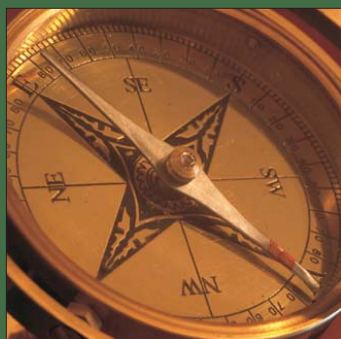


BOND MARKET REVIEW

A MONTHLY REVIEW OF
FIXED INCOME MARKETS



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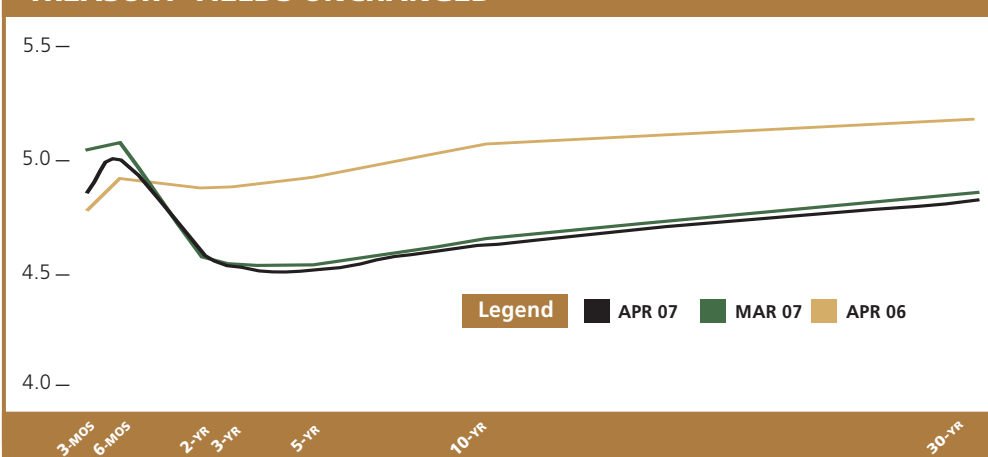
MARKET SUMMARY

Bond yields were mostly unchanged in April. The market's recent activity indicates that participants remain uncertain about the future course of economic growth. Accordingly, each new economic release or FOMC pronouncement is being scrutinized even more closely than usual.

The economy displayed mixed signals in April. The Non-Farm Payroll number was weaker than expected, with the creation of just 88,000 new jobs, and the unemployment rate rising to 4.5 percent. Both figures indicate continue moderate growth in the job market. Inflation readings remained higher than the FOMC would prefer. Housing data were mixed during the month, and some market participants worry that housing weakness will spillover to the broader economy.

The FOMC took no action at its May 9th meeting, leaving its target for the Fed Funds rate at 5.25%. The accompanying statement said that "economic growth slowed in the first part of this year" but that "core inflation remains somewhat elevated." The next FOMC meeting is on June 28th, and most market participants anticipate no action on interest rates.

TREASURY YIELDS UNCHANGED



YIELDS	4/30/07	3/31/07	Change
3 Month	4.84	5.03	(0.19)
2 Year	4.59	4.57	0.02
3 Year	4.53	4.53	0.00
5 Year	4.51	4.53	(0.02)
10 Year	4.62	4.64	(0.02)
30 Year	4.81	4.84	(0.03)

YIELD SPREADS	4/30/07	3/31/07	Change
5yr - 2yr T-Note	(0.08)	(0.04)	(0.04)
10yr - 2yr T-Note	0.03	0.07	(0.04)

Source: Bloomberg

The Federal Open Market Committee (FOMC) of the Federal Reserve meets approximately every six weeks in order to determine monetary policy. At the end of these meetings, the FOMC releases a statement containing its target level for short-term interest rates and a brief assessment of economic conditions. Investors carefully scrutinize this statement for clues to the future direction of interest rates and bond prices.

But what exactly is the Federal Reserve and what does it do? How does the FOMC operate? In this article, we'll examine the mission of the Federal Reserve (the Fed), its history, and its structure. Next month, we'll talk about the tools the Fed has at its disposal, as well as how it has chosen to use them over the past several years. At the end of this series, you'll have a clearer understanding of how the Federal Reserve operates, allowing you to better understand its impact on the economy and the financial markets.

The Mission of the Federal Reserve

The mandate of the Federal Reserve is to manage short-term interest rates and the money supply in order to promote economic growth and maximum employment while maintaining an environment of moderate inflation and reasonable long-term interest rates. In practice, various Federal Reserve officials have stated that their goal is to keep inflation in the range of 1%-2% annually with GDP growth of 3%-3.5% annually. While managing monetary policy is the Fed's primary and most visible role it also has various other responsibilities. These include: providing financial services to banks and other financial institutions, supervising the banking system, and responding to the needs of the market in times of economic crisis.

History of the Federal Reserve

The Federal Reserve was created in 1913 by an act of Congress. Over the years the Fed has had various successes and failures. In the late 1970's Fed Chairman Paul Volker tightened short-term interest rates dramatically in order to curb extremely high inflation levels. Although this pushed the economy into recession, inflation was curtailed, and has remained under control for most of the past twenty five years. One of the Fed's most notable mistakes came at the start of the Great Depression in 1929 when it chose to tighten credit. Many scholars, including current Fed Chairman Ben Bernanke, blame this Fed tightening for turning an economic setback into something far worse.

Having learned from the Fed's mistake in 1929, Chairman Alan Greenspan flooded the banking system with liquidity following the 1987 stock market crash. This proved a wise move, and the economy continued to prosper despite the stock market turbulence. Greenspan went on to serve as Chairman for nearly 20 years, earning a great deal of

respect for the Federal Reserve by overseeing one of the best economic periods in U.S. history.

Greenspan retired at the end of his term in early 2006, and was replaced by Ben Bernanke. To date most market participants approve of the job that Bernanke has done. In addition to guiding the economy, Bernanke has also indicated that he wants the Fed to be more open and transparent in its communications with the public.

Structure of the Federal Reserve System

The Federal Reserve System consists of four main participants: the Board of Governors, the regional Federal Reserve Banks, the Federal Open Market Committee, and private sector member banks. These participants work together to maintain a strong national banking system and a robust economy.

The Board of Governors has seven members, each of whom is appointed by the president to serve a 14-year term. The length of these terms is designed to insure that no president can control the entire board, thereby keeping the body independent and apolitical. Due to their position at the center of the Reserve system, the Board of Governors is ideally situated to monitor national economic developments.

While members of the board of Governors focus on the national economy, the regional Federal Reserve Banks are more closely attuned to local conditions. The regional Reserve Banks also interact with, and are owned by, private member banks such as Citigroup and Wells Fargo. This structure provides for both Federal Reserve oversight of the banking system as well as private sector input in formulating economic policy. In effect, these regional Banks serve as a "bank for banks", by providing many of the same services to private financial institutions that commercial banks do to individuals or corporations.

The Board of Governors and the regional Reserve Banks come together to form the FOMC. All FOMC meetings are attended by the seven Federal Reserve Board Governors and the presidents of the twelve regional Reserve Banks. However, not all attendees vote. There are only twelve voting members at each FOMC meeting: the seven Governors plus five of the regional presidents. These five are chosen on a rotating basis from among the regional Bank presidents, although by tradition the president of the New York Fed is always chosen to vote. The decisions that these twelve voters reach are perhaps the most important factor in determining the performance of fixed income portfolios.

Next month we'll look more closely at what occurs at these FOMC meetings, as well as some of the other tools the Fed has at its disposal in guiding monetary policy.

-Brian Perry, Research Analyst

CONSUMER PRICES

During March, the economy's headline inflation reading rose as the year-over-year CPI increased to 2.8% from 2.4% in February, partly due to an increase in energy and food prices. The year-over-year Core CPI (CPI less food and energy) declined to 2.5%. 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 April non-farm payroll employment report showed an increase of 88,000 jobs, which was slightly lower than consensus expectations. The unemployment rate increased to 4.5%. The six-month average for non-farm payroll employment is now 157,000 jobs. April's employment report indicates continued moderate growth in the labor market.

HOUSING STARTS

Single-family housing starts rose by 2.0% in March, to a 1.22 million annual pace. This follows February's reading of 1.19 million. Single family housing permits also increased. The increase in housing starts was limited to the Midwest; other areas of the country showed a decline in housing. Going forward, market participants will watch closely to see whether or not the decline in the housing market has run its course.

MANUFACTURING

During April the ISM Manufacturing Index increased to 54.7 from March's reading of 50.9. 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. For the past several months ISM readings had been fluctuating on either side of 50, but April's reading marked an 11 month high for the index.

CREDIT SPREADS WIDER

CREDIT SPREADS	Spread to Treasuries (%)	One Month Ago (%)	Change
3-month top-rated commercial paper	0.35	0.17	0.18
2-year AA corporate note	0.42	0.36	0.06
5-year AA corporate note	0.61	0.51	0.10
5-year Agency note	0.31	0.31	0.00

Source: Bloomberg

Data as of 4/30/07

MIXED ECONOMIC DATA

ECONOMIC INDICATOR	Current Release	Prior Release	One Year Ago
Trade Balance	(58.4) \$Bln FEB 07	(58.9) \$Bln JAN 07	(62.9) \$Bln FEB 06
GDP	1.3% MAR 07	2.5% DEC 06	5.6% MAR 06
Unemployment Rate	4.5% APR 07	4.4% MAR 07	4.7% APR 06
Prime Rate	8.25% APR 07	8.25% MAR 07	7.75% APR 06
CRB Index	312.71 APR 07	316.88 MAR 07	349.89 APR 06
Oil (West Texas Int.)	\$65.71 APR 07	\$65.87 MAR 07	\$71.88 APR 06
Consumer Price Index (y/o/y)	2.8% MAR 07	2.4% FEB 07	3.4% MAR 06
Producer Price Index (y/o/y)	3.2% MAR 07	2.5% FEB 07	3.6% MAR 06
Dollar / EURO	1.36 APR 07	1.34 MAR 07	1.26 APR 06

Source: Bloomberg

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