

BOND MARKET REVIEW

A MONTHLY REVIEW OF
FIXED INCOME MARKETS



WHAT'S INSIDE

MARKET SUMMARY 1

YIELD CURVE

CURRENT YIELDS

TREASURY YIELD SPREADS

ACTIVE MANAGEMENT: WHAT
STRATEGIES DO ACTIVE FIXED
INCOME PORTFOLIO MANAGERS
EMPLOY? 2

ECONOMIC ROUND-UP 3

CREDIT SPREADS

ECONOMIC INDICATORS

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.

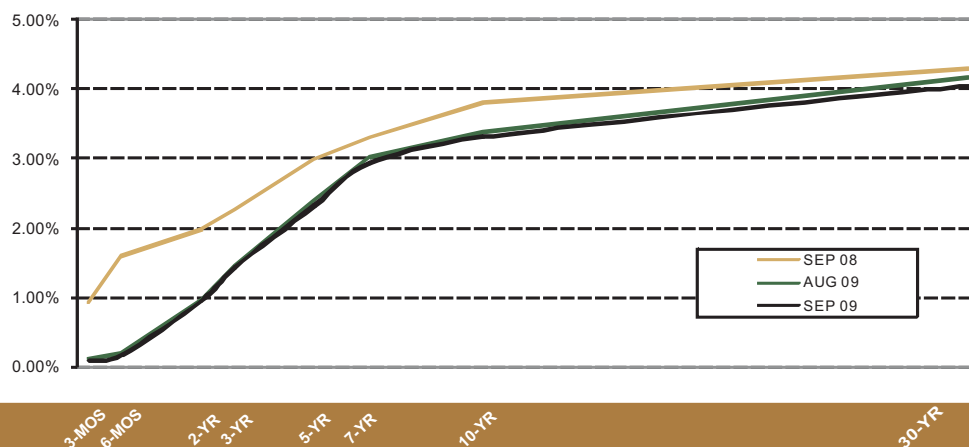
MARKET SUMMARY

It appears that the worst recession since World War II is coming to an end as market participants have begun to focus on the strength and durability of the coming economic recovery. The combined effects of massive government stimulus, inventory rebuilding, and pent-up consumer demand have led many forecasters to predict relatively strong second half economic growth both in the US and around the globe. However, concern remains about the sustainability of the recovery as the impact of government stimulus begins to fade and consumer activity remains weak.

Treasury bond yields were volatile again in September as market participants debated the strength of the economic recovery. Investors also remain concerned about the very large volumes of Treasury bonds being issued. Treasury prices have been supported by forecasts that inflation is unlikely to rise in the near-term.

The Federal Reserve stated that "economic activity has picked up following its severe downturn" at their September 23 meeting. Debate has begun on the timing of eventual interest rate increases, although most market participants anticipate that the Fed will remain on hold at least through the first quarter 2010. The next scheduled FOMC meeting is on November 4.

TREASURY YIELDS SLIGHTLY LOWER IN SEPTEMBER



Treasury yields declined slightly in September as market participants debated the impact of increased levels of Treasury bond issuance and the strength and durability of the expected economic recovery. The yield curve remains steep as long-term interest rates are much higher than short-term rates.

YIELDS	9/30/09	8/31/09	Change
3 Month	0.10	0.12	(0.02)
2 Year	0.95	0.98	(0.03)
3 Year	1.43	1.47	(0.04)
5 Year	2.32	2.39	(0.07)
7 Year	2.93	3.03	(0.10)
10 Year	3.31	3.40	(0.09)
30 Year	4.04	4.18	(0.14)
YIELD SPREADS	9/30/09	8/31/09	Change
5yr - 2yr T-Note	1.37	1.41	(0.04)
10yr - 2yr T-Note	2.36	2.42	(0.06)

Source: Bloomberg

ACTIVE MANAGEMENT: WHAT STRATEGIES DO ACTIVE FIXED INCOME PORTFOLIO MANAGERS EMPLOY?

What exactly do fixed income portfolio managers do and how do they add value to a portfolio? In most instances, a client will select a strategy that meets their investment objectives along with a benchmark index which they would like their portfolio to track. The choice of this strategy will depend upon the client's unique goals, risk constraints and cash flow considerations. Portfolio managers then guide the client's fixed income portfolio according to the chosen benchmark.

Portfolio managers are evaluated by how their returns compare to the benchmark index. There are two important considerations here. First, how does the return of the portfolio compare to the return of the index? Secondly, and equally important, how does the volatility (risk) of the portfolio compare to the index?

There are several active management strategies which a fixed income portfolio manager may employ in order to optimize portfolio performance and manage portfolio risk. These include:

Risk management

The first and most important job of a portfolio manager is to manage risk. This can be achieved through consistent monitoring of any developments among individual securities held in the portfolio, as well as careful consideration of overall portfolio risk. Portfolio risk will vary depending upon the strategy that the client has chosen and can be managed in accordance with the client's appetite for risk but can never be completely eliminated. Over time, a disciplined approach can result in superior risk-adjusted returns for the portfolio, as well as increased peace of mind and a better night's sleep for the client!

Managing portfolio interest rate risk

Most academic and professional research indicates that interest rate forecasting is not a viable long-term investment strategy. Correctly predicting the direction, magnitude and timing of interest rate movements is nearly impossible to do on a consistent basis. However, duration, which is a measure of a bond's sensitivity to interest rate changes, has been shown to be the greatest single determinant of portfolio performance. Therefore, astute portfolio managers manage interest rate risk by actively structuring their portfolios to match the risk profiles of their clients, in relation to the duration of the chosen benchmark index.

Structuring portfolios to take advantage of changes in the shape of the yield curve

As the shape of the yield curve changes, a portfolio manager can outperform a market benchmark by holding different mixes of asset maturities. For instance, a portfolio consisting of equal parts of bonds maturing in one year and bonds maturing in five years may perform differently than a portfolio composed of 100% bonds maturing in three years, despite the fact that the average maturity of each portfolio is the same. An astute portfolio manager will take advantage of expected steepening

or flattening of the yield curve by structuring the portfolio to hold the optimal mix of bond maturities.

Taking advantage of relative value among different asset classes and market sectors

At various points in the economic and market cycle, treasury, corporate, mortgage, or agency securities become relatively more or less attractive. These changes in relative value are often intensified by market sentiment or the actions of other market participants. At these times, a shrewd portfolio manager can alter the proportions of investments among various sectors of the bond market. By doing so, the portfolio manager can generate additional returns without increasing market risk.

Security selection

Due to fluctuating market conditions, individual securities often become under or overvalued. Resourceful portfolio managers actively and continuously monitor the financial markets and can identify these mispriced securities to buy or sell. For example, if average single "A" rated corporates are trading at a spread of 75 basis points above treasuries, a portfolio manager may be able to identify a single "A" corporate issue that is yielding 80 or even 90 basis points above treasuries. If this security is issued by a company that has strong underlying fundamentals and a sound credit profile, there is an opportunity for the portfolio manager to add value by purchasing the security. By doing this the manager has the ability to increase portfolio return and decrease risk.

Actively managing the elements of portfolio risk, concentrating particularly on portfolio duration relative to the appropriate benchmark, a portfolio manager can position their client for success. The portfolio manager with an active management strategy then utilizes portfolio structuring techniques, sector allocation, and individual security selection to further enhance investor returns in an effort to outperform the market benchmark without undue risk.

Working with a professional portfolio manager that properly implements these techniques can help a client to reach their financial goals.

Brian Perry, Vice President, Investment Strategist

CONSUMER PRICES

In September, the CPI showed that consumer prices decreased 1.3% on a year-over-year basis. The year-over-year Core CPI (CPI less food and energy) increased at a 1.5% y-o-y rate. Despite hopes for an economic recovery and an increased money supply, many economists believe that inflation will remain moderate over the next 12 months.

RETAIL SALES

In September, Retail Sales declined 5.7% on a year-over-year basis, an improvement over the previous several months' readings. Consumers have increased their savings rate and slowed their spending in reaction to a general tightening of credit standards, job losses, and the housing market contraction.

LABOR MARKETS

The September non-farm payroll employment report showed a larger-than-expected decrease of 263,000 jobs while the unemployment rate increased to 9.8%. Although the payroll data reflected the twenty-first consecutive month of negative job creation, the pace of losses has slowed in recent months. Nevertheless, even as the economy gradually begins to recover, the job market is expected to remain weak and the unemployment rate may rise further.

HOUSING STARTS

Single-family housing starts decreased 3.0% in August to 479,000, following five consecutive month-to-month increases. Other housing market indicators also appear to be stabilizing.

CREDIT SPREADS WIDER

CREDIT SPREADS	Spread to Treasuries (%)	One Month Ago (%)	Change
3-month top-rated commercial paper	0.17	0.17	0.00
2-year AA corporate note	0.64	0.61	0.03
5-year AA corporate note	0.83	0.80	0.03
5-year Agency note	0.41	0.43	(0.02)

Source: Bloomberg

Data as of 9/30/09

MIXED ECONOMIC DATA

ECONOMIC INDICATOR	Current Release	Prior Release	One Year Ago
Trade Balance	(31.96) \$Bln JUL 09	(27.50) \$Bln JUN 09	(64.89) \$Bln JUL 08
GDP	(0.7%) JUN 09	(6.4%) MAR 09	1.5% JUN 08
Unemployment Rate	9.80% SEP 09	9.70% AUG 09	6.20% SEP 08
Prime Rate	3.25% SEP 09	3.25% AUG 09	5.00% SEP 08
CRB Index	259.39 SEP 09	253.68 AUG 09	345.50 SEP 08
Oil (West Texas Int.)	\$70.61 SEP 09	\$69.96 AUG 09	\$100.64 SEP 08
Consumer Price Index (y/o/y)	(1.50%) AUG 09	(2.10%) JUL 09	4.90% SEP 08
Producer Price Index (y/o/y)	(4.30%) AUG 09	(6.80%) JUL 09	8.80% SEP 08
Dollar / EURO	1.46 SEP 09	1.43 AUG 09	1.41 SEP 08

Source: Bloomberg

© 2009 Chandler Asset Management, Inc, An Independent Registered Investment Adviser.

The information contained herein was obtained from sources we believe to be reliable, but we do not guarantee its accuracy. Opinions and forecasts regarding industries, companies, and/or the economy are all subject to change at any time, based on market and other conditions, and should not be construed as a recommendation.