



BOND MARKET WEEKLY

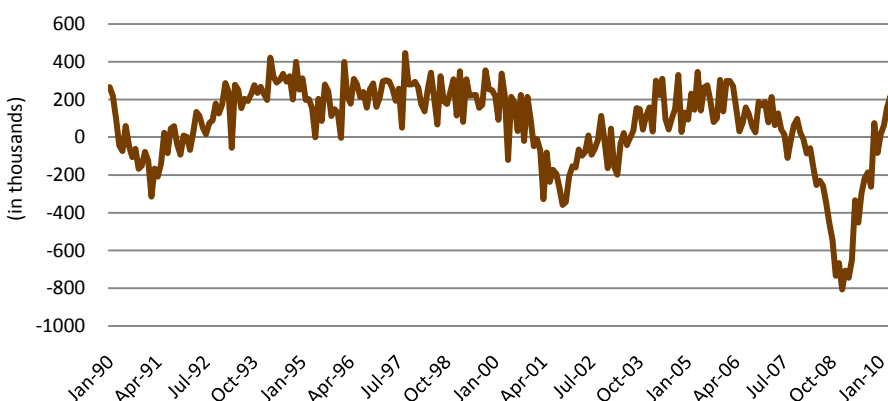
WEEK OF JUNE 7, 2010

MARKET OVERVIEW

- The holiday-shortened week finished with a disappointing May employment report and a renewed flight into U.S. Treasuries. As a result, the benchmark 10-year yield fell 9 bps on the week to 3.20%.
- Treasury demand was not entirely even along the curve as long maturities outperformed and flattened the yield curve 5 bps from 2- to 10-year (+247) while 2- to 30-year spreads (+340) fell 4 bps.
- While TIPS netted positive performance for the week, they underperformed nominal Treasuries. Breakeven inflation over the current 5-year horizon fell 4 bps to 1.70% while the 5-year, 5-year forward period dropped 9 bps to 2.47%.
- Economic data released offered little surprise, until Friday's employment report showed just 41,000 jobs added in private payrolls in May. Total hiring was 431,000 and significantly below the consensus estimate of 536,000. The unemployment rate dipped to 9.7%, but according to the household survey, the number of employed actually fell in May because of individuals ceasing their job hunt. Some bright spots were found in better than expected hourly earnings measures and an increase in temporary hiring, but overall, this report was not in-line with a V-shaped recovery story.
- Other data during the week included ISM Manufacturing which remains high (59.7) but is rolling over and showing signs of fatigue in the inventory rebuilding cycle. More focus will likely come on this data during the second half of 2010 as a strengthening dollar and inevitable end of the inventory cycle provide headwinds.
- Consumers showed a decent rebound in May with a 2.6% increase in the ICSC Chain Store Sales data after a very disappointing April of +0.8%. Vehicle sales also continued to hold up with 11.64 million units sold in May, but a large U.S. Government purchase provided an artificial boost over April levels. Is the auto sector as solid as it looks when stacked up against an estimated 12 million unit per month replacement need?

US Employees on Nonfarm Payroll Total MoM

1/1/1990 - 5/31/2010; Source: Bloomberg



TAX EXEMPT MARKETS

- The tax exempt market was a bit calmer this week and the performance of municipal bonds reflected that fact. When it was all said and done, 10-year AAA rated municipals saw rates unchanged at 3.12% and AAA 30-year yields rose 1 bp to 4.48%. The recent surges in "flight-to-quality" activity are a reminder of the greater relative volatility of Treasuries vs. municipal securities.
- With income tax rates expected to increase in 2011 and stock market volatility on the rise, demand for municipal bonds remains strong. The Investment Company Institute reported that \$459 million flowed into tax exempt bond funds, while equity funds experienced an outflow of \$17.4 billion for the week ending May 26th.
- Forward supply experienced a significant increase as municipalities look to capture lower rates. Week over week, the Bond Buyer 30-Day Visible Supply Index increased \$1.9 billion to \$10.5 billion. In the secondary market, the demand last week remained a bit choppy as high quality issues continued to be well bid and less liquid issuers were spotty.



TAX EXEMPT MARKETS (CONT.)

- Faced with a loss of state education funds, New York City Mayor Michael Bloomberg announced that he will eliminate scheduled pay raises for teachers. Mayor Bloomberg estimated that by removing the 2% pay hikes in 2011 and 2012 he would be able to avoid laying off 4,400 teachers.
- California Controller John Chiang said that the State had cash available to pay bills through August and would not need to issue IOU's. The news gives the California Legislature a bit of breathing room as they seek to close their projected budget gap. California is looking to draft a budget for the new fiscal year, which begins on July 1st.
- New York continues to work on its budget two months into the new fiscal year. Days after a Federal judge blocked the State worker furloughs that Governor Paterson had proposed, the Governor announced that he would lay off thousands of workers beginning Jan 1, 2011. The layoff date coincides with the expiration of his no-layoff pledge he made with State workers last year.
- This week we found better value in the secondary market, and we were somewhat active. From a new issuance perspective, the holiday-shortened week saw New Jersey sell higher education bonds and Arkansas come with their largest slate of issuance since 2000.

A FEW WORDS ON THE BP OIL SPILL

- The oil spill in the Gulf of Mexico, combined with the upcoming hurricane season, has many investors asking questions about the implications to the municipal markets, especially with respect to the Gulf Coast states such as Florida. With respect to the spill, we think it is premature to conclusively assess ultimate credit impact given the developing conditions. Nevertheless, WSC's portfolios tend to be inherently insulated from these type of events due to strong credit risk management policies and portfolio diversification strategies. Case in point, WSC exposure to the most vulnerable Gulf Coast region (AL, LA, MS, FL Panhandle) is very limited as a result of the post-Katrina risk analysis WSC completed in 2005 and 2006. We will continue to broaden our surveillance efforts beyond the immediately affected Gulf Coast region as the situation develops. In either case, storm or oil spill, we believe we have a very manageable risk profile in this regard.
- WSC does not make credit decisions based solely on isolated events, such as hurricanes, floods, tornados, volcanic eruptions, earthquakes, terrorist attacks, or oil leaks. However, such events, while isolated, have and will continue to pose actual and potential future credit risks to certain issuers of municipal bonds and, accordingly, WSC does monitor, screen for, and analyze these various types of risks, among others.

TAXABLE MARKETS

- As typical of a holiday-shortened week, the taxable markets were pretty quiet. Corporates priced just \$6.95 billion of investment-grade new issuance for the week. A few companies though such as Duke Energy Carolinas (A1/A) and Waste Management (Baa3/BBB) came with 10-year bonds priced at +100 and +147 to Treasuries, respectively.
- The Gulf oil spill held much of the focus for the corporate market during the week.
- Corporate spreads were 4 bps wider for the week to end at +191 OAS (option-adjusted spread) in the Barclays U. S. Corporate Investment Grade Index. It appears the latest round of European contagion concerning Hungary had little bearing on corporate spreads on Friday as corporate spreads only widened 1 bp even as equity sold off heavily.
- On an OAS basis, the MBS market tightened 6 bps for the week to finish at +15 OAS. The FHLMC national survey of 30-year mortgage rates shows the rate this week to be 4.79%. Refinancing activity continued its roll, its fourth weekly increase in the Mortgage Bankers Association survey posting a 2.4% increase for the week due in part to the low mortgage rates.
- Work begins to reconcile the House and Senate versions of financial regulatory reform this week with the goal of voting on a final version before the July 4th summer recess.



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