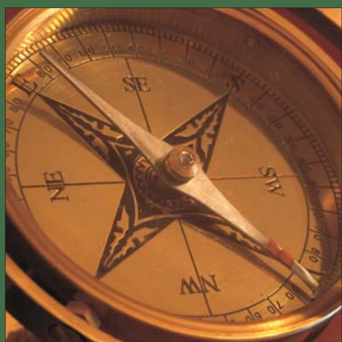
CHANDLER ASSET MANAGEMENT

July 2007

BOND MARKET REVIEW

A MONTHLY REVIEW OF FIXED INCOME MARKETS



WHAT'S INSIDE

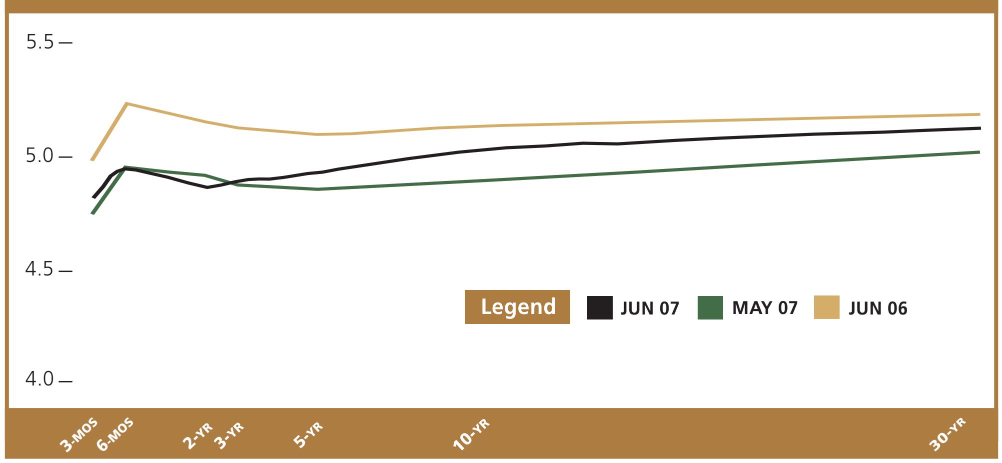
MARKET SUMMARY

Bond yields were mostly higher in June. While yields on bonds with maturities between 6 months and two years declined, yields on most other maturities showed increases. The market's recent activity indicates that participants may be losing hope for a near-term interest rate cut by the Federal Reserve. As a result of last month's market movements, the yield curve has moved to a more normal shape, with the highest rates being found in the thirty year sector.

The economy continued to display mixed signals in June. The Non-Farm Payroll number was slightly stronger than expected, showing an increase of 132,000 new jobs, and the unemployment rate remained at 4.5 percent. Both figures indicated that the job market continues to display moderate growth. Inflation readings remain higher than the FOMC would prefer. Housing data weakened during the month, indicating that the housing market may not be ready to begin a recovery. Going forward, market participants will continue to look for signs as to whether or not economic activity is poised to rebound in the second half of the year.

The FOMC took no action at its June 28th meeting, leaving its fed funds target at 5.25%. The next FOMC meeting is on August 7th, and most market participants anticipate no action on interest rates.

TREASURY YIELDS HIGHER



The yield curve shifted higher in June as the curve moved to a more normal, positive slope.

YIELDS	6/30/07	5/31/07	Change
3 Month	4.80	4.73	0.07
2 Year	4.86	4.91	(0.05)
3 Year	4.88	4.87	0.01
5 Year	4.92	4.85	0.07
10 Year	5.02	4.89	0.13
30 Year	5.12	5.01	0.11

YIELD SPREADS	6/30/07	5/31/07	Change
5yr - 2yr T-Note	0.06	(0.06)	0.12
10yr - 2yr T-Note	0.16	(0.02)	0.18

Source: Bloomberg

Yield is a commonly used measure of a fixed income portfolio's growth. Yield appears to be a simple, straightforward measure that is easy to understand and easy to describe to interested parties. However, when we take a closer look at yield measurement, we observe that, it may not be as simple as it seems at first.

The biggest problem that users encounter when discussing yield is simply determining what measure of yield we are talking about. There are a variety of yield measures, based on different calculations, which may result in different yields. Imagine the following exchange.

Our bond portfolio has been performing well, says the county treasurer. It yields 5.35%. No it doesn't says the city manager, it yields 5.28%. No, you're both wrong says the investment officer, our portfolio yield is 5.39%.

Who is right? Do two of the people not know what they are talking about? In fact, all three of the people are correct. The same bond portfolio can show yields of 5.35%, 5.28%, and 5.39%, depending upon the yield measure that you are using.

The preceding discussion should make it abundantly clear that when using yield as a measure of portfolio performance (or a bond's value) it is extremely important to use the proper yield measure. The chart below includes several popular yield measures and their definitions:

Current Yield = the annual coupon payments divided by the market price of the bond.

Yield to Maturity = the internal rate of return of a bond or portfolio, based upon either the current market price or the initial cost assuming all coupon payments are reinvested at exactly the same rate. Two problems here: First assuming all coupon payments will be invested at the same rate is unrealistic. Second, the yield to maturity calculated at cost is likely to be very different from the yield calculated at market distinction that interested parties may not understand.

Book Yield = this is another term for the yield to maturity based upon the price actually paid for the bond when purchased

Yield to Call = the yield that will be received if the bond is called at the next call date. When purchasing callable bonds at a premium it is very important to note the yield to call, which will be lower than the yield to maturity, and is your "worst case" return.

Bond Equivalent Yield = the yield on a bond when semiannual, quarterly, or monthly payments are converted into annual payments. This allows bonds with different payment schedules to be compared to each other.

Money Market Yield = a bond yield calculation based upon semiannual payments, and a 360 day year (as opposed to a 365 day year)

All of these yield measures can be useful, *as long as they are used properly and in the correct context*. Unfortunately, it is often difficult to keep track of the proper yield measures. That is why yield, while useful, is not always the best measure of a bond portfolio's return. Let's take a closer look at when yield might be useful, as well as situations in which it is not the best tool to use.

When is yield useful?

Yield is useful when trying to predict future cash flows. An excellent example of this is the budget process. If you need to figure out how much cash your investment portfolio is going to generate, yield to maturity is an excellent measure.

When isn't yield useful?

Yield is less useful in measuring a portfolio's performance. In part, this is because of possible confusion as to which yield measure is appropriate for assessing portfolio return. For instance, if you are comparing your portfolio's yield to a benchmark, and you use purchase yield while the benchmark uses current yield, you no longer have an apples to apples comparison and therefore do not have an accurate measure of your true performance.

In addition to the confusion over its proper measurement, yield also has another shortcoming. A portfolio's return consists of three components: interest, reinvestment of principal and interest, and gains/losses from security purchases and sales. When using yield as a measure of portfolio performance, you are only measuring the first part of portfolio return.

A better practice is to use total rate of return calculations in order to measure portfolio performance. Total rate of return calculations overcome the two shortcomings of yield. First of all, there is only a single, agreed upon definition and measurement of total return. Second of all, total rate of return measures all three of the components of a portfolio's performance.

Yield measures are excellent tools when used properly. Always remember to specify which yield measure you are using when calculating yield. Also yield should be used only when appropriate, such as for forecasting cash flows or preparing a budget. Do not use yield measurements when they are not appropriate, such as when measuring a portfolio's return. When evaluating the performance of your internal or external money managers, total return is the appropriate measurement tool.

Note: Yield and total return can be confusing topics. If this article has prompted additional questions, contact your investment providers (investment advisor or broker) or search the web for more information (www.investinginbonds.com is an excellent site).

Brian Perry, Vice President, Portfolio Specialist

Consumer Prices

During May, the economy's headline inflation reading rose as the year-over-year CPI increased to 2.7% from 2.6% in April. The year-over-year Core CPI (CPI less food and energy) declined to 2.2%. While Core CPI remains above the FOMC's comfort level, the trend has been relatively positive over the past six months. Going forward, market observers will watch carefully to see if there is a trend towards higher or lower inflation.

Labor Markets

The June non-farm payroll employment report showed an increase of 132,000 jobs, which was slightly higher than consensus expectations. The reports for the previous several months were also revised higher. The unemployment rate remained at 4.5%. The six-month average for non-farm payroll employment is now 145,000 jobs. June's employment report indicates continued moderate growth in the labor market.

Housing Starts

Single-family housing starts declined by 3.4% in May, to a 1.17 million annual pace. This follows April's reading of 1.21 million. Single family housing permits also declined. While the housing sector has not shown signs of a strong rebound, the pace of decline has slowed. Going forward, market participants will watch closely to see whether or not the decline in the housing market has run its course.

Manufacturing

During June the ISM Manufacturing Index increased to 56.0 from May's reading of 55. ISM readings below 50 indicate that the manufacturing sector of the economy is contracting; readings above 50 indicate that the manufacturing sector is in an expansionary phase. The recent trend in ISM readings indicates that the manufacturing sector of the economy remains relatively healthy. Nevertheless, it is important to remember that manufacturing constitutes a smaller portion of the US economy than in the past.

Credit Spreads Wider

CREDIT SPREADS	Spread to Treasuries (%)	One Month Ago (%)	Change
3-month top-rated commercial paper	0.41	0.47	(0.06)
2-year AA corporate note	0.39	0.45	(0.06)
5-year AA corporate note	0.62	0.71	(0.09)
5-year Agency note	0.36	0.32	0.04

Source: Bloomberg

Data as of 6/30/07

Mixed Economic Data

ECONOMIC INDICATOR	Current Release	Prior Release	One Year Ago
Trade Balance	(58.5) $Bln APR 07	(62.4) $Bln MAR 07	(62.3) $Bln APR 06
GDP	0.7% MAR 07	2.5% DEC 06	5.6% MAR 06
Unemployment Rate	4.5% JUN 07	4.5% MAY 07	4.6% JUN 06
Prime Rate	8.25% JUN 07	8.25% MAY 07	8.25% JUN 06
CRB Index	315.74 JUN 07	311.46 MAY 07	346.39 JUN 06
Oil (West Texas Int.)	$70.68 JUN 07	$64.01 MAY 07	$73.93 JUN 06
Consumer Price Index (y/o/y)	2.7% MAY 07	2.6% APR 07	4.2% MAY 06
Producer Price Index (y/o/y)	4.1% MAY 07	3.2% APR 07	4.5% MAY 06
Dollar / EURO	1.35 JUN 07	1.35 MAY 07	1.28 JUN 06

Source: Bloomberg