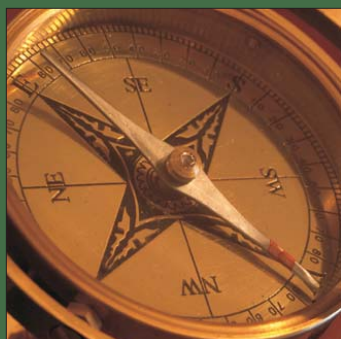


BOND MARKET REVIEW

A MONTHLY REVIEW OF
FIXED INCOME MARKETS



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Since 1988, Chandler Asset Management has specialized in the management of portfolios of high quality, fixed income securities. Chandler's mission is to provide fully customizable, client-centered portfolio management that preserves principal, manages risk and generates income in our client's portfolios.

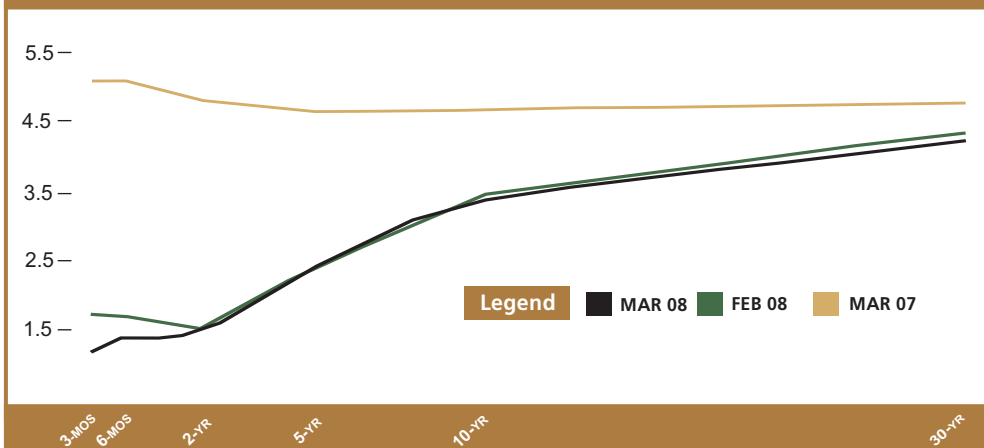
MARKET SUMMARY

Bond yields were lower in March. The market's recent activity stems from concerns that difficulties in the housing and mortgage market have resulted in slower economic growth. The global market volatility has continued, and market participants remain extremely sensitive to signs of housing, mortgage, and credit weakness.

The economy displayed slower growth in March. The Non-Farm Payroll number showed a decrease of 80,000 jobs, and the unemployment rate rose to 5.1%. This was the third straight report that demonstrated negative job growth and increased fears that the economy has entered a recessionary period. Housing data remains weak. Inflation readings have moved slightly higher, raising concerns that the recent decline in inflation may be ending. Going forward, market participants will continue to look for signs as to whether or not weakness in the housing, mortgage and credit markets is reflected in the broader economy.

The FOMC lowered the federal funds rate and the discount rate 75 basis points at their meeting on March 18. The federal funds rate currently stands at 2.25%. The next scheduled FOMC meeting is on April 30th.

TREASURY YIELDS SLIGHTLY LOWER



Treasury yields were lower in March as market participants attempted to ascertain the consequences of financial market volatility, a housing-led economic slowdown and Federal Reserve interest rate cuts. The yield curve retained its normal shape.

| YIELDS | 3/31/08 | 2/29/08 | Change |
|---------|---------|---------|--------|
| 3 Month | 1.30 | 1.84 | (0.54) |
| 2 Year | 1.61 | 1.63 | (0.02) |
| 5 Year | 2.46 | 2.50 | (0.04) |
| 10 Year | 3.43 | 3.53 | (0.10) |
| 30 Year | 4.30 | 4.42 | (0.12) |

| YIELD SPREADS | 3/31/08 | 2/29/08 | Change |
|-------------------|---------|---------|--------|
| 5yr - 2yr T-Note | 0.85 | 0.87 | (0.02) |
| 10yr - 2yr T-Note | 1.82 | 1.90 | (0.08) |

Source: Bloomberg

THE CREDIT CRUNCH REVISITED; WHERE ARE WE NOW?

In July of 2007, the financial markets ended an extended period of stability and low volatility as the subprime mortgage market collapsed leading to a broad based credit crisis. We explored the origins of this crisis and some of its results in our September 2007 newsletter article. However, this crisis has proven to be one of the longest and most severe in memory. A full nine months after the inception of the credit crisis, it seems an opportune time to discuss recent developments and their effect on your investment portfolio.

Update on recent market and economic events

The past six months have witnessed an almost constant barrage of headline news, unparalleled financial market volatility, and sporadic signs of recovery. A detailed recitation of every important event since the last article on the credit crisis would likely kill far too many trees while also boring the reader to tears. Therefore, I'll concentrate here on just a couple of "highlights" from the past six months.

First, the economy has weakened substantially over the past six months. This is apparent from national economic reports, and is even more evident in certain regions of the country such as the industrial Midwest, Florida, Arizona, Las Vegas and California. These areas have all been especially hard hit by the weakening housing market; financial market volatility and tightening credit conditions have exacerbated this weakness. As many forecasters have been predicting, housing market weakness seems to have finally spilled over to the broader economy.

This opinion has been corroborated by recent employment data, which for the past three months have indicated that the economy has lost jobs. *Generally speaking*, job losses coincide with a much weaker economy.

Many economists believe that the economy is currently in a recessionary period and many more believe that we will soon enter one. Even economists that are not forecasting a recession are predicting a period of slower economic growth. The final reading for fourth quarter 2007 Gross Domestic Product (GDP) showed growth of only 0.6%. Forecasts for Q1 2008 GDP call for very weak growth or even a decline in economic activity.

Both the Federal Government and the Federal Reserve Bank (Fed) have been working hard to minimize the severity and duration of the economic slowdown. The Federal Government has passed a stimulus package designed to reinvigorate the economy. Rebate checks will be mailed out to most Americans in May, and this fiscal stimulus should begin to take effect by summer,

hopefully providing a boost to the economy. Changes have also been made that are designed to allow the federal housing agencies to provide additional liquidity to the beleaguered mortgage market.

The Fed has been even more aggressive in fighting the credit crunch. In addition to cutting interest rates 300 basis points since September 2007, the Fed has also implemented many technical measures designed to restore liquidity to the marketplace. For the first time since the 1930s, investment banks now have access to the discount window, where financial institutions can borrow money directly from the Federal Reserve. (Previously only "traditional" banks had been granted access to this important line of credit). Although an expensive source of funding, the discount window serves as a valuable source of liquidity during times of stress, and is not subject to changes in market sentiment.



The forced sale of Bear Stearns, a Wall Street investment bank, to JP Morgan represented perhaps the most tenuous period of the credit crisis. In the span of 72 hours, Bear Stearns went from a wounded but still profitable entity to the verge of bankruptcy. This was due to a lack of liquidity and a loss of confidence - a refusal of many counterparties to conduct business with Bear. Fearful that a Bear Stearns collapse would severely damage the entire financial system, the Fed orchestrated a purchase of Bear by JP Morgan, even going so far as to guarantee some of Bear's liabilities. This action coincided with the opening of the discount window to other investment banks and it is generally believed that if the discount window had been opened sooner, Bear Stearns would not have been forced into selling to JP Morgan at a fire-sale price. Although controversial, the opening of the

discount window and the sale of Bear Stearns have reduced financial market volatility, at least temporarily.

With this brief synopsis of the credit crisis out of the way, let's take a closer look at what really matters: the impact of the credit crisis on your portfolio, and what lessons we can learn from recent events.

Impact on your portfolio

First of all, let me show you a couple of financial market "highlights" that have occurred as a result of the credit crisis and economic slowdown. Since last July:

- Two year treasury yields have fallen from 5.10% to 1.35% (3/17/08)
- Stocks have fallen; the S&P 500 fell 18.6% (3/10/08)
- Dollar has weakened 16% vs. Euro; 21% vs. Yen
- Additional compensation required to invest in risky assets has increased
- General risk aversion; there is a lack of liquidity for risky assets

THE CREDIT CRUNCH REVISITED; WHERE ARE WE NOW?

Fortunately, not all of the news has been bad for investors in high-quality fixed income. As treasury yields fell sharply, prices increased, and high quality portfolios posted very strong returns. The Merrill Lynch 1-5 Year Government Index, a popular benchmark, returned nearly ten percent (9.97%) over the twelve months ending March 31, 2008. While treasuries have been the best performing fixed income asset class, government agencies have also performed well. Despite mortgage market turmoil, the financial health of the housing agencies remains strong, and both Fannie Mae (FNMA) and Freddie Mac (FHLMC) continue to represent a core component of many investors' portfolios. Prudence also leads many investors to diversify their agency holdings by including Federal Farm Credit Bank (FFCB) and Federal Home Loan Bank (FHLB) securities.

The recent decline in market yields has also demonstrated why most investors should hold the majority of their agency portfolio in non-callable securities. Chances are that if you own callable securities, some of them have been called in the past six months, forcing you to re-invest at lower yields. This is because callable securities display negative convexity, which is just a fancy way of saying that they usually get called when interest rates are falling—right when you don't want them to get called (they also tend not to get called when you wish they would be—when rates are rising.) Sophisticated evaluation of callable securities needs to go beyond yield comparisons; investors without the resources to do so should generally avoid callable securities.

The news for investors in high grade corporate bonds has not been as good. Spreads on 5 year corporate bonds rated "A" or "AA" widened significantly during the past six months, moving from approximately 75 basis points (0.75%) to more than 200 basis points (2.0%) above treasuries. Many individual issuers performed even worse. While this underperformance might cause some investors to re-evaluate their decision to invest in corporate bonds, there are several reasons that this might not be prudent.

The reason that corporate bonds pay a higher yield is that they are more risky than government securities. In the long run, though, we know that corporates offer a higher expected return. To be effective, a strategy that includes corporate securities must be in place through both good and bad markets. Furthermore, from a valuation standpoint, corporate securities yielding 200 basis points over treasuries are plainly more attractive than when they were trading at just 75 basis points over treasuries. The historical record shows that corporate bonds add value to portfolios over time, for those investors with the resources to properly evaluate and monitor their corporate holdings. It is important to remember that if you lack the proper resources, it is ok to choose not to buy corporate bonds.

What comes next?

The recent actions of the Federal Reserve have gone a long way towards easing concern about systemic risk to the US financial system. However, the impact of the credit crisis and housing downturn continues to reverberate throughout the economy. Any hopes for an economic rebound are predicated upon several factors. First of all, it generally takes six months for interest rate cuts to work their way through the economy, so by the second half of the year we should benefit from the cumulative effects of the 300 basis points of easing. A second positive event will be the arrival of IRS rebate checks starting in May. As Americans begin to spend this money, the economy should receive a boost. Finally, outside of the US, economic growth remains relatively strong. Strong overseas growth, aided by a weaker dollar, should boost exports, providing a source of strength for the US economy.

Lessons for your investment portfolio

The first and most important thing to remember in managing your investment portfolio is to have a well thought out, long-term plan. This point is so important that I am going to repeat it: regardless of market volatility or economic uncertainty, it's important not to deviate from your long-term investment plan.

As markets fluctuate and new information becomes available, you can re-evaluate your investment program and your holdings. A change in your investment goals, risk tolerance, return objectives or legal constraints might prompt changes in your investment program. So too can fundamental changes in any of the securities that you hold. The important thing is to make sure that fundamental changes are actually occurring, and that you are not simply altering your investment program because of market volatility or guesses on the future course of the market.

Maintaining a disciplined investment program in volatile markets can be very difficult. Your financial partners can be helpful in this regard, since talking with them can help you to evaluate whether your decisions are based upon changing fundamentals or discomfort with the level of market volatility.

Some key points to remember when investing:

- Have a plan and stick to the plan
- Avoid market timing, or attempting to guess the future direction of interest rates
- After providing for liquidity needs, choose the longest duration portfolio that satisfies your risk/return profile
- Make sure you have available sufficient resources to analyze and monitor your investments; never rely solely on credit rating agencies
- Make sure you can pass the "sleep test" if you are having trouble sleeping because you are worried about your investments, you are probably taking on too much risk

Brian Perry, Vice President, Portfolio Specialist

ECONOMIC ROUNDUP

CONSUMER PRICES

During February, the economy's headline inflation reading increased at a 4.0% year-over-year rate, lower than January's 4.3% rate. The year-over-year Core CPI (CPI less food and energy) rose at a 2.3% rate, lower than January's 2.5%. Although inflation readings remain somewhat elevated, the Fed continues to expect inflation to moderate as growth slows in the months ahead.

HOUSING STARTS

Single-family housing starts declined by 6.7% in February, to a 0.71 million annual pace. This follows January's reading of 0.76 million. The latest decline was the lowest level since January 1991. Recent data has supported the financial market concern that the decline in the housing market has not yet run its course.

RETAIL SALES

During February, Retail Sales decreased noticeably as the year-over-year growth slumped to 2.6% from a revised growth rate of 4.0% in January. Over the last several months, consumers have slowed their spending in reaction to higher energy prices, the housing market contraction, and a general tightening of credit standards.

LABOR MARKETS

The March non-farm payroll employment report showed a decrease of 80,000 jobs and the unemployment rate increased to 5.1%. This month's report was weaker than expected and is the third consecutive month of negative job growth. March's employment report validates the recent financial market concern about a slowing economy impacting the labor markets.

CREDIT SPREADS MIXED

| CREDIT SPREADS | Spread to Treasuries (%) | One Month Ago (%) | Change |
|------------------------------------|--------------------------|-------------------|--------|
| 3-month top-rated commercial paper | 130 | 1.09 | 0.21 |
| 2-year AA corporate note | 1.37 | 1.15 | 0.22 |
| 5-year AA corporate note | 1.62 | 1.38 | 0.24 |
| 5-year Agency note | 0.83 | 0.92 | (0.09) |

Source: Bloomberg

Data as of 3/31/08

ECONOMIC DATA

| ECONOMIC INDICATOR | Current Release | Prior Release | One Year Ago |
|------------------------------|---------------------|---------------------|---------------------|
| Trade Balance | (58.2) \$Bln JAN 08 | (57.9) \$Bln DEC 07 | (57.4) \$Bln JAN 07 |
| GDP | 0.6% DEC 07 | 4.9% SEP 07 | 2.1% DEC 06 |
| Unemployment Rate | 4.8% FEB 08 | 4.9% JAN 08 | 4.5% FEB 07 |
| Prime Rate | 5.25% MAR 08 | 6.00% FEB 08 | 8.25% MAR 07 |
| CRB Index | 386.89 MAR 08 | 412.69 FEB 08 | 316.88 MAR 07 |
| Oil (West Texas Int.) | \$101.58 MAR 08 | \$101.84 FEB 08 | \$65.87 MAR 07 |
| Consumer Price Index (y/o/y) | 4.0% FEB 08 | 4.3% JAN 08 | 2.4% FEB 07 |
| Producer Price Index (y/o/y) | 6.4% FEB 08 | 7.4% JAN 08 | 2.4% FEB 07 |
| Dollar / EURO | 1.58 MAR 08 | 1.52 FEB 08 | 1.34 MAR 07 |

Source: Bloomberg

Data as of 3/31/08

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