had positive performance in January as taxable bonds outperformed U.S. Treasuries to start the year. The Intermediate Govt/Credit index returned 1.02% for the month while the Intermediate Treasury index returned 0.51%. As you can see in the below graph, high quality corporate yield spreads versus U.S. Treasuries declined from where they finished 2011, contributing to the sector's outperformance.

The January 25th Federal Open Market Committee meeting saw the Fed extend it's pledge to keep short-term interest rates near zero through the end of 2014, extending their commitment to this level nearly 18 months. In addition, the committee lowered 2012 GDP forecasts to a range of 2.2% to 2.7% for 2012, from their previous estimate of 2.5% to 2.9%, as well as setting a long-term inflation goal of 2%. By keeping rates at such low levels, the Fed is making it an unwelcome prospect to invest money in U.S. Treasuries and urging banks and investors to lend more and buy riskier assets.

Overseas, S&P finally did what the world had expected, downgrading the majority of Europe's sovereign ratings. France lost it's coveted AAA rating with a one-notch downgrade to AA+, while Spain and Italy were cut even further. Germany is now the only large policy contributor remaining with their AAA rating intact. Meanwhile, private Greek debt holders continued to try to negotiate further write-downs of their holdings, with a critical €14.5 billion bond repayment coming due on March 20th.

Given our outlook on interest rates, we are being cautious and selective and are remaining defensive by purchasing higher quality bonds.

5 – 10 US Industrial and Agency Spreads



Source: Merrill Lynch