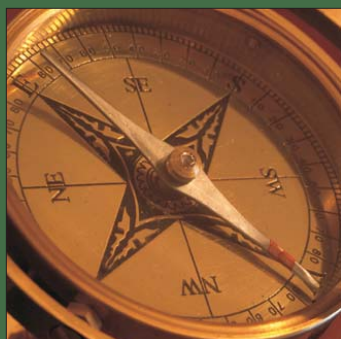


BOND MARKET REVIEW

A MONTHLY REVIEW OF
FIXED INCOME MARKETS



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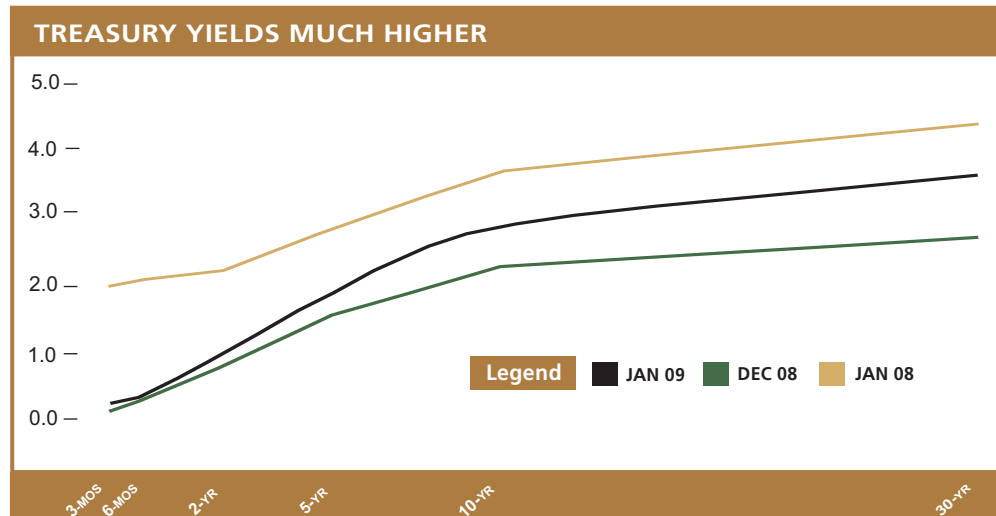
Since 1988, Chandler Asset Management has specialized in the management of portfolios of high quality, fixed income securities. Chandler's mission is to provide fully customizable, client-centered portfolio management that preserves principal, manages risk and generates income in our client's portfolios.

MARKET SUMMARY

Treasury bond yields were higher in January as market volatility moderated and investors debated the impact of much higher levels of Treasury issuance. Credit availability remained impaired and companies and individuals had difficulty accessing credit. Global stock markets continued their decline. The US economy has been in recession since December 2007 and the economic decline has accelerated following the financial market turmoil that began in September 2008.

The economy has now lost jobs for thirteen straight months. The January Non-Farm Payroll number showed a decrease of 598,000 jobs and the unemployment rate increased to 7.6%. The economy has now lost more than 2.5 million jobs since September 2008. Retail sales continued to decline as consumers sharply cut back their spending. The advance reading for 4th quarter GDP showed that the economy contracted by -3.8%. Forecasts call for continued declines in economic activity.

The next scheduled FOMC meeting is on March 17th.



Treasury yields were higher in January as market participants debated the impact of increased levels of Treasury bond issuance. The yield curve steepened as long-term interest rates rose more than short-term rates.

YIELDS	1/31/09	12/31/08	Change
3 Month	0.23	0.11	0.12
2 Year	0.95	0.76	0.19
5 Year	1.87	1.55	0.32
10 Year	2.84	2.25	0.59
30 Year	3.59	2.69	0.90

YIELD SPREADS	1/31/09	12/31/08	Change
5yr - 2yr T-Note	0.92	0.79	0.13
10yr - 2yr T-Note	1.89	1.49	0.40

Source: Bloomberg

PROSPECTS FOR A HOUSING RECOVERY

The long-held belief that home prices do not decline has been shattered during the past two years, as the largest drop in home values since the Great Depression helped spark the global financial crisis and a severe recession. It seems likely that if financial markets and the economy are to recover, the housing sector must at least show signs of stabilization. With that in mind, this seems an opportune time to examine the prospects for a housing market recovery.

The trend in home prices

Home prices in the United States continue to fall. In November (the most recent reading) the S&P/Case Shiller Home Price Index showed a year-over-year decline of more than 18%. Declines have been even greater in many hard-hit areas, and regions such as Riverside and San Bernardino in California have seen declines greater than 50%. As of this writing, home prices have shown no signs of stabilizing, as financial market turmoil and rising unemployment inhibits American's ability to purchase a new home.

Foreclosures and home prices

Foreclosures are continuing to soar in many parts of the country, and because foreclosure sales usually occur at lower prices than non-forced sales, higher levels of foreclosures have depressed home prices. Furthermore, with so many options to choose from among foreclosed homes, buyers are able to negotiate more attractive prices from non-foreclosure sellers.

There are two potential causes for optimism on the foreclosure front. First of all, as part of the government's continuing efforts to battle the economic slowdown, there is talk of a comprehensive plan to forestall further foreclosures. If enacted, this could be a positive for the housing market, but it is important to remember that studies have shown that the majority of homeowners receiving a reprieve from foreclosure eventually do end up losing their home.

A second, perhaps more important reason for optimism, has to do with the subprime mortgage cycle. A large number of homes that have gone into foreclosure were originally backed by subprime mortgages of dubious quality. These mortgages were especially popular from 2004 to 2006. As low initial teaser rates on these mortgages have reset, homeowners have found themselves unable to meet their new, higher payments. This has directly contributed to the increase in mortgage defaults and foreclosures. Most of these questionable mortgages have already reset or will do so shortly. As the housing market moves past this wave of mortgage resets, it is possible that defaults and foreclosures will decline.

The importance of housing inventory

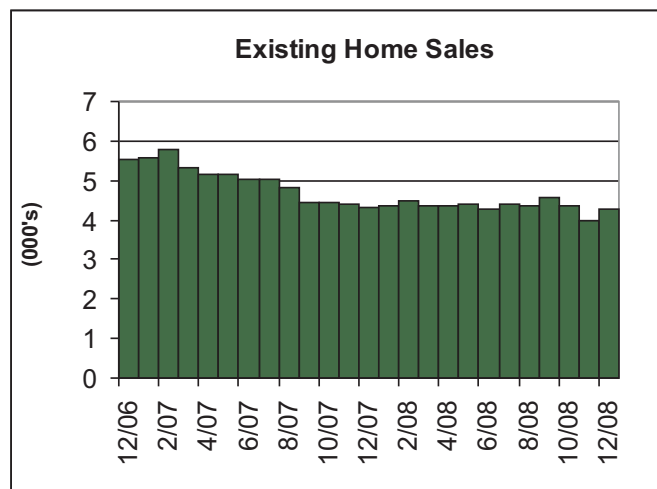
As home purchases declined, the inventory of houses for sale rose dramatically. This inventory continued to grow as new-home developers completed previously agreed-upon

projects. In order for the housing market to stabilize, the inventory of homes for sale needs to decline so that the market can achieve a more appropriate balance of supply and demand.

Construction on new homes has declined dramatically and has reached historic lows. With fewer new homes available, unsold inventory can decline even if sales remain weaker than usual. So far, this benefit has been partially offset by the increasing level of foreclosed homes coming onto the market. If foreclosures begin to decline, and the supply of new home construction remains low, housing inventory should move lower towards an equilibrium level.

Increased demand for housing?

Although painful for many homeowners, the large decline in house prices has improved affordability measures for prospective home buyers. In areas such as Southern California, home prices are now affordable to the average individual for the first time in many years. This affordability is reflected in the increased number of existing home sales, which rose 6.50% last month.



Reduced supply and lower prices should eventually return the housing market to a more normal state. However, there are several circumstances that could impact the timing of any recovery. If the economic slowdown intensifies or the unemployment rate increases dramatically, the housing market will suffer. Additionally, even though the overall level of mortgage interest rates is attractive, there are questions regarding the availability of mortgage finance. Many banks and lending institutions have made credit standards more stringent and reduced the amount

of money they are willing to lend. If the economy weakens further, or mortgage availability remains excessively tight, low home prices may not be enough to stimulate greater demand for housing.

Conclusion

When will the housing market recover? While the answer to this is not clear, it is possible to analyze the necessary preconditions for an eventual recovery. Prominent among these factors is equilibrium between supply and demand in the housing market. Reduced foreclosures, sharply lower new home construction, more affordable home prices, and attractive mortgage rates will all help to re-establish balance in the housing market.

Tentative signs have begun to emerge that some of these factors are beginning to occur and while it is still too early to forecast a housing market recovery, it does appear that if the availability of mortgage finance can be maintained, the housing market may bottom sometime during 2009. Although no one is expecting a rapid return to sharp price increases, at this point even home price stability may be sufficient to begin to rebuild consumer confidence. This in turn would eventually lead to a recovery from the country's ongoing economic malaise.

Brian Perry, Vice President, Investment Strategist

CONSUMER PRICES

In December, the CPI increased by only 0.1% on a year-over-year basis, compared to November's 1.1% reading, this month's decline was mainly due to falling energy prices. The year-over-year Core CPI (CPI less food and energy) rose at a 1.8% y-o-y rate. Inflation has significantly moderated in recent months as lower energy prices and slowing economic growth have resulted in a slower pace of price increases.

RETAIL SALES

In December, Retail Sales declined at a year-over-year rate of -9.8%. This was the 6th consecutive monthly decline. Recently, consumers have broadly slowed their spending in reaction to financial market turmoil, a general tightening of credit standards, job loss worries, and the housing market contraction. Retail spending is expected to remain weak in the months ahead.

LABOR MARKETS

The January non-farm payroll employment report showed a decrease of 598,000 jobs and the unemployment rate increased to 7.6%. The payroll data reflected the thirteenth consecutive month of negative job growth. Since November, the economy has lost an average of 591,000 jobs per month. December's employment reports showed continuing deterioration in the labor markets.

HOUSING STARTS

Single-family housing starts declined by -13.5% in December, to a 398,000 annual pace. This was the lowest level since data collection began in 1959. This follows November's reading of 460,000. The fall in housing starts is supporting the financial market concern that the decline in the housing market has not yet run its course.

CREDIT SPREADS WIDER

CREDIT SPREADS	Spread to Treasuries (%)	One Month Ago (%)	Change
3-month top-rated commercial paper	0.68	0.76	(0.08)
2-year AA corporate note	1.97	2.10	(0.13)
5-year AA corporate note	1.98	2.11	(0.13)
5-year Agency note	0.85	0.99	(0.14)

Source: Bloomberg

Data as of 1/31/09

MIXED ECONOMIC DATA

ECONOMIC INDICATOR	Current Release	Prior Release	One Year Ago
Trade Balance	(40.44) \$Bln NOV 08	(56.69) \$Bln OCT 08	(59.87) \$Bln NOV 07
GDP	(3.80%) DEC 08	(0.50%) SEP 08	(0.20%) DEC 07
Unemployment Rate	7.60% JAN 09	7.20% DEC 08	4.90% JAN 08
Prime Rate	3.25% JAN 09	3.25% DEC 08	6.00% JAN 08
CRB Index	220.37 JAN 09	229.54 DEC 08	369.46 JAN 08
Oil (West Texas Int.)	\$41.68 JAN 09	\$44.60 DEC 08	\$91.75 JAN 08
Consumer Price Index (y/o/y)	0.1% DEC 08	1.1% NOV 08	4.1% DEC 07
Producer Price Index (y/o/y)	(0.9%) DEC 08	0.4% NOV 08	6.2% DEC 07
Dollar / EURO	1.28 JAN 09	1.40 DEC 08	1.49 JAN 08

Source: Bloomberg

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